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19th
EDITION

Law *for* Business

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Law for Business, 19e

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Preface

WHY STUDY BUSINESS LAW?

Newspapers, magazines, television, radio—and even our computers—constantly relate business information to us. Behind the scenes of business activity—from startups of new businesses to corporate mergers, marketing, advertising, technology, and employment—laws governing business play a vital role. The study of business law is necessary to provide students with an overview of the law of commercial transactions and other business legal issues. *Law for Business*, nineteenth edition, focuses on these laws to prepare students to conduct business in our dynamic world marketplace.

PURPOSE OF THE TEXT

Law for Business, nineteenth edition, is a practical approach to law that emphasizes current, relevant topics involving business transactions and issues, such as contracts, property, employer–employee relations, and insurance. The basic concepts of business law are covered without the excessive theory that often makes law seem incomprehensible. Practical coverage of the law pertaining to business, without the detailed treatment found in other law school material, is the hallmark of this text. The substantial breadth of this text, complete with examples and cases, is an effective introduction to a variety of legal topics.

TEXT FEATURES

Integrated Learning Objectives. Each chapter begins with learning objectives that outline what the students will accomplish after reading the chapter. Margin icons indicate where learning objectives are first discussed in the text. Each objective is briefly restated as reinforcement, so students need not refer to the beginning of each chapter. These learning objective icons create a natural outline to help students easily comprehend the information.

Actual U.S. Court Cases with Citations. This book contains no make-believe cases. Every case example, problem, and summary is an actual U.S. court case, transferring theory into reality. These exciting actual cases help students relate to the subject as they learn about real-world legal situations that can occur in business. Case citations are included in the text for each case example, to further clarify these resources and inspire additional research and reading.

Ethical Points. In order to give greater focus to ethical considerations in various business situations, the text contains ethical point questions and comments interspersed in the margins. These questions highlight pertinent ethical issues, show the relationships between law and ethics, and serve as a basis for class discussion.

Ethics in Practice. The Ethics in Practice features appear at the end of each Part, just before the Part Summary Cases. Ethics in Practice poses a hypothetical business situation and asks students to consider the ethical implications. In

conjunction with the Ethical Points scattered throughout the chapters, the Ethics in Practice feature reinforces the importance of ethical responsibility in today's climate of corporate scandal and recrimination.

Enhanced Content and Other Important Features. In the nineteenth edition, the format of the previous edition has been largely retained, but of course, the content has been updated as needed throughout. In response to high-profile instances of computer hacking and growing privacy concerns, this edition includes an expansive discussion on privacy and data security laws applicable to businesses' collecting and storing customers' personal information. This topic is of particular importance given the online presence most businesses have. The nineteenth edition also includes an expanded discussion on the Office of Foreign Assets Control (OFAC), a powerful federal agency that enforces economic and trade sanctions imposed by the United States. OFAC regulations are especially significant to businesses operating in the global market. This edition has been shortened by two chapters in response to feedback from faculty and to better accommodate their use of the text. The part on Negotiable Instruments has combined two smaller chapters so that defenses are now included in Chapter 24 Liabilities and Defenses Specific to Negotiable Instruments. Important materials from the previous stand-alone chapter on labor legislation have been integrated and combined with material in the other chapters within the Agency and Employment part.

In addition, this edition contains many new cases, some of which are:

- *Michigan v. Bay Mills Indian Community*, 134 S.Ct. 2024 (U.S.)
- *Macy's Inc. v. Martha Stewart Living Omnimedia, Inc.*, 127 A.D.3d 48 (N.Y.A.D.)
- *U.S. v. Steele*, 595 Fed.Appx. 208 (4th Cir.)
- *Steinhausen v. Home Services of Nebraska, Inc.*, 289 Neb. 927 (Neb.)
- *SEC v. E-Smart Technologies, Inc.*, 2104 WL6612422 (D.D.C.)
- *Nichols v. Zurich American Ins. Co.*, 423 S.W.3d 698 (Ky.)

Ample Questions and Cases. The end-of-chapter materials include questions and case problems. This gives the teacher and the student the opportunity to check how well students understand the material.

Key Terms and Definitions. Key terms and their definitions, critical to students' understanding of business law, are printed in the margins for easy identification and mastery. The terms are also compiled into a glossary at the end of the text.

Improved Readability. In *Law for Business*, special attention has been given to improving the readability of the text and cases by using such techniques as shortened sentences, active voice, and information presented in lists rather than in paragraph form.

Short Chapters. Long chapters tend to dilute the critical points and confuse the reader. *Law for Business* is set up in short, easy-to-understand chapters so that critical points stand out.

Chapter Opening Preview Case and Preview Case Revisited. After two introductory chapters, each chapter begins with a Preview Case segment to involve students in the issues that will be discussed in the chapter. Each Preview Case ends with a question that is answered by the court's decision in the Preview Case Revisited.

DIGITAL COMPONENTS

MindTap. New for *Law for Business*, nineteenth edition, MindTap is a personalized teaching experience with relevant assignments that guide students to analyze, apply, and improve thinking, allowing you to measure skills and outcomes with ease. Personalized teaching becomes yours through a pre-built Learning Path designed with key student objectives and your syllabus in mind. The customizable online course allows you to control what students see and when they see it. Relevant readings, multimedia, and activities within the learning path intuitively guide students up the levels of learning to (1) Prepare, (2) Engage, (3) Apply and (4) Analyze business law content. These activities are organized in a logical progression to help elevate learning, promote critical thinking skills and produce better outcomes. Analytics and reports provide a snapshot of class progress, time in course, engagement and completion rates.

Instructors can personalize the experience by customizing authoritative Cengage Learning content and learning tools. MindTap offers instructors the ability to add their own content in the Learning Path with apps that integrate into the MindTap framework seamlessly with Learning Management Systems (LMS).

Instructor's Manual. The Instructor's Manual, written by the authors, acts as a guide to the text and course, providing teaching suggestions, lesson outlines, explanations, and citations for the example cases, as well as answers to the problems contained in the text. It also adds a suggestion for group projects at the beginning of each part.

Test Bank. This supplement provides more than 700 test questions. Each chapter includes true/false questions, multiple-choice questions, and a short essay question, giving the instructor additional assignments and questions for student testing. The test bank is available through Cognition.

Cengage Learning Testing Powered by Cognition is a flexible, online system that allows you to:

- author, edit, and manage test bank content from multiple Cengage Learning solutions
- create multiple test versions in an instant
- deliver tests from your LMS, your classroom or wherever you want

PowerPoint Presentation Slides. A PowerPoint presentation package provides enhanced lecture materials for the instructor, as well as study aids for students.

ACKNOWLEDGMENTS

We would like to thank the following reviewers who helped with the revision of this and other editions of the text, as well as the many reviewers whose assistance was invaluable throughout numerous past editions. It is your suggestions and comments that have helped make this text what it is today.

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ABOUT THE AUTHORS

John Ashcroft served as the seventy-ninth attorney general of the United States from February 2001 to February 2005. He served in the United States Senate from 1995 to 2001, and previously served as governor of Missouri for two terms. In addition he served as state auditor of Missouri and eight years as attorney general of Missouri.

Fortune magazine rated Ashcroft one of the top ten education governors. In the Senate, he took a leading role on key issues such as welfare reform, juvenile crime, and reform of the civil justice system, while authoring significant changes to federal law. He served on the Judiciary, the Commerce, Science, and Transportation, and the Foreign Relations Committees and was also the chairman of subcommittees on the Constitution, consumer affairs, and Africa, respectively.

Ashcroft, widely recognized for his innovative use of technology and the Internet, has taught students in Missouri and across the country about using the Internet and online information as a tool of citizenship.

Prior to entering public service, Ashcroft taught business law at what is now Missouri State University in Springfield. He graduated with honors from Yale University and met his wife, Janet, at the Law School of the University of Chicago where they received their law degrees. They later co-authored two college textbooks together.

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PART 1

The Legal System and the Legal Environment of Business

The court system involves much more than just the various types of courts and the judges who preside over them. You can learn more about the entire system, its administration, and its functioning at the U.S. Courts website, www.uscourts.gov. To find federal regulations and comment on them, visit www.regulations.gov.

- 1 Introduction to Law
- 2 Courts and Court Procedure
- 3 Business Torts and Crimes
- 4 Government Regulation of Business

Introduction to Law

LEARNING OBJECTIVES

- ① Define law.
- ② Explain why we have laws.
- ③ List four sources of law.
- ④ Distinguish among crimes, torts, and ethics.

LO ①

Define law

law
governmental rule
prescribing conduct and
carrying a penalty for
violation

damages
a sum of money a
wrongdoer must pay to an
injured party

business law
rules of conduct for the
performance of business
transactions

The famed jurist William Blackstone defined law by pronouncing: “**Law** is a rule of civil conduct, commanding what is right and prohibiting what is wrong.” Many rules of civil conduct commend what is right and condemn what is wrong, but rules are not necessarily laws. Only when a sovereign state issues rules prescribing what is right and what is wrong can a rule be called a law. Even then, rules are not effective unless penalties are applied when the rules are broken. Thus, a law is a rule that prescribes certain conduct and is enacted and enforced by a government.

Religious teachings, social mores, habits, and peer pressure all contribute to social control of conduct by various people, but only the rules of law apply with equal force to every member of society. A breach of some of these rules is a crime for which the penalty is a fine, a jail sentence, or both. A breach of other rules is a civil wrong for which the penalty most often is the payment of a sum of money called **damages**.

Business law is that class of laws that are concerned primarily with rules of conduct prescribed by government for the performance of business transactions. The laws governing business transactions in the United States did not come into existence overnight. Laws result from society’s changing concepts of what is right and what is wrong. They may be created or modified to deal with new technology or circumstances. For example, for several centuries in England and America, an individual who owned land owned the soil and minerals below the topsoil and the air above the land “all the way to heaven.” The law prohibited trespassing on a person’s land or air. A telephone company that wanted to string a telephone wire through the air had to buy a right of way. When airplanes were invented, this law became a millstone around society’s neck. Under this law, a transcontinental airline would have to buy a right of way through the air of every property owner in its path from New York to San Francisco. The modification of this rule by judicial decree shows how the law changes when circumstances change.

1-1 Objectives of Law

We live in a complex society. Every time we have business dealings with others—working, making a purchase, starting a business, traveling, renting an apartment, or trying to insure against loss—we have the potential for a dispute. The law seeks to establish rules so that we will be able to peacefully resolve those disputes that arise.

The law also sets the rules of conduct for many transactions so that we will know how to avoid disputes. The law thus tries to establish a stable framework to keep society operating as smoothly as possible.

LO ②

Why we have laws

1-2 Roots of Our Legal System

When European colonists settled in this country, they instituted legal systems similar to what they had in their native lands. Therefore, English, French, and Spanish colonists set up legal systems that resembled those in England, France, and Spain. The thirteen colonies that later became the United States were all English colonies, so they adopted a legal system like England's. Although additional territory was added, and other legal systems have influenced our laws, the system we have today is still based heavily on the English legal system of common law and equity.

1-3 The Common Law

Common law is a custom that came to be recognized by the courts as binding on the community and therefore law. In medieval England, there were no laws prescribing the proper rule of conduct in hundreds of situations. When a dispute came before a judge, the court prescribed a rule of its own based on the customs of the time. Over a period of several centuries, these court decisions developed into a body of law. The colonists brought this body of law from England to America. After the United States became a sovereign nation, most of these common laws, including legal maxims developed here, were either enacted as statutory laws or continued as judge-made laws. Much of our current law is based on this common law.

common law

English custom recognized by courts as binding

COURT CASE

FACTS: William Egan was charged with the common law offense of nonfeasance (the failure to perform a required duty). State law provided that, in relation to crimes, the common law of England was in full force and effect where there was no statute on the subject. Egan said the law was vague and that there was no need for it.

OUTCOME: The court said it was clear that the legislature intended the common law of England to apply. Because the common law provided for the offense of nonfeasance, the prosecution of Egan could continue.

—*State v. Egan*, 287 So.2d 1 (Fla.)

1-4 Equity

Uniformity in the common law spread throughout England because judges tended to decide cases the same way other judges had decided them. But some wrongs occurred for which the law provided no remedy except for money damages.

equity

justice system based on fairness; provides relief other than merely money damages

restraining order

court's temporary order forbidding an action

injunction

court's permanent order forbidding an action

LO ③

Sources of law

constitution

document that contains fundamental principles of a government

Bill of Rights

first ten amendments to the U.S. Constitution

statute

law enacted by legislative bodies

ordinance

law enacted by cities

In some cases, money was not an appropriate remedy. To obtain suitable relief, people began to petition the king for justice. The king delegated these matters to the chancellor, who did not decide the cases on the basis of recognized legal principles, but rather on the basis of *equity*—what in good conscience ought to be done. Eventually, an additional system of justice evolved that granted judicial relief when no adequate remedy at law existed. This system is called **equity**.

Courts of equity, although they sometimes recognized legal rights, also provided new types of relief. For example, instead of merely ordering a person who had breached a contract agreeing to sell real estate to pay money damages, courts would order “specific performance”—that is, require the seller to comply with the terms of the contract and sell the real estate. They also provided for preventive action to protect individuals from likely harm. In that type of case, a court with equity powers might initially issue a **restraining order**, a temporary order forbidding a certain action. Upon a complete hearing, the court might issue an **injunction**, a permanent order forbidding activities that would be detrimental to others. In most states, courts apply legal and equitable principles to each case as the facts justify, without making any formal distinction between law and equity.

