BUSINESS LAW

TEXT AND CASES

The First Course

Fourteenth Edition

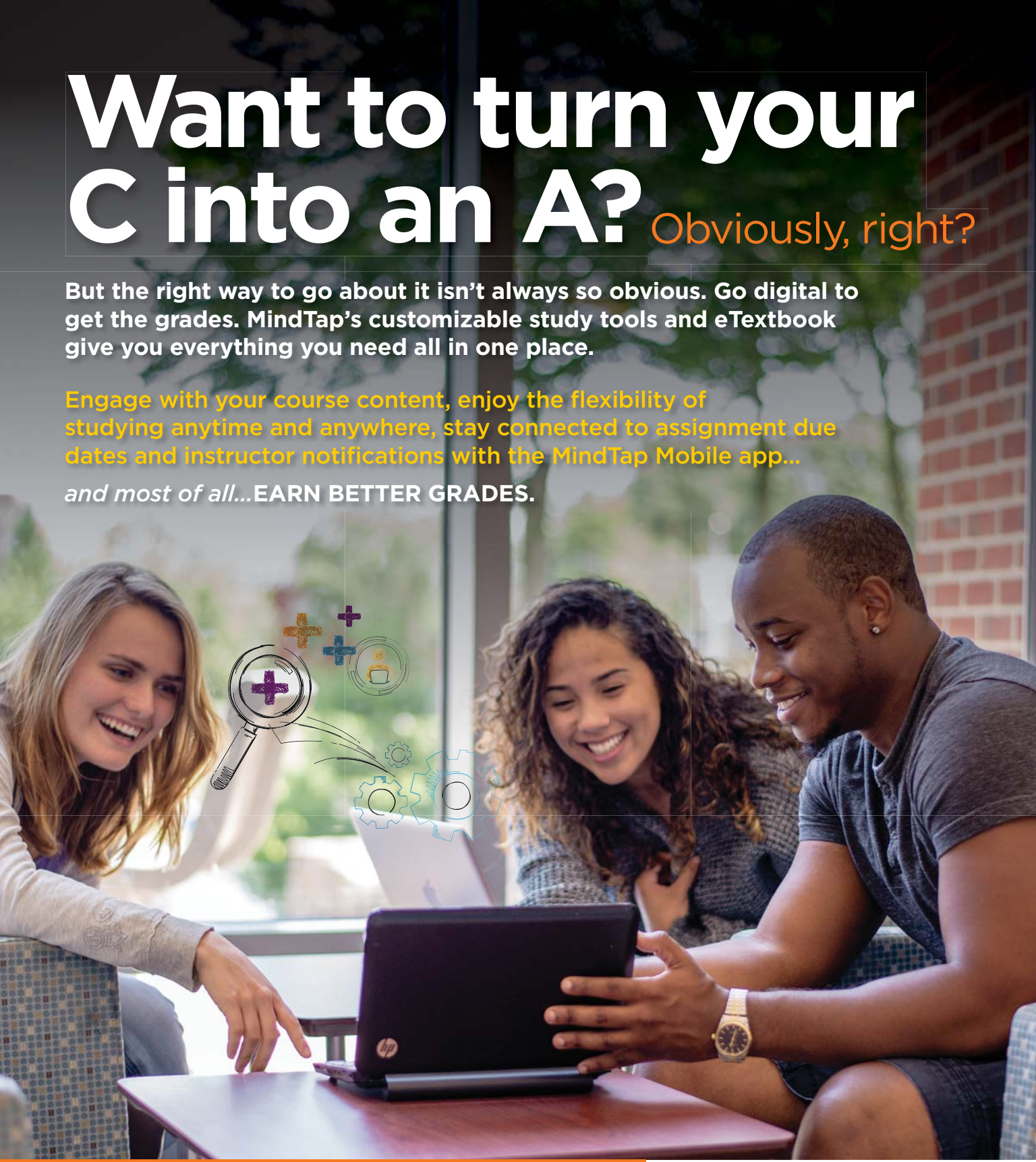
MILLER

Want to turn your C into an A? Obviously, right?

But the right way to go about it isn't always so obvious. Go digital to get the grades. MindTap's customizable study tools and eTextbook give you everything you need all in one place.

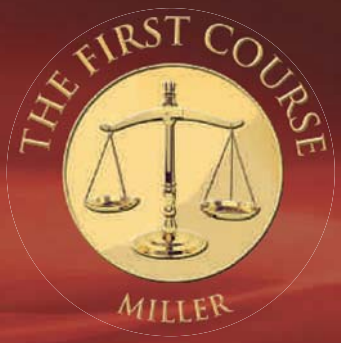
Engage with your course content, enjoy the flexibility of studying anytime and anywhere, stay connected to assignment due dates and instructor notifications with the MindTap Mobile app...