1-5 Sources of Law

Our laws come from several sources. They include federal and state constitutions, statutes, judges’ decisions, and administrative agency orders.

1-5a CONSTITUTIONS

A **constitution** is the document that defines the relationships of the parts of the government to each other and the relationship of the government to its citizens or subjects. The U.S. Constitution is the supreme law of the land. State constitutions, as well as all other laws, must agree with the U.S. Constitution. The Supreme Court of the United States is the final arbiter in disputes about whether a state or federal law violates the U.S. Constitution. A state supreme court is the final authority as to whether a state law violates the constitution of that state.

The section of the U.S. Constitution that is the basis for most laws regulating business is called the Commerce Clause. That section gives Congress the power to regulate commerce “among the several States.”

In 1791, after the U.S. Constitution had been adopted, it was amended by the addition of the Bill of Rights. The Constitution contained no specific guarantees of individual liberty. The **Bill of Rights** consists of ten amendments specifically designed to protect the civil rights and liberties of citizens and the states. It is a part of the U.S. Constitution. Rights protected by the Bill of Rights are frequently referred to by the number of the amendment in which they can be found. Most people have heard of First Amendment rights to free speech or Fifth Amendment rights against self-incrimination.

1-5b STATUTES

Statutes are laws enacted by legislative bodies. The federal Congress, state legislatures, and city councils, all composed of people that voters elect, comprise the three chief classes of legislative bodies in the United States. Cities and other municipalities make laws usually called **ordinances**, a specific type of statutory

law. Sometimes a systematic collection of the laws, rules, or regulations of a government body or authority is called a **code**.

code
collection of laws, rules, or regulations

Sometimes, statutes enacted by one legislative body conflict with statutes enacted by another legislative body. Statutes enacted by a higher legislative body prevail over those of lower legislative bodies. Thus, a state law prevails over conflicting county or municipal legislation. A constitutional federal statute prevails over a conflicting state statute.

Unlike constitutions, which are difficult to amend and are designed to be general rather than specific, statutes may be enacted, repealed, or amended at any regular or special session of the lawmaking body. Thus, statutes normally respond more to the changing demands of the people.

In the field of business law, the most important statute is the Uniform Commercial Code (UCC).¹ The UCC regulates sales and leases of goods; negotiable instruments, such as checks; secured transactions; and particular aspects of banking and fund transfers, letters of credit, warehouse receipts, bills of lading, and investment securities. Although all fifty states have enacted at least some portions of the UCC, individual states have made changes. Therefore, variations in the UCC exist from state to state.

1-5c JUDICIAL DECISIONS

Judicial interpretation is an important element of the legal process. Because courts can interpret laws differently, the same law might have somewhat different consequences in different states. Interpretations by the highest courts have the effect of setting **precedents**. A precedent is a decided case or court decision that determines the decision in a subsequent case because the cases are so similar. Under the doctrine of **stare decisis** (stand by the decision), these precedents bind the lower courts. These interpretations may concern a situation not previously brought before the court, or the court may decide to reverse a previous decision.

precedent
court decision that determines the decision in a subsequent, similar case

stare decisis
principle that a court decision controls the decision of a similar future case

COURT CASE

FACTS: The State of Michigan agreed to allow Bay Mills Indian Community, a federally recognized Indian Tribe, to operate a casino on reservation lands within Michigan. Bay Mills later bought additional land beyond the reservation with proceeds from a congressional land trust and built a second casino on the newly purchased land. Michigan sued to stop the gaming activity of the second casino. Bay Mills claimed that under common law, it was considered a sovereign authority and thus immune from lawsuits.

OUTCOME: The court held that a previous case had established that sovereign authorities were entitled to immunity from suit, and the doctrine of *stare decisis* compelled the court to adhere to the precedent case in the interest of promoting “consistent development of legal principles.” Bay Mills was immune from the suit.

—*Michigan v. Bay Mills Indian Community*,
134 S.Ct. 2024 (U.S.)

¹ The UCC has been adopted at least in part in every state. The UCC also has been adopted in the U.S. Virgin Islands and the District of Columbia.

Any state supreme court or the Supreme Court of the United States can reverse a decision of a lower court. For legal stability and so that we can know our rights before we undertake a transaction, courts must generally adhere to the judicial precedents set by earlier decisions. However, changing situations or practices sometimes result in the previous case law being overturned, and a new rule or practice being established.

1-5d ADMINISTRATIVE AGENCY ORDERS

administrative agency
governmental board or
commission with authority
to regulate matters or
implement laws

Administrative agencies set up by legislative bodies carry on many governmental functions today. **Administrative agencies** are commissions or boards that have the power to regulate particular matters or implement laws. At the federal level alone, there are dozens of agencies that are involved in regulatory activity. The legislative branch of government enacts laws that prescribe the powers that administrative agencies may exercise, the principles that guide the agencies in exercising those powers, and the legal remedies available to those who want to question the legality of some administrative action.

Administrative agencies may be given practically the same power to make law as the legislature and almost the same power to decide cases as the courts. However, agencies are created by laws and have the power to enact law only if the legislature has delegated them that power.

COURT CASE

FACTS: When the Department of Citywide Administrative Services (DCAS) denied Thomas Auringer's application for a hoisting machine operator's license, Auringer asked a court to vacate and annul the denial. The law required two years of "appropriate experience" for a person who wanted such a license. The DCAS interpreted the law to mean two years of "full-time experience."

OUTCOME: The requirement of two years of full-time experience as a condition for the issuance of a hoisting machine operator's license was not rational. The court advised Auringer to resubmit his application and the DCAS to reconsider its interpretation of the law.

—*Auringer v. Department of Bldgs. of City of New York*, 805 N.Y.S.2d 344 (N.Y.)

The president of the United States, with the consent of the Senate, appoints the heads of federal administrative agencies. The governor normally appoints heads of state administrative agencies. Administrative agencies are given wide latitude in setting up rules of procedure. They issue orders and decrees that have the force of law unless set aside by the courts after being challenged. If an agency rule or decision conflicts with a statute, the statute takes precedence.

LO ④

Distinguish among
crimes, torts, and ethics

civil law

law dealing with
enforcement or protection of
private rights

1-6 Civil Versus Criminal Law

Law may be classified as either civil or criminal. A person may file a lawsuit in order to enforce or protect a private right by requesting compensation for damage suffered or other action for restoration of his or her property. This action in **civil law** is concerned with private or purely personal rights.

Criminal law is that branch of the law dealing with crimes and the punishment of wrongdoers. A **crime** is an offense that tends to injure society as a whole. Therefore, an employee of the government—usually called the **prosecutor** or **district attorney**—institutes and pursues criminal actions. A criminal action differs from a civil action in other respects. The standard of proof required is greater than in a civil case. A person can be convicted of a crime only if proven guilty “beyond a reasonable doubt.” If a person accused of a crime is subject to the penalty of imprisonment, the accused has a right to an attorney even if he or she cannot pay for one. In addition, the constitutional prohibition against double jeopardy means that a person can only be tried for a particular crime once. This protection is not absolute, because it allows for retrial, for example, if a conviction is overturned or if there is no decision in a first trial.

Historically, crimes are usually classified, according to the nature of the punishment provided, as felonies or misdemeanors. Generally speaking, **felonies** are the more serious crimes and are usually punishable by death or by imprisonment in a penitentiary or state prison for more than one year. **Misdemeanors** are offenses of a less serious character and are punishable by a fine or imprisonment in a county or local jail. Forgery is a felony, but disorderly conduct and unauthorized entry of a dwelling are misdemeanors.

criminal law
law dealing with offenses
against society

crime
offense against society

**prosecutor or district
attorney**
government employee who
brings criminal actions

felony
a more serious crime

misdemeanor
a less serious crime

COURT CASE

FACTS: Roosevelt Terry reached into a car and stole a purse. This petty theft was normally a misdemeanor punishable by a fine and/or imprisonment in the county jail for, at most, six months. However, Terry had two prior felony convictions. In that case, state law provided that the penalty for petty theft was one year in the county jail or the state prison. The judge sentenced Terry to the state prison. The state had a “three strikes” sentencing law. Terry was sentenced to twenty-five years to life for the petty theft as if it

were a third felony. Terry argued he should not get such a severe penalty.

OUTCOME: The punishment imposed determines whether an offense is a felony or a misdemeanor. Because Terry had been sentenced to state prison for the petty theft, that offense was a felony, making it his third felony under the “three strikes” law.

—*People v. Terry*, 54 Cal.Rptr.2d 769 (Cal.)

Some offenses carry penalties that can be either misdemeanor penalties or felony penalties. These offenses are called **wobblers**. In the case of wobblers, if the punishment imposed is more than a year of imprisonment, the offense is a felony. If the punishment is less than a year of imprisonment, the offense is a misdemeanor.

Because there are some offenses punished by government that are not considered serious offenses and therefore do not carry severe penalties, a number of states have established a third level of offense. These offenses are at a level below that of misdemeanors and might be called violations or infractions. An infraction could be speeding or making an illegal U-turn while driving. In some states, **violations** or **infractions** might not even be considered criminal offenses. They would carry penalties of a fine or imprisonment, but only in a local jail for a few days. Obviously, criminal statutes vary somewhat from state to state.

wobbler
an offense that can
be either a felony or a
misdemeanor

violation or infraction
offense less serious than a
misdemeanor

COURT CASE

FACTS: Laurie Ann Benoit was arrested as part of the “Occupy” movement and jailed with other protesters. The state charged Benoit with a criminal trespass misdemeanor. As permitted under state law, prosecutors opted to prosecute the charge as a violation, which meant that if convicted, Benoit could face a maximum fine of \$1,250 and risked no incarceration. Benoit moved for a trial by jury, arguing that a violation was still considered a crime and that she was entitled to protections afforded other criminal defendants.

OUTCOME: The court held that in all criminal prosecutions, the state constitution required the defendant be entitled to a jury trial. Because the court deemed the violation was still a criminal proceeding in nature, Benoit could not be deprived of a jury trial.

—*State v. Benoit*, 311 P.3d 874 (Or.)

1-7 Ethics

ethics

principles that determine the morality of conduct, its motives, and its duties

This chapter has discussed the basis for laws. One of the most important ideas mentioned is that “laws are the result of society’s changing concepts of what is right and what is wrong.” That means laws are based on our judgment regarding what human conduct is right and therefore should be encouraged, and what conduct is wrong and therefore should be discouraged. We thus base our laws on our morals. Those principles that help a person determine the morality of conduct, its motives, and its duties are called our **ethics**.

1-7a BASES FOR ETHICAL JUDGMENT

Everyone has opinions on what behavior and thinking is right and what is wrong, basing these ethical judgments on personal values. We develop our values from our religious beliefs, our experience, our cultural background, and our scientific knowledge. Because people have differing backgrounds, our judgments as to what is right and wrong vary somewhat.

1-7b ETHICAL PRINCIPLES

In considering how ethics relates to the law, several principles regarding the application of ethics emerge. These principles include:

1. Seriousness of consequences
2. Consensus of the majority
3. Change in ethical standards

Seriousness of Consequences. Although law is based on what we believe to be right and wrong, our laws do not reflect everything that we believe is right or wrong. Our laws set a minimum standard for behavior. Ethics sets a higher standard of behavior.

When unethical behavior can harm others—when the matter is of serious consequence to people—laws are usually enacted to regulate that behavior. Less

serious matters can be considered wrong, but laws do not address them. For example, rules of etiquette frequently reflect our ethical judgments about behavior, but they do not have serious enough consequences that we pass laws to enforce them.

Consensus of the Majority. Our laws cannot express every individual's ethical principles because individuals do not agree on what is moral. There may be no law reflecting a judgment on a particular matter, or the laws might reflect the judgment of some. For example, vegetarians and nondrinkers may not believe laws permitting the eating of meat or the consumption of alcoholic beverages are ethical. Their morality may not be reflected in law. In a democratic society such as the United States, the laws are designed to reflect the ethical view of the majority.

Change in Ethical Standards. Ethical standards change over time. Behavior once believed ethical can become unethical, and behavior previously viewed as immoral can become acceptable. Consider the matter of cigarette smoking on airplanes.

Many years ago, airline passengers could smoke no matter where they were seated. Then the law mandated smoking and nonsmoking sections on planes. Now, all commercial airlines in the United States prohibit smoking in all sections, and the federal government uses the force of law to enforce this rule.

This change in government rules reflects most people's change in the view about the harmful effects of cigarette smoking. Our ethical standards have changed, and this is reflected in the law.

1-7c BUSINESS ETHICS

Our ethical standards apply to every aspect of life. For businesspeople, this means that ethical standards help determine their business practices. In our competitive economic system, the standard that people in business have been expected to follow in determining behavior is "the bottom line." Is the behavior something that will help the business financially? When studying ethics as applied to business, we ask whether a business has obligations other than simply to make a profit or maximize "the bottom line."

Many types of businesses and professional organizations have adopted codes of ethics to guide the behavior of their members. Variety exists not only in the types of businesses that have adopted such codes, but also in the impact of the codes on business. Some codes are legally enforceable, technically making them laws, not ethical rules. Other codes are strictly voluntary and are thus truly rules of ethics.

Legally Enforceable. A number of professions have codes of ethics, usually called *codes of professional responsibility*, which when violated provide the basis for penalties against members of the profession. For example, the American Bar Association has produced a model code and model rules for ethical behavior by lawyers. Although these particular models have not been adopted by every state, each state has adopted an ethical code for lawyers. A violation of the ethical code subjects a lawyer to discipline, including suspension from practicing law or even disbarment.

Voluntary. Some businesses have adopted codes of ethics as guides for individuals employed in these businesses. Because government has not imposed the codes, they do not carry legal penalties for violation. However, employees who violate ethical codes subject themselves to discipline by their employers. The codes recognize that ethical business conduct is a higher standard than that required by law and encourage behavior that is fair, honest, and, if disclosed, not embarrassing to the individual or the business.

The need for ethical practices, particularly in business, is greater than ever. The demand for such ethical behavior is so great that we often see it reflected in new legislation. If the public is not confident that businesses will comply with their ethical responsibilities, we will undoubtedly see more and more legislation asking business to rise to ethical, rather than just the previously legal, standards. Chapter 34 discusses some requirements for ethical behavior by corporate officers.

1-7d ETHICS IN PRACTICE

The law seeks to make business behavior conform to society's standards of what is appropriate behavior by punishing those who do not live up to the standards. In reality, businesspeople find that there is a positive incentive to be ethical in business. In the long run, it is a good business practice to be ethical. Businesses find that customers are more likely to want to do business with ethical establishments.

Customers who deal with unethical businesses are much more likely to have problems with the business, causing additional time and expense.

QUESTIONS

1. What is business law?
2. What is the normal penalty for breach of a civil wrong?
3. What kind of relief were courts of equity designed to give?
4. Explain what the roots of our legal system are.
5. Why do courts generally adhere to the judicial precedents set by earlier decisions?
6. Why was the Bill of Rights enacted?
7. Explain the difference between actions in civil and criminal law.
8. What section of the Constitution is the basis for most laws governing business transactions, and what does it provide?
9. What determines whether an offense is a felony or a misdemeanor? Are there offenses less serious than misdemeanors?
10. List some guiding principles that determine how ethics relates to the enactment of laws.

Courts and Court Procedure

CHAPTER

2

LEARNING OBJECTIVES

- ① Explain the function of the courts.
- ② Explain the relationships of the various courts in our society.
- ③ Describe the procedure for filing a lawsuit.
- ④ Describe the basic procedure for a jury trial.

Each state has two distinct court systems—federal and state. Federal courts are part of the federal government headquartered in Washington, D.C. There are fifty different state court systems, each being part of a state government headquartered at its state capital. Although the federal and state court systems are largely independent of each other, they have similar functions.

2-1 Function of the Courts

LO ①

Function of courts

A court declares and applies judicial precedents, or case law, and applies laws passed by the legislative arm of government. However, this is not the whole story. Constitutions, by their very nature, must be couched in generalities. Statutes are less general than constitutions, but they could not possibly be worded to apply to every situation that may arise. Thus, the chief function of the courts is to interpret and apply the law from whatever source to a given situation. For example, the U.S. Constitution gives Congress power to regulate commerce “among the several States.” This is the power to regulate interstate commerce. Under this power, Congress passes a law requiring safety devices on trains. If the law is challenged on constitutional grounds, the court must decide whether this is a regulation of interstate commerce.

Similarly, an act of Congress regulates the minimum wage for the vast majority of workers. A question may arise as to whether this applies to the wages paid in a sawmill located in a rural section of the country. The court must decide whether or not the sawmill owner engages in interstate commerce. The court’s decision may become a judicial precedent that will be followed in the future unless the court changes its decision in a subsequent case.

2-2 Jurisdiction of Courts

jurisdiction

authority of a court to hear a case

The power or authority of a court to hear cases is called its **jurisdiction**. Before any court can try a case, it must be established that the court has jurisdiction over the subject matter of the case, the persons involved, and the geographic area where the events in controversy occurred.

Subject-matter jurisdiction is the authority to hear a particular type of case or relating to a specific subject matter. If a claim is made for damages as a result of an automobile accident, a probate court does not have jurisdiction over the subject matter, because a probate court deals with the distribution of deceased persons' property. The damage action would have to be brought in a court of general jurisdiction.

A court may have jurisdiction over the subject matter but not over the person. If a resident of Ohio is charged with trespassing on a neighbor's property in that state, the courts in Indiana do not have personal jurisdiction over the accused. Nor does the Ohio court system have jurisdiction over the person of the accused if the accused has not been properly served with notice of the trial.

COURT CASE

FACTS: Cheap Escape Co. published a magazine and in Summit County, Ohio, entered into contracts to sell ads in the magazine to Haddox LLC. The contracts stated that any legal action based on them "will be in the Franklin County Municipal Court or Franklin County Common Pleas." Haddox allegedly defaulted on the contracts, so Cheap Escape sued in Franklin County Municipal Court and got a judgment. Subject matter jurisdiction of municipal courts in Ohio is set by statute as "original jurisdiction within its territory." Haddox argued this meant a municipal

court only had jurisdiction over events having a territorial connection to the court.

OUTCOME: The court reasoned that the logical way to read the phrase "original jurisdiction within its territory" was that a municipal court could only hear cases that had a territorial connection to it. The judgment was reversed and the case dismissed.

—*Cheap Escape Co. Inc. v. Haddox LLC*, 900 N.E.2d 601 (Ohio)

long-arm statute

law allowing a state to have jurisdiction over nonresidents

Because Americans travel so much, and because businesses frequently operate in more than just one state, laws have been enacted that in specified cases allow the courts of one state to have jurisdiction over residents of another state. These laws are called **long-arm statutes** and normally are based on some action in the state where suit is brought. The party being sued must have had minimum contacts in that state. A court may try a case and enter an enforceable judgment even against a nonresident when the minimum contacts exist. If you drive a car in another state and are involved in an accident, a long-arm statute would allow a person injured in the accident to sue you in the state where the accident occurred after you return to your home state.

2-2a VENUE

Once it is determined which court system has jurisdiction to decide a case, it must be decided at what location the case should be tried. Determining the location where a case is to be tried means determining the proper venue. Each state has

trial courts throughout the state. Proper venue requires choosing the proper one of these courts. For example, if two citizens of San Diego have a controversy, proper **venue** would be in San Diego, not Sacramento. However, the right to a particular venue can be surrendered. In criminal cases, the court frequently changes venue to try to give the defendant a fairer trial.

venue

location where a case is to be tried

2-3 Classification of Courts

Courts are classified for the purpose of determining their jurisdiction. This classification can be made in a variety of ways. One classification can be made according to the governmental unit setting up the court. Under this classification system, courts are divided into (1) federal courts, (2) state courts, and (3) municipal courts.

The same courts may be classified according to the method of hearing cases. Under this system, they are classified as trial courts and appellate courts. **Trial courts** conduct the original trial of cases. **Appellate courts** review cases appealed from the decisions of lower courts. A losing party appeals to the higher court to review the lower court's decision by claiming the lower court made a mistake that caused the party to lose. Appellate courts include courts of appeals and supreme courts. Appellate courts exercise considerable authority over the courts under them. Lower courts are bound by the decisions of their appellate courts.

LO ②

Relationships of various courts

trial court

court that conducts original trial of a case

appellate court

court that reviews the decision of another court

2-3a FEDERAL COURTS

The federal courts have exclusive jurisdiction over such matters as bankruptcy, claims against the United States, and patent and copyright cases. Federal courts (see Illustration 2-1) include:

1. Special federal courts
2. Federal district courts
3. Federal courts of appeals
4. The United States Supreme Court

Special Federal Courts. The **special federal courts** are limited in their jurisdiction by the laws of Congress creating them. For example, the Court of International Trade hears cases involving the rates of duty on various classes of imported goods, the collection of the revenues, and similar controversies. The U.S. Court of Federal Claims hears cases involving claims against the U.S. government. The U.S. Tax Court hears only cases involving tax controversies. Bankruptcy courts decide bankruptcy cases. Most bankruptcy appeals are to a three-judge appellate panel of bankruptcy judges.

special federal court

federal trial court with limited jurisdiction

Federal District Courts. By far, the largest class of federal courts consists of the almost one hundred **federal district courts**. There is at least one district court in each state, and in some states there are as many as four. These courts are trial courts in which criminal cases involving a violation of the federal law are tried. The district courts also have jurisdiction over civil suits that: (1) are brought by the United States; (2) arise under the U.S. Constitution, federal laws, or treaties; or (3) are brought by citizens of different states—called **diversity jurisdiction**—or between citizens of one state and a foreign nation or one of its citizens in which the amount in controversy is more than \$75,000.

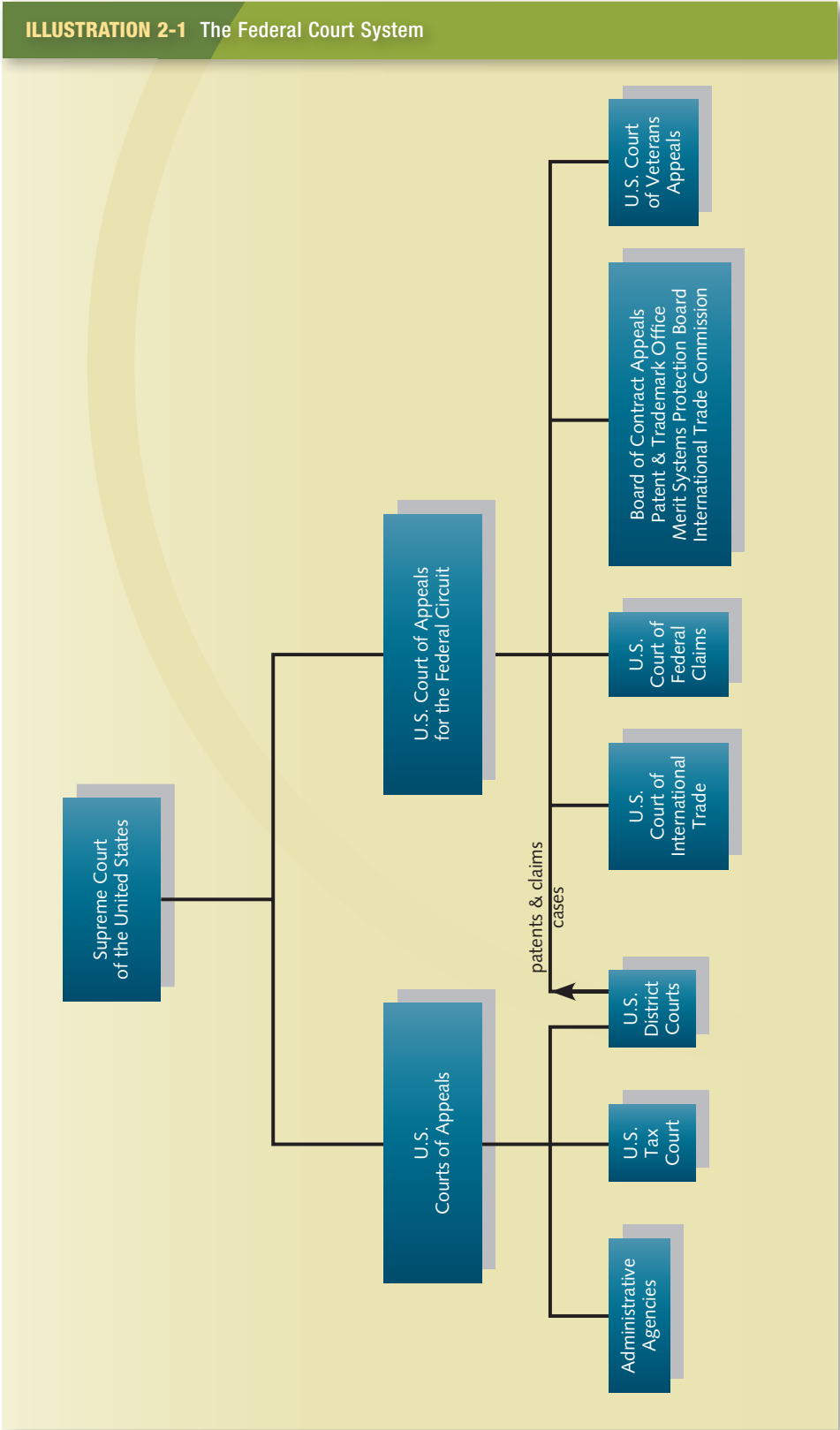
federal district court

trial court of federal court system

diversity jurisdiction

federal jurisdiction based on parties being from different states

ILLUSTRATION 2-1 The Federal Court System



COURT CASE

FACTS: Acorne Productions, LLC contracted with filmmakers Zareh and Alina Tjeknavorian to produce a documentary film on the Armenian Genocide. The parties agreed that Acorne would pay the Tjeknavorians a monthly fee and provide film-making equipment. The parties also agreed to a funding limit and deadline for the project. After the Tjeknavorian's failed to meet the deadline and went over budget, Acorne filed a lawsuit in a New York state court for breach of contract and other state-law claims. The Tjeknavorians moved the case to federal court,

because, they argued, the claims arose under the Copyright Act—a federal law.