*and most of all...***EARN BETTER GRADES.**



TO GET STARTED VISIT
WWW.CENGAGE.COM/STUDENTS/MINDTAP

CENGAGE Learning® | MindTap®



BUSINESS LAW

TEXT AND CASES

The First Course

Fourteenth Edition

Roger LeRoy Miller
Institute for University Studies
Arlington, Texas

CENGAGE Learning®

Australia • Brazil • Mexico • Singapore • United Kingdom • United States

CENGAGE Learning

Business Law
TEXT AND CASES

The First Course
Fourteenth Edition

Roger LeRoy Miller

Vice President for Social Science and Qualitative Business: *Erin Joyner*

Product Director: *Jason Fremder*

Senior Product Manager: *Vicky True-Baker*

Managing Content Developer: *Suzanne Wilder*

Content Developer: *Sarah Huber*

Product Assistant: *Christian Wood*

Marketing Director: *Kristen Hurd*

Marketing Manager: *Katie Jergens*

Marketing Coordinator: *Casey Binder*

Production Director: *Sharon Smith*

Senior Content Project Manager: *Ann Borman*

Digital Content Specialist: *Charles Nichols*

Manufacturing Planner: *Kevin Kluck*

Senior Inventory Analyst: *Terina Bradley*

Senior IP Director: *Julie Geagan-Chavez*

IP Analyst: *Jennifer Nonenmacher*

IP Project Manager: *Reba Frederics*

Senior Art Director: *Michelle Kunkler*

Interior and Cover Designer: *Harasymczuk Design*

Design Elements:
linen texture: Lisa-Blue/iStockphoto; justice scales: imagedb.com/Shutterstock; gavel: koosen/Shutterstock; media network: solarseven/Shutterstock; building windows: Nneirda/Shutterstock; puzzle icon: Shebeko/Shutterstock; spotlight: Ivan Lord/Shutterstock; ethics scale: Lightspring/Shutterstock; magnifying glass icon: sergign/Shutterstock; globe: mj007/Shutterstock; compass: Taddeus/Shutterstock; Insight Global globe: evantravels/Shutterstock

Library of Congress Control Number: 2016952785

Student Edition ISBN: 978-1-305-96726-7

Cengage Learning
20 Channel Center Street
Boston, MA 02210
USA

Cengage Learning is a leading provider of customized learning solutions with employees residing in nearly 40 different countries and sales in more than 125 countries around the world. Find your local representative at **www.cengage.com.**

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

To learn more about Cengage Learning Solutions, visit **www.cengage.com.**

Purchase any of our products at your local college store or at our preferred online store **www.cengagebrain.com.**

Printed in Canada
Print Number: 01 Print Year: 2016

Brief Contents

Contents

Concept Summaries

Exhibits

Preface

The study of business law and the legal environment of business has universal applicability. A student entering any field of business must have at least a passing understanding of business law in order to function in the real world. *Business Law: The First Course,* Fourteenth Edition, provides the information that students need in an interesting and contemporary way.

Additionally, students preparing for a career in accounting, government and political science, economics, and even medicine can use much of the information they learn in a business law and legal environment course. In fact, every individual throughout his or her lifetime can benefit from knowledge of contracts, intellectual property law, agency relationships, and other business law topics. Consequently, I have fashioned this text as a useful "tool for living" for all of your students (including those taking the revised 2017 CPA exam).

For the Fourteenth Edition, I have spent a great deal of effort making this best-selling text more modern, exciting, and visually appealing than ever before. I have added twenty-eight new features, sixty new cases, and fourteen new exhibits. The text also contains more than a hundred new highlighted and numbered *Cases in Point* and *Examples,* and sixty-nine new case problems. Special pedagogical elements within the text focus on legal, ethical, global, and corporate issues while addressing core curriculum requirements.

Highlights of the Fourteenth Edition

Instructors have come to rely on the coverage, accuracy, and applicability of *Business Law: The First Course.* To make sure that this text engages your students, solidifies their understanding of legal concepts, and provides the best teaching tools available, I now offer the following.

A Variety of New and Exciting Features

The Fourteenth Edition of *Business Law: The First Course* is filled with many new features specifically designed to cover current legal topics of high interest. Each feature is related to a topic discussed in the text and ends with *Critical Thinking* or *Business Questions.* **Suggested answers to all the *Critical Thinking* and *Business Questions* are included in the *Solutions Manual* for this text.**