OUTCOME: The federal court held that Acorne's claims did not arise out of the Copyright Act and thus the court lacked jurisdiction over the claims. The case was sent back to the state court to be decided.

—*Acorne Productions, LLC v. Tjeknavorian*, 33 F.Supp.3d 175 (E.D.N.Y.)

Federal Courts of Appeals. The United States is divided geographically into twelve federal judicial circuits. Each circuit has a court of appeals, which hears appeals from cases arising in its circuit. The **federal courts of appeals** hear appeals from federal district courts and from federal administrative agencies and departments. A decision of a federal court of appeals is binding on all lower courts within the jurisdiction of that circuit.

federal court of appeals
court that hears appeals in federal court system

It is possible that one court of appeals could decide an issue one way and another court of appeals could decide it another way. Because the lower courts within each court of appeals' jurisdiction must follow the decision of its court of appeals, courts in different circuits might decide similar cases differently. When this occurs, there is a conflict between the circuits. The conflict lasts until one circuit changes its decision or the U.S. Supreme Court rules on the issue.

There is also another court of appeals called the Court of Appeals for the Federal Circuit. It reviews decisions of special federal courts (such as the Court of International Trade and the U.S. Court of Federal Claims), decisions of four administrative agencies, and appeals from district courts in patent and claims cases.

United States Supreme Court. The **Supreme Court of the United States** has original jurisdiction in cases affecting ambassadors, public ministers, and consuls, and in cases in which a state is a party. It has appellate jurisdiction in cases based on the U.S. Constitution, a federal law, or a treaty.

Supreme Court of the United States
the highest court in the United States

The majority of cases heard by the U.S. Supreme Court are cases appealed from the federal courts of appeals. Under certain circumstances, a decision of a federal district court may be appealed directly to the Supreme Court. A state supreme court decision also may be reviewed by the U.S. Supreme Court if the case involves a federal constitutional question or if a federal law or treaty has been held invalid by the state court. Unlike the courts of appeals, the Supreme Court does not have to take all cases appealed. It chooses which appealed cases it will hear.

The normal way a case gets to the Supreme Court is by application for a **writ of certiorari**. The party asking for the Supreme Court review of a case asks the court to issue a writ of *certiorari*, which requires the lower court that has decided the case to produce the record of the case for the Supreme Court's review. The Court issues a writ for only a small number of requests.

writ of certiorari
order to produce record of a case

The U.S. Supreme Court is the highest tribunal in the land, and its decisions are binding on all other courts. Its decisions are final until the court reverses its own decision or until the effect of a given decision is changed by a constitutional amendment or an enactment by Congress. The Constitution created the Supreme Court and gave Congress the power to establish inferior courts.

2-3b STATE COURTS

State courts (see Illustration 2-2) can best be classified into the following groups:

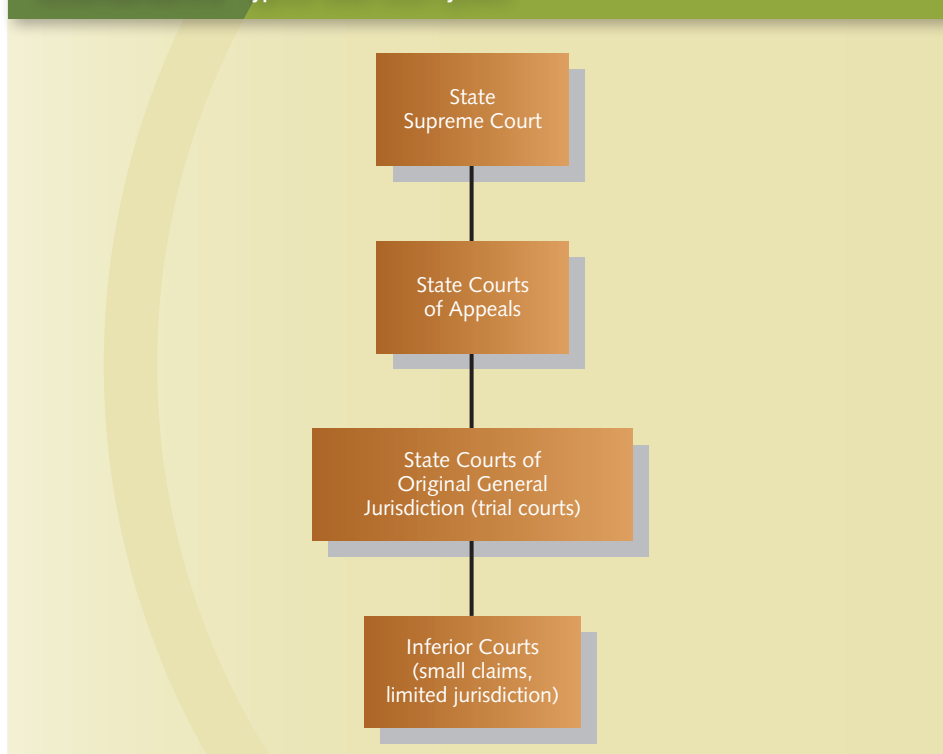
1. Inferior courts
2. Courts of original general jurisdiction
3. Appellate courts
4. Special courts

inferior court
trial court that hears only cases involving minor offenses and disputes

Inferior Courts. Most states have **inferior courts** that hear cases involving minor criminal offenses and minor disputes between citizens. The names of inferior courts vary greatly from state to state. These courts are most frequently called district, magistrate, county, municipal, small claims, justice, or even taxi courts.

Some states have more than one of these named courts. Civil jurisdiction is limited to controversies involving a maximum amount of money, which generally varies from \$1,000 to \$25,000, or to a particular type of controversy. In addition, these courts may try all criminal cases involving misdemeanors. The loser in any of these courts may normally appeal to a court of original general jurisdiction.

ILLUSTRATION 2-2 Typical State Court System



Courts of Original General Jurisdiction. The most important courts of a state for the average citizen are called **courts of original general jurisdiction**. These courts have broad jurisdiction over disputes between two or more parties as well as criminal offenses against the state. They are called courts of original general jurisdiction because the case is first instituted in them. On occasion, they hear appeals from inferior courts, but this does not make them true appellate bodies, because the entire case is retried at this level. Thus, such an appeal is actually treated as a case of original jurisdiction. These courts are also called trial courts because they hear witnesses, receive evidence, and try the case.

An official, permanent record is kept of the trial showing the testimony, evidence, statements of counsel and the judge, the judgment, and the findings of the court. For this reason, these courts are referred to as **courts of record**. The official name of such a court of original general jurisdiction varies from state to state but in almost every state it is one of the following: circuit court, district court, or superior court.¹

Appellate Courts. All states provide for an appeal to an appellate court by the party dissatisfied with the final judgment of the trial court or any of its rulings and instructions. Most states have a system of intermediate appellate courts, usually called **state courts of appeals**, as well as one final appellate court. Decisions of the appellate courts bind lower courts. The **state supreme court** is usually the title of the highest appellate court of a state.

Special Courts. Many states have additional special courts, such as **probate courts** that handle wills and estates; **juvenile courts** that are concerned with delinquent, dependent, and neglected children; and **domestic relations courts** that handle divorce and child custody cases. These are not courts of general jurisdiction but of special jurisdiction. In some states, these courts are on the same level as the trial courts. When this is the case, they are properly called *trial courts* and are courts of record. In other states, they are on the same level as the inferior courts and are not courts of record.

2-4 Court Officers

The chief officer of an inferior court is the **judge, justice of the peace, magistrate, trial justice**, or similar officer. The executive officer is the constable or bailiff. In a state court of record, the chief officer is the judge, the executive officer is the **sheriff**, and the recorder is the clerk of the court. These titles are the same in the federal courts, except that the executive officer is called a **marshal**.

Persons educated in the profession of the law and licensed to practice law, which means they may represent others in legal matters, are known as **lawyers** or **attorneys**. They are officers of the court and are subject to punishment for a breach of duty. Lawyers ordinarily represent the parties in a civil or a criminal action, although many states permit the parties to represent themselves. The practice of presenting one's own case, however, is usually not advisable, because a disinterested person is normally better able to assess and present the case rationally.

court of original general jurisdiction
court of record in which case is first tried

court of record
court in which an official record of the proceedings is kept

state courts of appeals
intermediate appellate court

state supreme court
highest court in most states

probate court
court that handles estates

juvenile court
court that handles delinquent, dependent, and neglected children

domestic relations court
court that handles divorce and related cases

judge, justice of the peace, magistrate, or trial justice
chief officer of court

sheriff
court of record executive officer

marshal
executive officer of federal court

lawyer or attorney
person licensed to represent others in court

¹ In New York, this court is known as a supreme court, and in Ohio it is known as a court of common pleas.

LO ③

Lawsuit procedure

procedural law

law specifying how actions are filed and what trial procedure to follow

2-5 Procedure in Courts of Record

Procedural laws specify how parties are to go forward with filing civil actions and how these actions are to be tried. They are a method of enforcing rights or getting compensation for violation of rights and must be followed if the parties wish to have the case settled by a court. If they are not followed, the case can be lost, and the decision will be as final as if it was decided on the merits of the case.

COURT CASE

FACTS: Brian Guyer was convicted of sexual assault. As a result, he was required to, and did, register as a sex offender stating his place of employment. Ten years later, the registration law was amended to require sex offenders to inform the police within three days if they changed jobs. Guyer changed jobs but did not notify the police. He alleged that the amended law could not be applied retrospectively to him.

OUTCOME: The court held that the amended law was just a procedural device to make sure the information Guyer was required to give, following his conviction, was accurate. It did not impose any new substantive obligation on him. As a procedural law, it could constitutionally be applied to him.

—*State v. Guyer*, 353 S.W.3d 458 (Mo. Ct. App.)

complaint or petition
written request to a court to settle a dispute

plaintiff
person who begins a civil lawsuit

defendant
person against whom a case is filed

summons or process
notice of suit

answer or motion
response of defendant to a complaint

discovery
means of obtaining information from other party before a trial

2-5a FILING SUIT IN A CIVIL ACTION

With few exceptions, courts are powerless to settle disputes between individuals unless one of the parties so requests the court. The written request, called a **complaint** or **petition**, begins a civil suit. The individual who institutes a civil action is called the **plaintiff**, and the individual against whom action is brought is called the **defendant**. The order of events in bringing an action is generally as follows:

1. **Filing suit.** The first step in a lawsuit is the filing of the complaint or petition with the clerk of the court by the plaintiff. This petition sets forth the jurisdiction of the court, the nature of the claim, and the remedy sought.
2. **Notice of suit.** As soon as the petition is filed, the clerk issues a **summons** or, as it is sometimes called, a **process**. This gives the defendant notice of the complaint and informs the defendant of the time in which to respond.
3. **Response.** The defendant has a specified number of days available in which to file an **answer** or a **motion**. The answer admits or denies the facts alleged in the complaint. A motion is an application to the judge for an order requiring an act be done in favor of the moving party. The complaint and answer constitute the first pleadings.
4. **Discovery.** To obtain information relevant to the subject matter of the action, the parties may request unprivileged information from another party in a number of ways, called **discovery**, including:
 - a. Interrogatories: Written questions to be answered in writing
 - b. Depositions: Examination of a party or potential witness outside court and under oath

- c. Admissions: Requests to agree that a certain fact is true or a matter of law is decided
- d. Medical examination by a physician
- e. Access to real and personal property

If a court issues an order compelling discovery, failure to comply can result in punishment. The party who does not comply may be found in contempt of court, or the judge may dismiss the case.

The parties may take other actions after a case has been instituted and before it goes to trial. A party may file a wide variety of motions, including a motion to dismiss the case, a motion for a judgment based solely on the pleadings, and a motion to obtain a ruling on the admissibility of certain evidence or to suppress evidence prior to trial.

- 5. *Fact finding.* If disagreements occur about facts of the case, a jury may be impaneled to decide these facts. If neither party requests a jury, the case may be tried before a judge alone, who would act as both judge and jury.

2-5b TRIAL PROCEDURE

A typical jury trial proceeds in the following order:

1. The jury is selected and sworn in.
2. The attorney for the plaintiff makes an opening statement to the jury indicating the nature of the action and what the plaintiff expects to prove. This is usually followed by the defendant's attorney's opening statement.
3. The plaintiff presents evidence in the form of testimony of witnesses and exhibits designed to prove the allegations made in the plaintiff's petition. The plaintiff has the burden of proving facts adequate to support the petition's allegations. If this burden is not met, the case can be dismissed, and the lawsuit ends. The plaintiff's evidence is followed by the defendant's evidence. The defendant tries to disprove the plaintiff's allegations. The defendant also may present evidence excusing the behavior complained of by the plaintiff.
4. The attorneys for each side summarize the evidence and argue their points in an attempt to win the jury to their version of the case.
5. The judge instructs the jury as to the points of law that govern the case. The judge has the sole power to determine the points of law, and the jury decides what weight is to be given to each point of evidence.
6. The jury adjourns to the jury room and in secret arrives at its decision, called the **verdict**. The judge may set aside this verdict if it is contrary to the law and the evidence. Unless this is done, the judge enters a judgment in accordance with the verdict.

LO ④

Jury trial procedure

verdict
decision of a jury

2-5c APPEALS

If either the plaintiff or the defendant is dissatisfied with the judgment and can cite an error of law by the court, an appeal generally may be taken to a higher court. The procedure by which the court learns about the case is very different when an appeal is taken than when the trial court hears a case. A complete transcript or written record of the trial court proceedings is given to the appellate court. Rather than hear testimony from witnesses, the appellate court reviews the proceedings

from the transcript. The attorneys for each side file a written brief, setting forth their arguments as to why the appellate court should either affirm or reverse the judgment of the lower court. In some cases, the attorneys also make oral arguments before the appellate court. The decision of the appellate court becomes judicial precedent and is binding on lower courts. The appellate court may, however, reverse itself in a future case, although this seldom occurs.

2-6 Procedure in Small Claims Court

Filing and trying a suit in an inferior court like a small claims court is a much simpler matter than filing and trying a suit in a court of record. A form for the complaint may be obtained from the court and filled out by the plaintiff without help from a lawyer. Frequently, court employees will assist in filling out the forms. The defendant is then served with the complaint.

When the case is tried, the procedure is much more informal than in a court of record. A judge tries the case, so there is no jury. Because neither party has to be represented by an attorney, and in some courts may not be so represented, the judge asks the parties to state their positions. Witnesses and evidence may be presented, but the questioning is more informal. The judge is likely to ask questions in order to assist in ascertaining the facts. The judge then renders the verdict and judgment of the court. Normally, either party may appeal the judgment to a court of record, in which case the matter is retried there.

QUESTIONS

1. What is the chief function of the courts?
2. Over what must a court have jurisdiction before it can try a case?
3. How does a party get a case to the U.S. Supreme Court?
4. Name the court in which the following disputes would be settled:
 - a. A claim for an unpaid bill of \$100
 - b. A dispute over the amount of income taxed owed
 - c. An allegation that a lower court made a mistake
 - d. A controversy among cousins regarding their share of a deceased grandparent's estate
 - e. A divorce case
 - f. A damage suit for \$7,500
5. Must a party to a lawsuit be represented by a lawyer? Explain.
6. Why are courts of original general jurisdiction referred to as courts of record?
7. Who are the officers of
 - a. An inferior court?
 - b. A state court of record?
 - c. A federal court?
8. Why is it important to comply with procedural laws?
9. List the ordered events that occur when a civil action is brought.
10. What is the procedure by which an appellate court learns about a case?

Business Torts and Crimes

CHAPTER

3

LEARNING OBJECTIVES

- ① Discuss the basis for intentional and negligent tort liability.
- ② List and explain the generally recognized business torts.
- ③ Explain what business crimes are.
- ④ Describe what computer crimes are and the three types that affect business.

PREVIEW CASE

With their sons, aged seven and four, in car seats in the back seat, Thomas and Shawn Ardizzone backed their car out of their garage. Thomas went back into the house for something. Shawn followed, leaving the boys in the car with the engine running. Ledon Taylor saw the car and got into it. As he started to back out of the driveway, the Ardizzones came outside. They ran to the car, but Taylor drove off. Thomas followed in another car. With two children in the car and the owner following, Taylor decided to abandon the car. He pulled off the road and, as he got out, he took Shawn's purse. After he was arrested, he was charged, among other crimes, with two counts of larceny. He alleged he had committed only one. When he saw the car, what did he intend to steal? When he got in the car, do you think Taylor inventoried what was in it? Do you think he saw the children?

How do businesses relate to society and to other businesses? Can the activity of a business unfairly damage another business or even violate a criminal law? With some variations among the states, courts have found some activities by businesses, and some activities against businesses, to be actionable.

3-1 Torts

A **tort** is a private or civil wrong or injury for which there may be an action for damages. A tort may be intentional, or it may be caused by negligence. **Negligence** is the failure to exercise reasonable care toward someone. It is tort law that allows a person injured by a product to sue the manufacturer for damages. Injured persons

LO ①

Basis for tort liability

tort

private wrong for which damages may be recovered

negligence

failure to exercise reasonable care

tortfeasor

person whose action causes injury

themselves must sue for any injuries caused by the intentional or negligent acts of others. The person who causes the injury is called a **tortfeasor**.

3-1a INTENTIONAL TORTS

To recover for an intentional tort, the injured person must show three things:

1. An act by the defendant
2. An intention to cause the consequences of the act
3. Causation—the injury was caused by the defendant’s act or something set in motion by the act

Intentional torts include such actions as assault (putting a person in fear of a wrongful touching), battery (a wrongful touching), trespass (invading someone’s property), and false imprisonment (improperly confining a person). Although a business could be involved in these torts, the parties could be anyone.

COURT CASE

FACTS: Security personnel of Liz Claiborne, Inc. questioned Andria Arrington, a clerical employee, about her time sheet. She admitted in writing that she had falsified it. After being fired, Arrington sued Liz Claiborne for false imprisonment. She alleged that she “thought” the door to the office in which she had been questioned was locked. She also did not “feel” free to leave because she had been told that if she did not cooperate, the police would be called. Questioning Arrington was clearly an

intentional act, so she claimed there had been an intentional tort.

OUTCOME: To find the intentional tort of false imprisonment, the court said Arrington had to prove that the Claiborne personnel intended to confine her, not just question her. She did not do this.

—*Arrington v. Liz Claiborne, Inc.*, 688 N.Y.S.2d 544 (N.Y. App. Div.)

3-1b NEGLIGENCE TORTS

To recover for a tort based on negligence, the plaintiff (the injured party) must show:

1. A duty of the tortfeasor to the injured party
2. Breach of that duty
3. That the breach was the actual and a proximate cause of the injury, and
4. Injury or damage

One common type of tort lawsuit based on negligence is one resulting from an automobile accident. The duty of a driver is to operate a vehicle in a safe and prudent manner. A breach of that duty occurs if the driver operates the vehicle in an unsafe manner. If operating the vehicle in an unsafe manner causes someone

injury, the breach of the duty would be a proximate cause of the injury. Proximate cause requires that the plaintiff shows injury and that the injury was a foreseeable result of the defendant's action. Finally, the plaintiff would have to prove the amount of the damage. If more than one person's action is a proximate cause of a plaintiff's injuries, everyone whose breach of duty contributed to the plaintiff's injuries could be liable.

In some states, in order for an injured party to recover anything in a negligence action, the injured party cannot have been negligent. Negligence on the part of the injured party is called **contributory negligence**. However, other states allow injured parties to recover even when they have been partially at fault. The doctrine of **comparative negligence** allows courts to reduce damage awards to plaintiffs by the percentage of the damage attributable to the plaintiffs' negligence. For example, if a plaintiff's total damages are \$100,000, and the plaintiff was 20 percent at fault, the award would be \$80,000.

contributory negligence

negligence of the injured party

comparative negligence

contributory negligence that reduces but does not bar recovery

3-1c BUSINESS TORTS

The type of tort caused by a business or involving a business is a **business tort**. Businesses become involved in a tort action in several common ways.

Product Liability. Manufacturers, dealers, suppliers, and rental companies incur potential liability in tort for injuries caused by products they have provided. Liability can be based on two theories:

1. Negligence
2. Strict liability

Negligence. The suppliers of products are potentially liable for negligence as a result of one of the following three reasons:

1. The use or condition of the product
2. A design defect
3. Failure to warn

A person injured through the use or condition of a product could sue on the basis of the manufacturer's negligence in the preparation or manufacture of the article. In that case, the plaintiff must learn how the article was made and prove negligence. Unless the plaintiff can show negligence in the design of the manufacturer's product, the general method of manufacture, or a failure to warn, it is unlikely that the plaintiff will be able to prove negligence.

Whenever a manufacturer, as a reasonable person, should foresee that a particular class of people would be injured by the product, the manufacturer is liable to an injured member of that class without regard to whether such member purchased from the manufacturer or from anyone else.

Strict Liability. Because of the difficulty of proving negligence, courts have expanded a doctrine called **strict liability**. This doctrine makes entities in the chain of manufacture of a product—manufacturer, wholesaler, or retailer—liable without proof of negligence. It applies to anyone injured because of a defect in the manufacture of a product when such defect makes the use of the product dangerous to the user or people in the vicinity of the product.

LO ②

General business torts

business tort

tort caused by or involving a business

strict liability

manufacturer of product liable without proof of negligence for dangerous product

COURT CASE

FACTS: While “Great Balls of Fire” played on the jukebox, the bartender at Brother Jimmy’s BBQ poured 151 proof Bacardi rum onto the bar and then lit it. Unfortunately the flame blew back into the bottle, and the burning contents shot out. Lauren Sclafani, a patron, was severely burned and sued the restaurant and Bacardi claiming strict liability.

Bacardi had included warning labels and installed a removable flame arrester.

OUTCOME: The court held that Sclafani had a viable claim for strict liability against Bacardi.

—*Sclafani v. Brother Jimmy’s BBQ, Inc.*, 930 N.Y.S.2d 566 (N.Y. App. Div.)

Business Activity. Other business activities have been widely recognized as intentional torts. Although state laws vary, an injured party may recover damages on the basis of conduct that causes:

1. Interference with a contract or economic advantage
2. Confusion about a product

3-1d INTERFERENCE WITH A CONTRACT OR ECONOMIC ADVANTAGE

The tort of interference with a contract or economic advantage occurs when a business relationship has been formed, and in some way a third party intentionally causes one party to end the relationship. If injured, the other party to the business relationship may have a cause of action against the party causing the breakup.

Many states require that the intentional interference be improper. Improper interference can occur because of an improper motive or an improper means, or

COURT CASE

FACTS: Macy’s, Inc. and Martha Stewart Living Omnimedia, Inc. entered a licensing agreement that granted Macy’s exclusive rights to certain products designed by Martha Stewart and branded with her mark. The contract provided that Macy’s would manufacture the products, which included bedding, housewares, and cookware, and sell them exclusively in Macy’s stores. Martha Stewart promised not to enter into any new agreement with another department store that would provide for the sale of the same branded products that Macy’s was licensed to sell. JCPenney executives began to negotiate a retail partnership with Martha Stewart, despite their knowledge of the Macy’s licensing agreement and its exclusivity provision. As a result of the negotiations, Martha Stewart entered into an

agreement with JCPenney permitting the department store to manufacture products under the Martha Stewart brand and to have them retailed within JCPenney stores. Macy’s sued JCPenney for tortious interference with a contract, arguing that JCPenney intentionally caused Martha Stewart to breach the exclusivity provision of the Macy’s agreement.

OUTCOME: The court found that JCPenney’s efforts to engage Martha Stewart “exceeded the minimal level of ethical behavior in the marketplace” and wrongfully caused Martha Stewart to breach the contract with Macy’s.

—*Macy’s Inc. v. Martha Stewart Living Omnimedia, Inc.*, 127 A.D.3d 48 (N.Y.A.D.)

by acting other than in the legitimate exercise of the defendant's own rights. It is not improper to protect one's economic or safety interests or assert honest claims. Interference with leasing opportunities, with the opportunity of buying and selling goods, and with hiring employees are interferences that can be actionable.

3-1e CONFUSION ABOUT A PRODUCT

Intentionally causing confusion about another's product can be a tort. This can be done by making false statements about another's product or by representing goods or services as being the goods or services of someone else.

Injurious Falsehood. When a person makes false statements of fact that degrade the quality of another's goods or services, the tort of **injurious falsehood** occurs. Some courts call this tort **commercial disparagement** or **trade libel**. The false statement must be made to a third person. This is **communication**. The hearer must understand the statement to refer to the plaintiff's goods or services and to degrade their quality. An injured party must show the statement was a substantial element in causing damage. In some states, the plaintiff must identify specific customers lost as a result of the statement.

The false statement normally must have been made maliciously. Malice can be shown by proving that the statement was made as a result of ill will, spite, or hostility with the intention of causing the plaintiff harm. In some jurisdictions, the plaintiff need only show that the defendant knew the statement was false or had a reckless disregard as to its truth or falsity.

injurious falsehood, commercial disparagement, or trade libel

false statement of fact that degrades quality of another's goods or services

communication
telling a third person

COURT CASE

FACTS: Brook Mays Music Co., a retail seller of band instruments, published a document titled "ISO Alert." The ISO Alert was headed, "Instrument Shaped Object; Attention: Music Supervisors, Bank Directors. . . ." It stated that stores were selling beginner "instruments" or "Instrument Shaped Objects under the name brands of First Act" and others. It further stated, "we have determined that they will not play for the long term (if even the short term)! The ISO's break and parts are NOT available. . . . [S]tudents that will be playing these instruments will likely not survive the first

few months of band because of the design and quality." First Act sued Brook Mays for injurious falsehood. Brook Mays said First Act had to prove malice.

OUTCOME: The court stated that Brook Mays either intended or reasonably should have recognized that the ISO Alert would cause First Act pecuniary loss. First Act was awarded damages.

—*First Act Inc. v. Brook Mays Music Co.*, 429 F.Supp.2d 429 (D. Mass.)

Confusion of Source. The tort that occurs when a person attempts to represent goods or services as being the goods or services of someone else is **confusion of source**. The law assumes customers would be confused as to the source of the goods or services. Actual confusion need not be shown. This tort occurs from trademark or trade name infringement or unfair competition.

Trademarks. A **trademark** is a word, name, symbol, device, or any combination thereof adopted and used to identify and distinguish one's goods from another's goods and to indicate the source of the goods. A trademark or trade name gives

confusion of source
representing goods or services as those of another

trademark
word, symbol, device, or combination of them used to identify and distinguish goods

the owner the exclusive right to use a word or device to distinguish a product or a service. As a type of property, trademarks are discussed in Chapter 14.

Only those marks used by a business in a way that identifies its goods or services and differentiates them from others are entitled to trademark protection. The mark normally must be inherently distinctive, which means unique, arbitrary, and nondescriptive.

Marks that are fanciful or subtly suggest something about the product can be protected. They include words such as *Ivory* for soap, abbreviations and nicknames such as *Coke*, made-up words such as *Exxon* and *Rolex*, and the shapes of packages and products.

A mark that is not distinctive may be a trademark if it has acquired **secondary meaning**. Secondary meaning is a special or trade meaning developed by usage that distinguishes the goods or services so as to warrant trademark protection.

A trademark may be registered or unregistered. A trademark registered under the federal trademark law gives the holder the rights and remedies of that law. The holder of an unregistered trademark has some rights under the federal law and rights provided by the common law. Many states also have trademark laws that vary greatly.

Trademark or **trade name infringement** is unauthorized use or confusingly similar imitation of another's mark or name. A trademark owner may get a court to halt anyone's commercial use of the mark. Courts will halt imitation if it is likely to cause confusion, mistake, or deception. Factors that commonly indicate a likelihood of confusion include:

1. The similarity of the two marks
2. The similarity of the products represented by the marks
3. The similarity of marketing and customers
4. The similarity and amount of advertising used
5. The area of overlapping use
6. The intent of the parties in adopting the marks
7. The strength of the marks
8. Actual confusion by the public

secondary meaning
special meaning of a mark
that distinguishes goods

**trademark or trade
name infringement**
unauthorized use or
imitation of another's mark
or name

COURT CASE

FACTS: Janet Travis, Inc. had operated family-owned restaurants under the trademark "TRAVIS" since 1944 and registered the mark in the 1960's. Preka Holdings, LLC purchased a restaurant that was licensed to use the "TRAVIS" trademark. However, Preka bought only the restaurant and did not discuss rights to retain the license to use the "TRAVIS" mark. Nonetheless, Preka continued using the "TRAVIS" mark by calling the restaurant Travis Grill, using the trademark on advertisements, and including the "famous Travis burger" on its menu. Janet Travis sued Preka for trademark infringement and presented affidavits from customers stating that

they mistakenly believed the Travis Grill was affiliated with Janet Travis. Preka argued that "TRAVIS" was not a valid trademark, because it was merely a surname and not distinctive.

OUTCOME: The court held that Janet Travis' decades long use of the "TRAVIS" mark had caused the mark to attain a secondary meaning that distinguished their restaurant business to customers. Preka's use of the mark was trademark infringement.

—*Janet Travis, Inc. v. Preka Holdings, LLC*, 856 N.W.2d 206 (Mich. App.)

Where the imitation of another's mark is for the purpose of jest or commentary, the parody is successful when there is no confusion and therefore no infringement.

Trademarks identify and distinguish tangible goods; service marks identify and distinguish services. The same legal principles govern trademark and service mark infringement.

Trademark or **trade name dilution** reduces the capacity of a mark to identify and distinguish goods or services. This could be done by *blurring* a trademark. Blurring diminishes the selling power of a trademark by unauthorized use on noncompeting products. Blurring would be making McDonald's light bulbs or Chrysler tires, for example. Dilution can also *tarnish* a trademark by using the mark in a disparaging manner or on low-quality goods.

The federal Anticybersquatting Consumer Protection Act (ACPA) gives trademark owners the right to sue people who register Internet domain names of trademarks and then try to profit from them. The trademark owner needs to show ownership of the mark, that the defendant registered or trafficked in identical or confusingly similar domain names, and that the defendant in bad faith intended to profit from the mark.

trademark or trade name dilution
lessening the capacity of a famous mark to identify and distinguish goods

COURT CASE

FACTS: Webadviso, owned by J. Taikwok Yung, acquired 180 domain names and parked them with providers of domain parking services in order to produce pay-per-click revenue. The domain names included well-known trademarks of Merrill Lynch (ML) and Bank of America (B of A), and the websites at times displayed information relating to financial services. When ML and B of A found out about the websites, Yung offered to sell the sites to them. A lawsuit resulted.

OUTCOME: In seeking to produce pay-per-click revenue, the court said Yung clearly intended to profit from the goodwill associated with the trademarks. Since he wanted to divert Internet users to his website, which had content that could tarnish the infringed marks, he had registered the names in bad faith and violated the ACPA.

—*Webadviso v. Bank of America Corp.*, 448 Fed. Appx. 95 (2d Cir.)

Unfair Competition. **Unfair competition** exists when the total impression a product gives to the consumer results in confusion as to the origin of the product. When unfair competition is claimed, the total physical image conveyed by the product and its name are considered together.

Unfair competition
total impression of product results in confusion as to its origin

3-2 Business Crimes

Crimes committed against a business or in which the perpetrator uses a business to commit a crime are **business crimes**. Some criminal offenses, such as forgery, fraudulent conveyances, shoplifting, and embezzlement, closely relate to business activities.

LO ③
What business crimes are
business crime
crime against a business or committed by using a business

3-2a TYPES OF BUSINESS CRIMES

In this age of computers, electronic transfers, and organized crime, the range of crimes against businesses has been growing. There are also laws which can have a

serious impact on businesses and make some seemingly innocuous business transaction criminal. Businesses should be aware of:

1. Theft
2. RICO cases
3. Computer crimes
4. Privacy and data security laws
5. The Foreign Corrupt Practices Act

theft

taking another's property without consent

Theft. **Theft** is the crime of stealing. It involves taking or appropriating another's property without the owner's consent and with the intention to deprive the owner of it. This includes when a thief initially obtains the property lawfully.

Theft includes shoplifting, embezzlement, and larceny. The crimes generally consist of the following:

shoplifting

taking unpurchased goods from a store

1. **Shoplifting:** Taking possession of goods in a store with the intent to use them as the taker's own without paying the purchase price. Concealing unpurchased goods while in a store can constitute shoplifting.

embezzlement

fraudulent conversion of property lawfully possessed

2. **Embezzlement:** Fraudulent conversion of another's property by someone in lawful possession of the property with the intent to defraud the owner of the property. Conversion means handling the property inconsistently with the arrangement by which the defendant has possession of it. Because businesses rely on employees to receive payments and make disbursements, embezzlement is often a crime against a business.

COURT CASE

FACTS: Kriemhilde Bixby had deteriorating health, so Heidi Hemmingway and Beverly Cogswell took care of her and handled all household tasks for her. Hemmingway persuaded Bixby to execute a living will and contacted attorney Sheri Paige. Paige told Hemmingway and Cogswell that Bixby's assets should be sold to avoid estate taxes. Bixby purportedly signed a document allowing Hemmingway to sell her house. Paige held the proceeds of the sale in her attorney's account. On September 19, she issued two checks from the account for \$15,000 each, to herself and her husband. By then, Bixby was suffering from severe

dementia and died eight days later. When charged with embezzlement, Paige produced a document supposedly signed by Bixby, dated September 19, authorizing the checks. Paige alleged that Bixby had authorized the checks.

OUTCOME: It was reasonable to conclude that with severe dementia, Bixby could not have known she was authorizing the sale. Since Bixby had not consented, as trustee of the proceeds of the house sale, Paige had embezzled \$30,000.

—*State v. Paige*, 40 A.3d 279 (Conn.)

larceny

taking and carrying away of property without consent

3. **Larceny:** Taking the property of another without the consent of the person in possession, with the intent of depriving the possessor of the property. The intent to deprive the possessor of the property must exist when the property is taken. The taker need not take the property from the owner. Whenever someone takes any business property, whether inventory, tools, or even office supplies, larceny occurs.

PREVIEW CASE REVISITED

FACTS: With their sons, aged seven and four, in car seats in the back seat, Thomas and Shawn Ardizone backed their car out of their garage. Thomas went back into the house for something. Shawn followed, leaving the boys in the car with the engine running. Ledon Taylor saw the car and got into it. As he started to back out the driveway, the Ardizones came outside. They ran to the car, but Taylor drove off. Thomas followed in another car. With two children in the car and the owner following, Taylor decided to abandon the car. He pulled off the road, and, as he got out, he took Shawn's purse. After he was arrested, he was charged, among other crimes, with two counts of larceny. He alleged he had committed only one.

OUTCOME: The court said that, although the purse was in the car when Taylor stole the car, when he decided it was not worthwhile to keep a car with two children in it, he made an independent decision to steal the purse. He had committed two larcenies.

—*Taylor v. State*, 879 N.E.2d 1198 (Ind. Ct. App.)

RICO Cases. The Racketeer Influenced and Corrupt Organizations Act, also called RICO, is a federal law designed to prevent the infiltration of legitimate businesses by organized crime. It prohibits investing income from racketeering to obtain a business, using racketeering to obtain a business (through, for example, conspiracy, and extortion), using a business to conduct racketeering, and conspiring to do any of these.

RICO includes civil sanctions as well as criminal ones. As a result, it has been used by one business against another in cases not involving organized crime. The injured party brings the action under RICO based on the perpetration of criminal activity and requests damages. In criminal cases, the government brings the action. To prove a business violation of RICO, a plaintiff must show:

1. Conduct
2. Of an enterprise (at least two people)
3. Through a pattern (at least two related acts within ten years)
4. Of racketeering activity

Racketeering activity means acts specified in the law that are labeled criminal under state or federal laws. Examples of the specified crimes include murder, kidnapping, arson, robbery, bribery, distribution of illegal narcotics, obstruction of justice, mail or wire fraud, money laundering, forgery, and securities fraud. The defendant does not have to have been convicted; it is enough to have engaged in activity for which a conviction could be obtained. This makes it easier to win a civil RICO case than a criminal one.

Civil suits under RICO have been popular because RICO provides recovery of three times the damages suffered as a result of the RICO violation. It also allows the recovery of attorneys' fees, which can be a very substantial sum.

Computer Crimes. Crimes committed with the aid of a computer or because computers are involved are called **computer crimes**. Computers can be involved in crimes in various ways:

1. They can be the objects of crime—such as when a computer is stolen or damaged.
2. They can be the method of committing a crime—such as when a computer is used to take money from an account.

LO 4

What computer crimes are

computer crime

crime that is committed with the aid of computers or because computers are involved

3. They can represent where the crime is committed—such as when copyrights are infringed on the Internet.

Sometimes prosecutors can successfully prosecute computer offenses by using existing criminal laws prohibiting theft, mail fraud, wire fraud, and the transportation of stolen property. However, both the federal government and the states have enacted specific computer crime legislation.

COURT CASE

FACTS: Seikaly & Stewart, P.C., a small law firm, contracted with The Rainmaker Institute, LLC to provide Internet marketing services and create new business for the law firm. Rainmaker promised to improve the firm's ranking and visibility in search engine results through an optimization process that involved Internet link building and the creation of blogs. Despite a lack of results, Rainmaker persuaded the firm to renew its marketing contract and continued marketing the same services to other small law firms. After several years of seeing no additional Internet business, Seikaly & Stewart claimed that Rainmaker had fraudulently marketed a search engine optimization process that it knew violated major search engine's guidelines, causing

the firm's website to be downgraded and ineffective for search engine purposes. The firm sued Rainmaker under RICO, citing repeated instances where Rainmaker used the Internet, telephones, and U.S. Mail to advance the fraudulent scheme to the Seikaly law firm and other small law firms.

OUTCOME: The court held that Seikaly had sufficiently alleged a pattern of at least two related acts of racketeering in the form of mail fraud and wire fraud. The firm successfully stated a cause of action against Rainmaker under RICO.

—*Seikaly & Stewart, P.C. v. Fairley*, 18 F.Supp.3d 989 (D. Ariz.)

The federal government has enacted the Electronic Communications Privacy Act. The law prohibits the interception of computer communications, such as e-mail, or obtaining and divulging without permission data stored electronically.

State laws generally prohibit alteration of a computer program or intentional, unauthorized access to a computer regardless of the reason for the access and the disclosure of any information gained by such access.

Criminal activity relating to computers can be classified as three types: trespass, fraud, and criminal copyright infringement.

computer trespass
unauthorized use of, or
access to, a computer

Trespass. **Computer trespass** means unauthorized use of, or access to, a computer. Using a business computer to play games or prepare personal documents may constitute computer trespass. More serious trespasses include learning trade secrets, gaining customer lists, and obtaining classified defense information. Because computer trespass involves the use of computer time without permission, all trespass is theft of computer time.

Computer trespass has been the focus of state computer crime laws. Most jurisdictions protect the confidentiality of all information stored in computers.

Unauthorized access might be by:

1. An employee not authorized to use a computer in the business
2. An employee authorized to use a computer who uses it for nonbusiness purposes

3. An unauthorized outsider who gains access to the business's computer system—called a **hacker**

One method of trespass involves the use of **rogue programs**. A rogue program is a set of software instructions that produces abnormal or unexpected behavior in a computer. Rogue programs have such colorful names as “viruses,” “bacteria,” “worms,” “Trojan horses,” and “time bombs.” They may cause computer users difficulty or inhibit normal use by altering the operations of a program, or impose injury by destroying data or screen displays, creating false information, or damaging the computer. The programs can infect a computer by being attached to a useful program or e-mail; they spread to other computers through modems, removable storage, or network connections. Rogue programs might not show up for some time, so they can spread and damage all files in a computer system.

hacker

unauthorized outsider who gains access to another's computer system

rogue program

set of software instructions that produces abnormal computer behavior; see www.copyright.gov

Fraud. As applied to computer crime, fraud encompasses larceny and embezzlement. It includes causing bank deposits to be credited to one individual's account. Such action might be prosecuted under traditional crime statutes or new computer crime statutes.

COURT CASE

FACTS: S&M Brands made a \$6,500 loan to its director of human resources, Jeremy DiMaio. DiMaio agreed to pay back the loan by having money withheld from his paycheck starting six months later. Three months after the withholdings were to have started, DiMaio quit. S&M found out he had asked a payroll employee not to make the withholdings and that she had complied. William Snell, DiMaio's replacement, found that hundreds of valuable documents and computer files were missing from S&M's personnel records. DiMaio agreed to return the missing items if S&M would

forgive the loan. DiMaio was then arrested and charged with computer fraud. Snell and S&M's lawyer testified that the value of the more than 800 personnel files DiMaio had taken was more than \$10,000.

OUTCOME: The court found that the testimony of Snell and the lawyer about the value of the files taken was adequate to prove their value. The charge of computer fraud was proven.

—*DiMaio v. Com.*, 636 S.E.2d 456 (Va.)

The federal Computer Fraud and Abuse Act makes it an offense to, without authorization, access a computer or exceed authorized access of a computer used by or for the U.S. government or a financial institution and to (1) fraudulently obtain anything of value; (2) intentionally and without authorization obtain or destroy information; (3) affect the use of the computer; or (4) intentionally cause damage. It is also an offense to (1) deal in computer passwords and thereby affect interstate commerce; (2) knowingly access a computer, obtain national defense information, and disclose, attempt to disclose, or retain that information; or (3) transmit a threat to damage a U.S. government or financial institution computer in order to extort money.

COURT CASE

FACTS: Robert Steele worked for a company that provided contract IT services to governmental agencies. Through his job duties, Steele had access to the company's server and other employees' email accounts. Several years later, Steele resigned from SRA International, Inc. and took a job with a competing company that also provided IT services to government agencies. Upon his resignation, SRA took back Steele's company-issued computer, denied him access to the office building, and terminated his access to the main computer system. The company, however, neglected to change the password on a backdoor account to the server that Steele had created. In the nine months following his departure, Steele secretly logged into the email server of his former employer over 80,000 times and downloaded

emails and documents related to the company's bids for government contracts. Steele was convicted of violating the Computer Fraud and Abuse Act. He argued that the evidence did not support the charge that his access to SRA's server was "without authorization," because the company never changed the password on his backdoor account.

OUTCOME: The court noted that SRA took steps to deny Steele access to company property and systems after his departure, and it was logical to conclude that Steele was not authorized to access to the computer system after leaving the company. His conviction was upheld.

—*U.S. v. Steele*, 595 Fed. Appx. 208 (4th Cir.)

A wide variety of frauds have been perpetrated on unsuspecting businesses and individuals via the Internet. These have included a long-distance telephone company employee selling more than 50,000 calling card numbers. That employee was sent to prison. Businesses frequently suffer losses quietly in preference to advertising to customers, stockholders, and clients that they are vulnerable to hackers, so it is impossible to measure accurately the dollar amount of loss to business from computer fraud.

Criminal Copyright Infringement. The crime of criminal copyright infringement has been estimated to cost copyright holders billions of dollars each year. In order to establish the offense, a prosecutor needs to prove (1) there has been copyright infringement, (2) the infringement was willful, and (3) the infringement was done for business advantage or financial gain.

pirated software
software copied illegally

A particularly serious type of copyright infringement for business occurs when software is copied. Software that is copied illegally is called **pirated software**. Pirating software is a worldwide industry because the Internet links people everywhere. Software can be copied, and within a relatively short time, people all over the world can make numerous illegal copies.

Privacy and Data Security Laws. In response to computer hacking and growing privacy concerns, state and federal laws now require businesses which collect and store personal data to do so in a secure manner. Personal data may include information such as a person's birthdate, Social Security Number, e-mail and physical addresses, credit card number, and health records. At the federal level, several laws regulate businesses in specific industries, but there is no single, comprehensive privacy framework to govern the collection and storage of personal information. Under the Health Insurance Portability and Accountability Act (HIPAA), for example, health-care providers and plans, as well as the directors, officers, and employees of these entities, can be held criminally liable for knowingly obtaining and disclosing an individual's personal health information in violation of HIPAA rules. In addition to criminal prosecution, businesses may be subject to civil

COURT CASE

FACTS: Robin Rothberg, Christian Morley, and perhaps hundreds of others were members of a computer software piracy group called “Pirates with Attitudes.” The group stored huge numbers of pirated software programs at file transfer protocol (called FTP) sites. Members of the group could download the pirated software to their own computers. When the FBI seized computer hardware at the University of Sherbrooke in Canada, there were still 5,000 programs on it; however, at trial, an FBI computer specialist testified that more

than 54,000 programs had been uploaded to the hardware. Rothberg, Morley, and others were charged with conspiracy to commit copyright infringement.

OUTCOME: All the defendants either pled guilty or were found guilty after trial of the conspiracy charge. The pirated software was clearly on the computer hardware and available for downloading.

—*United States v. Rothberg*, 2002 WL 171963 (N.D. Ill.)

penalties for their failure to protect customers’ personal information. The Federal Trade Commission (FTC) is a leading agency that enforces laws against companies for failing to implement adequate safeguards to secure customers’ personal data.

Even with safeguards in place, businesses may still experience security breaches. Many laws require businesses to notify customers of a security breach within a specified time of the company’s discovery of the breach, so that customers can monitor their personal and financial records for fraudulent activity. Businesses are also often required to notify state attorneys general of security breaches.

The Children’s Online Privacy Protection Act (COPPA) is a far-reaching law enforced by the FTC that applies to businesses operating websites and online services directed to children under the age of 13. The FTC considers factors such as the use of animated characters, subject matter content, and the age of models to determine whether children are a website’s target audience. COPPA also covers businesses operating general audience websites that knowingly collect information from children under the age of 13. COPPA requires businesses to provide notice on the website of what information the website is collecting on children and how the data is used. Businesses must also obtain parental consent prior to collecting and using personal information from children, and the law gives parents the right to review and prevent the retention of the information.

Foreign Corrupt Practices Act. After more than 400 companies admitted making hundreds of millions of dollars in questionable or illegal payments to foreign government officials, politicians, and political parties, Congress enacted the Foreign Corrupt Practices Act (FCPA). It prohibits corrupt payments (bribes) to foreign officials, politicians, and political parties in order to get or keep business and mandates record-keeping requirements by companies.

The anti-bribery sections apply to any U.S. person (including a business) who bribes a foreign official and also to foreign businesses and persons who act in the United States in furtherance of such a bribe. The record-keeping requirements apply to publicly held corporations, domestic or foreign, whose securities are listed on U.S. stock exchanges.

In most of the recent FCPA cases, liability resulted from misconduct by foreign third persons such as agents, suppliers, distributors, and consultants. Businesses are responsible for the acts of foreign subsidiaries when they have authorized, directed, or controlled the acts.

Understanding the breadth of this law can be difficult. This is true with respect to knowing who a “foreign official” is, what outlays constitute a bribe, and what the standard for knowledge of a questionable activity is.

Foreign Officials. In addition to individuals employed in running the government, employees of businesses controlled by foreign governments are considered to be foreign officials. In countries with national health-care systems, for example, doctors would be considered foreign officials.

COURT CASE

FACTS: Lindsey Manufacturing Company (LMC) made payments to Grupo Internacional (Grupo) ostensibly as commissions for services of Enrique Aguilar, LMC’s sales representative in Mexico. Large portions of the payments were used to bribe Nestor Moreno and Arturo Hernandez, high-ranking employees of the Comisión Federal de Electricidad (CFE). CFE was an electric utility wholly owned by the government of Mexico. LMC was charged with violating the FCPA. LMC alleged that Moreno and Hernandez were not “foreign

officials” because a state-owned corporation could not be a department, agency, or instrumentality of a foreign government.

OUTCOME: The court held that a state-owned corporation could be an instrumentality of a foreign government and that officers of such a corporation may be “foreign officials” for purposes of the FCPA.

—*U.S. v. Aguilar*, 783 F.Supp.2d 1108 (C.D. Cal.)

While in the Aguilar case the government totally owned the electric utility for which the bribed individuals worked, an entity need not be wholly owned or even majority owned by a government in order for its employees to be considered foreign officials under the FCPA.

Bribes. The mere offer or promise of a corrupt payment can constitute a bribe in violation of the act. The payment can be money or anything of value, including entertainment.

Standard for Knowledge. Managers and executives may be held strictly liable for company books and records that do not honestly account for corrupt payments, even if they have no knowledge of the payments. They may not knowingly avoid or fail to implement proper accounting controls or knowingly falsify records. But “knowing” can mean a person is merely aware of a high likelihood that a forbidden situation exists. A business cannot avoid the impact of the FCPA by being purposely blind or intentionally avoiding learning whether a bribe is likely to be paid.

Consequences of Violation. The potential consequences for violation of the law include heavy fines, imprisonment of individuals, and debarment as well as the potential of civil suits by stockholders.

Fines. Companies, and individuals who are not allowed to be reimbursed by their companies, have had to pay criminal penalties—from tens of thousands to

hundreds of millions of dollars. Companies also frequently must pay back any profits received as a result of corrupt payments. This is called **disgorgement of profits**.

disgorgement of profits

having to pay back profits received illegally

Imprisonment. Individuals found in violation of the FCPA have been sentenced to prison for terms ranging from months to several years.

Debarment. **Debarment** means a firm is prohibited from doing business with the government. When a company does a lot of business with the government, debarment is a severe penalty. Corporations or individuals in violation of the FCPA may be subject to debarment. In fact, a corporation guilty of a felony is subject to debarment.

debarment

prohibition on doing business with government

The FCPA does except from the bribery provisions payments made to speed up performance of a “routine governmental action.” This includes such things as obtaining a permit, water, mail or phone service, or police protection.

QUESTIONS

1. a. What must an injured party show in order to recover for an intentional tort?
b. What must be shown for a negligence tort?
2. Is it always a tort when competitors intentionally injure one another? Explain.
3. Explain the benefit to plaintiffs of the doctrine of strict tort liability.
4. What marks are entitled to trademark protection?
5. How does the Anticybersquatting Consumer Protection Act (ACPA) protect trademark owners from trademark infringement and dilution?
6. What rights do parents have under the Children's Online Privacy Protection Act (COPPA)?
7. Why have civil RICO cases been so popular?
8. What are the three elements of criminal copyright infringement?
9. To whom does the FCPA apply?
10. For what companies is debarment a serious penalty and why?

CASE PROBLEMS

When the concluding question in a case problem can be answered simply yes or no, state the legal principle or rule of law that supports your answer.

1. Frank Martini and Satanand Sharma hired James Little to represent them when sued by Amber Hotel Company. Little agreed to be paid \$100 an hour less than his normal fee, provided that he would have a lien against any attorney fee award. In December, the court entered judgment against Amber. Amber appealed. The court then amended the judgment to award Martini and Sharma \$152,700 in attorney's fees, and Amber did not appeal this. Martini, Sharma, and Amber negotiated about a settlement, and Little advised them of his right to the attorney's fee award. Martini and Sharma signed a settlement agreement by which Amber agreed to dismiss its appeal, and the plaintiffs agreed to abandon the fee award. The parties did not inform Little. He sued Amber for intentionally interfering with the performance of a contract. Should he recover?
2. Teleline, Inc. ran a telephone gambling game called “Let's Make a Deal” (LMD) using a 900 phone number. Playing the game cost \$3.88 a minute. People who called were not charged for the phone

LO ②

LO ③

CASE PROBLEMS (CONTINUED)

calls, but only for the ability to gamble provided by Teleline. AT&T carried the calls over its long-distance lines, and Teleline paid AT&T for the cost of the calls. Felix Kemp's grandson called the 900 number. AT&T listed Teleline's charges under the heading "direct-dialed calls," as long-distance charges mixed in with charges for long-distance calls on phone bills mailed to Kemp. AT&T's name and logo were displayed on the pages showing the LMD charges. The LMD charges were illegal gambling debts not collectable under state law. Kemp's local phone company told him he had to pay the charges, or his phone would be disconnected. He paid the phone bill and sued AT&T for violating RICO, claiming mail fraud. Were the bills so misleading that they constituted fraud?

LO ①, ②

3. Shelly Nitz, a real estate agent affiliated with Home Services of Nebraska, Inc., represented the seller of a home. The home purchaser hired Matthew Steinhausen, sole member of Steinhausen Home Inspections, LLC, to perform an inspection prior to closing the home sale. Nitz considered some of the items in Steinhausen's report to be beyond the scope of a typical home inspection and felt his comments were detrimental to the home seller. Some time later, Nitz responded to a question regarding Steinhausen's services via an e-mail forum for Home Services agents. Nitz stated that Steinhausen had done an inspection for one of her listings and that she "would never let him near one of [her] listings ever again!!! Total idiot." Steinhausen sued Nitz and Home Services, alleging libel. Was Nitz's description of Steinhausen as a "total idiot" fact or opinion? Should she be liable?

LO ②

4. Universal Furniture International, Inc. held copyrights on the designs of two furniture lines it sold. The designer had started with public domain sources, but blended elements from different historical periods and created changes until he found the designs aesthetically pleasing. He had blended the elements to create a different look. A major buyer of the lines asked Collezione Europa USA, Inc. to produce a cheaper version. Collezione did not know of the copyrights, but thought the designs were not entitled to copyright protection and could be imitated. It produced furniture so similar that when Universal's senior vice president saw the pieces, he thought they actually were Universal pieces. Universal sued Collezione for infringement. Did Collezione have the right to imitate the designs?

LO ③, ④

5. The Los Angeles Police Department charged police officer Kelly Chrisman with misuse of department computers. He accessed the police department's computer system for nonduty-related activities—specifically to search about people such as celebrities, his girlfriend, her friends, and himself. The relevant statute made it a crime to access any computer knowingly and without permission. Did Chrisman violate the statute?

LO ④

6. When Emeka Uyamadu tried to check his luggage at an airport, seven laptop computers in it set off an alarm. Since he did not have required export documents, customs officials kept the computers. When Uyamadu returned to the United States, he told police and signed a statement saying he had bought the computers at Internet auctions in May, even though he was told they were stolen June 6. He was charged with their theft. Should he be found guilty of computer theft?

LO ②

7. Haydel Enterprises owned and operated a bakery in New Orleans, Louisiana, selling pastries such as Mardi Gras king cakes. Haydel asked an artist to design a "bead dog" to replicate the dogs made out of beads thrown at Mardi Gras celebrations. Haydel registered the words "MARDI GRAS BEAD DOG" and the bead dog design as trademarks covering items such as king cake pastries, jewelry, and clothing. Over a six-year period, Haydel sold about 80 clothing items and 300 jewelry items featuring bead dogs, plus an unidentified number of king cakes with bead dogs. One magazine article featuring Haydel's products called bead dogs "an iconic Mardi Gras symbol." Three years after Haydel registered the bead dog trademarks, Raquel Duarte began selling jewelry featuring bead dogs. Duarte filed a lawsuit against Haydel in which she asked the court to declare that she was not breaking any trademark law by selling the bead dog jewelry and requested Haydel's trademarks be canceled. Duarte argued that Haydel's trademarks were descriptive in nature and had not acquired distinctiveness whereby customers associated the trademarks with Haydel's goods. Was Duarte correct?

CASE PROBLEMS (CONTINUED)

8. While they were dating, Heather Borrack and her boyfriend, Charles Reed, spent a day with his family on a lake swimming. Reed led Borrack up a steep path to a cliff above the lake. Once at the top of the cliff, Borrack told Reed that she wanted to return to the lake, but he refused to go back down the path with her and she was too frightened to return on the steep path by herself. Reed then tricked Borrack into jumping off the cliff by jumping himself and leaving her alone at the top. Borrack jumped off the cliff and was severely injured when she hit the water. She sued Reed for negligence, arguing that his conduct created a significant risk for her due to the terrain and that he had a duty to lessen the risk or take precautions so that Borrack did not harm herself. Did Reed's actions create a duty to Borrack? **LO ①**
9. Charles Ndhlovu regularly purchased large quantities of materials used in counterfeit manufacturing, such as blank CDs and DVDs, cases, and labeling paper. A store run by Ndhlovu did not display a business license and offered no signage or advertisement to indicate he sold CDs and DVDs. Law enforcement authorities sent a confidential informant to Ndhlovu's store to purchase CDs and DVDs. With \$180, the informant bought 80 counterfeit discs labeled with well-known movie and music titles. Police raided Ndhlovu's store and seized over 6,500 counterfeit CDs and DVDs. Ndhlovu was charged and convicted of criminal copyright infringement. He argued on appeal that the government had failed to prove that his copyright infringement was committed for purposes of commercial gain. Should Ndhlovu's conviction be upheld? **LO ②**
10. A shipment of computers arrived at a freight-moving facility and was moved to a trailer. At night, employees in the warehouse at the facility heard suspicious noises outside and called the police. Upon arriving, an officer saw a man carrying a box and stepping down from a trailer. The officers approached but could not find the man. They looked under the trailers and found five unopened computer boxes hidden behind the wheels of a trailer. The officers finally spotted the legs of two people under another trailer. Adolph Spears, Jr., was one of the men. A hand truck was found near a hole in the fence enclosing the facility. Was there evidence of any computer crime? **LO ③**

Government Regulation of Business

LEARNING OBJECTIVES

- ① Explain why government regulates business.
- ② Discuss the types and powers of administrative agencies.
- ③ List the major antitrust laws.
- ④ Summarize the areas in which the federal government has enacted legislation for environmental protection.

PREVIEW CASE

The Psychologist's Licensing Act was enacted by the Texas Legislature for the purpose of regulating the practice of psychology. The Legislature also established the Texas State Board of Examiners of Psychologists under the law and gave the Board authority to "set standards for the issuance of licenses to psychological personnel who hold a master's degree" and to adopt rules necessary to perform its duties. The Board established a rule requiring licensed psychological associates holding master's degrees to practice only under the supervision of a psychologist with a doctorate degree. The Texas Association of Psychological Associates (TAPA) challenged the rule, arguing that the Psychologist Licensing Act was silent on the matter of the supervision of associates and that the Board had no authority to promulgate the rule requiring supervision. Does it make sense to require psychological associates with less education be supervised as a condition of their licensing? Was the supervisory requirement consistent with the language of the Texas law that established the Board's authority?

Government rules and regulations affect the operation of every business, no matter what type. Government regulations, both state and federal, affect areas of business operation ranging from prices and product safety to the relationship of the business to its employees. This chapter discusses some ways in which government regulates the operation of business. Some other aspects of governmental regulation of business are discussed in Chapter 19 (consumer protection) and in Chapters 28 and 29 (employers and employees).

4-1 Purpose of Regulation

Government regulates business in order to eliminate abuses and to control conduct considered to be unreasonable. The goal is to enhance the quality of life for society as a whole by setting the rules under which all businesses compete.

LO ①

Why government regulates

4-2 Administrative Agencies

Chapter 1 defined administrative agencies as governmental boards or commissions with the authority to regulate or implement laws. Most governmental regulation of business is done by administrative agencies.

Most administrative agency regulation occurs because of the complex nature of the area of regulation. Each administrative agency can become a specialist in its particular area of regulation. Agencies can hire scientists and researchers to study industries or problems and set standards which businesses must follow. Agencies conduct research on proposed drugs (the Food and Drug Administration), examine the safety of nuclear power facilities (the Nuclear Regulatory Commission), certify the wholesomeness of meat and poultry (the Food Safety and Inspection Service), and set standards for aircraft maintenance (the Federal Aviation Administration). In all these areas, research has been necessary to determine a safe level for the public.

Some agencies investigate industries and propose rules designed to promote fairness to the businesses involved and the public. This occurs in the area of trading in stocks (the Securities and Exchange Commission), the granting of radio and television licenses (the Federal Communications Commission), and the regulation of banks (the Federal Deposit Insurance Corporation). The legislature thus can set up the guidelines and specify the research to be done by specialists in the field.

4-2a STRUCTURE OF ADMINISTRATIVE AGENCIES

Agencies may be run by a single administrator who serves at the pleasure of the executive, either the president of the United States in the case of federal agencies or the governor in the case of state agencies. Alternatively, a commission, the members of which are appointed for staggered terms, frequently of five years, may run agencies.

LO ②

Types and powers of agencies

4-2b TYPES OF AGENCIES

The two types of administrative agencies are usually referred to as regulatory and nonregulatory. Regulatory agencies govern the economic activity of businesses by prescribing rules stating what should or should not be done in particular situations. They decide whether a law has been violated and then proceed against those violating the law by imposing fines and, in some cases, ordering that the activity be stopped. Regulatory-type agencies include agencies such as the Environmental Protection Agency, the Securities and Exchange Commission, and the Federal Trade Commission.

Regulatory agencies also regulate a wide variety of professions that serve the public. Those supervised by governmental agencies in an effort to protect the interests of consumers include barbers, doctors, insurance agents, morticians, cosmetologists, fitters of hearing aids, and restaurateurs. In order to be licensed to practice a regulated profession, an individual must meet the requirements set by the appropriate regulatory agency.

Public utility companies, which are granted monopoly status, are regulated to ensure that they charge fair rates and render adequate service. Such businesses include natural gas, electric, and water companies. A public service commission or public utilities commission regulates these companies in most states.

Nonregulatory agencies, also called social regulatory agencies, dispense benefits for social and economic welfare and issue regulations governing the distribution of benefits. Such agencies include the Railroad Retirement Board, the Farm Credit Administration, and the Department of Health and Human Services.

Office of Foreign Assets Control (OFAC)

federal agency that enforces economic and trade sanctions

4-2c OFFICE OF FOREIGN ASSETS CONTROL

Agencies are also used by the government to carry out foreign policy objectives and enhance national security. The **Office of Foreign Assets Control (OFAC)** is a powerful agency that enforces economic and trade sanctions imposed by the United States against foreign countries, terrorists, drug dealers, and other individuals and organizations deemed a threat to national security. OFAC regularly publishes lists naming thousands of individuals and organizations with whom American companies are prohibited from conducting business. Many businesses screen their customers against the names on OFAC lists to ensure they do not process transactions for prohibited individuals and entities. OFAC also administers sanction programs against foreign governments, such as those in North Korea and Sudan. In special cases, companies may apply for a license granting them permission to do business with individuals and entities named on OFAC lists. Violations of OFAC regulations may result in civil and criminal penalties.

4-2d POWERS OF AGENCIES

Different regulatory agencies have different powers. However, the three major areas of regulations include:

1. Licensing power—Allowing a business to enter the field being regulated
2. Rate-making power—Fixing the prices that a business may charge
3. Power over business practices—Determining whether the activity of the entity regulated is acceptable or not

Agencies such as the Federal Communications Commission, the Nuclear Regulatory Commission, and the Securities and Exchange Commission have licensing power. The Civil Aeronautics Board, the Federal Power Commission, and the Interstate Commerce Commission all have rate-making power. The primary powers of the Federal Trade Commission and the National Labor Relations Board are to control business practices.

4-2e RULE MAKING

Administrative agencies primarily set policy through the issuance of rules and regulations. When an agency's rule is challenged, courts primarily focus on the procedures followed by the agency in exercising its rule-making power. The rule-making procedure followed by state agencies resembles that which federal agencies must use.

After investigating a problem, an agency will develop a proposed rule. A federal agency must publish a notice of the proposed rule in the *Federal Register*. This allows interested parties the opportunity to comment on the proposed rule.

The agency might hold formal hearings, but informal **notice and comment rule making** has become more and more common. When an agency uses notice and comment rule making, it publishes a proposed rule but does not hold formal hearings. After allowing time for comments from the public, the proposed rule could be published as proposed, changed, or entirely abandoned by the agency. Once a rule or regulation is adopted, it has the force of a statute; however, people affected by it may challenge it in court.

notice and comment rule making
enacting administrative rules by publishing the proposed rule and then the final rule without holding formal hearings

4-2f STATE AGENCIES

Whereas federal administrative agencies affect businesses throughout the country, state administrative agencies affect businesses operated in their states. The most common state agencies include public service commissions, state labor relations boards or commissions, and workers' compensation boards.

PREVIEW CASE REVISITED

FACTS: The Psychologist's Licensing Act was enacted by the Texas Legislature for the purpose of regulating the practice of psychology. The Legislature also established the Texas State Board of Examiners of Psychologists under the law and gave the Board authority to "set standards for the issuance of licenses to psychological personnel who hold a master's degree" and to adopt rules necessary to perform its duties. The Board established a rule requiring licensed psychological associates holding master's degrees to practice only under the supervision of a psychologist with a doctorate degree. The Texas Association of Psychological Associates (TAPA) challenged the rule, arguing that the Psychologist Licensing Act was silent on the matter of the supervision of associates and that the Board had no authority to promulgate the rule requiring supervision.

OUTCOME: The court held that the plain language of the Psychologist's Licensing Act gave the Board broad discretion in setting licensing standards for psychological associates. The Board had authority to issue the rule requiring supervision of associates, because the rule did not impose conditions in excess of the Act and was consistent with the Act.

—*Texas Ass'n of Psychological Associates v. Texas State Bd. of Examiners of Psychologists*,
439 S.W.3d 597 (Tex. App.)

4-3 Antitrust

Government also regulates business by means of **antitrust laws** that seek to promote competition among businesses.

The most important antitrust law, the federal Sherman Antitrust Act, declares, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations is . . . illegal."¹ It further provides that anyone who monopolizes or tries to obtain a monopoly in interstate commerce is guilty of a felony.

The Sherman Act applies to commerce or trade between two or more states and to buyers and sellers. Most states also have antitrust laws, very similar to the Sherman Act, which prohibit restraint of trade within their states.

In interpreting the Sherman Act, the federal courts have said it prohibits only those activities that *unreasonably* restrain trade. The *rule of reason* approach means

LO ③

Major antitrust laws

antitrust law
statute that seeks to promote competition among businesses

¹15 U.S.C. § 1.