1. ***Ethics Today*** These features focus on the ethical aspects of a topic discussed in the text to emphasize that ethics is an integral part of a business law course. Examples include:
   - *Stare Decisis* versus Spiderman (Chapter 1)
   - Forced Arbitration: Right or Wrong? (Chapter 15)
   - Is It Ethical (and Legal) to Brew "Imported" Beer Brands Domestically? (Chapter 24)
   - Is It Fair to Classify Uber and Lyft Drivers as Independent Contractors? (Chapter 25)
2. ***Global Insight*** These features illustrate how other nations deal with specific legal concepts to give students a sense of the global legal environment. Subjects include:
   - Islamic Law and *Respondeat Superior* (Chapter 26)
   - Does Cloud Computing Have a Nationality? (Chapter 32)
3. **NEW *Digital Update*** These features are designed to examine cutting-edge cyberlaw topics, such as the following:
   - Using Social Media for Service of Process (Chapter 3)
   - Should Employees Have a "Right of Disconnecting"? (Chapter 5)
   - Revenge Porn and Invasion of Privacy (Chapter 6)
   - Monitoring Employees' Social Media—Right or Wrong? (Chapter 9)
   - Hiring Discrimination Based on Social Media Posts (Chapter 28)
4. ***Managerial Strategy*** These features emphasize the management aspects of business law and the legal environment. Topics include:
   - Should You Consent to Have Your Business Case Decided by a U.S. Magistrate Judge? (Chapter 2)
   - Marriage Equality and the Constitution (Chapter 4)
   - When Is a Warning Legally Bulletproof? (Chapter 7)
   - The Criminalization of American Business (Chapter 10)
   - Commercial Use of Drones (Chapter 21)

Entire Chapter on Internet Law, Social Media, And Privacy

For this edition, I continue to include a whole chapter (Chapter 9) on *Internet Law, Social Media, and Privacy.* Social media have entered the mainstream and become a part of everyday life for many businesspersons. In this special chapter, I give particular emphasis to the legal issues surrounding the Internet, social media, and privacy. I also recognize this trend throughout the text by incorporating the Internet and social media as they relate to the topics under discussion.

Highlighted and Numbered *Examples* and *Case in Point* Illustrations

Many instructors use cases and examples to illustrate how the law applies to business. Students understand legal concepts better in the context of their real-world application. Therefore, for this edition of *Business Law: The First Course,* I have expanded the number of highlighted numbered *Examples* and *Cases in Point* in every chapter. I have added one hundred and two new *Cases in Point* and thirty-four new *Examples*.

Examples illustrate how the law applies in a specific situation. *Cases in Point* present the facts and issues of an actual case and then describe the court's decision and rationale. These two features are uniquely designed and consecutively numbered throughout each chapter for easy reference. The *Examples* and *Cases in Point* are integrated throughout the text to help students better understand how courts apply legal principles in the real world.

New Unit-Ending *Application and Ethics* Features

For the Fourteenth Edition, I have created an entirely new feature that concludes each of the six units in the text. Each of these *Application and Ethics* features provides additional analysis on a topic related to that unit and explores its ethics ramifications. Each of the features ends with two questions—a *Critical Thinking* and an *Ethics Question.* Some topics covered by these features include the following:

- The Biggest Data Breach of All Time (Unit 2)
- Fantasy Sports—Legal Gambling? (Unit 3)
- Health Insurance and Small Business (Unit 5)

Suggested answers to the questions in *Application and Ethics* features are included in the *Solutions Manual* for this text.

New Cases and Case Problems

For the Fourteenth Edition of *Business Law: The First Course,* I have added sixty new cases and sixty-nine new case problems, most from 2016 and 2015. The new cases and problems have been carefully selected to illustrate important points of law and to be of high interest to students and instructors. I have made it a point to find recent cases that enhance learning and are relatively easy to understand.

1. ***Spotlight Cases* and *Classic Cases.*** Certain cases and case problems that are exceptionally good teaching cases are labeled as *Spotlight Cases* and *Spotlight Case Problems.* Examples include *Spotlight on Amazon, Spotlight on Beer Labels, Spotlight on Gucci, Spotlight on Nike,* and *Spotlight on the Seattle Mariners.* Instructors will find these *Spotlight Cases* useful to illustrate the legal concepts under discussion, and students will enjoy studying the cases because they involve interesting and memorable facts. Other cases have been chosen as *Classic Cases* because they establish a legal precedent in a particular area of law.
2. ***Critical Thinking Section.*** Each case concludes with a *Critical Thinking* section, which normally includes two questions. The questions may address *Legal Environment, E-Commerce, Economic, Environmental, Ethical, Global, Political,* or *Technological* issues, or they may ask *What If the Facts Were Different?* Each *Classic Case* has a section titled *Impact of This Case on Today's Law* and one *Critical Thinking* question.
3. ***Longer Excerpts for Case Analysis.*** I have also included one longer case excerpt in every chapter—labeled *Case Analysis*—followed by three *Legal Reasoning Questions.* The questions are designed to guide students' analysis of the case and build their legal reasoning skills. These *Case Analysis* cases may be used for case-briefing assignments and are also tied to the *Special Case Analysis* questions found in every unit of the text (one per unit).

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

Business Case Problem with Sample Answer in Each Chapter

In response to those instructors who would like students to have sample answers available for some of the questions and case problems, I include a *Business Case*

Problem with Sample Answer in each chapter. The *Business Case Problem with Sample Answer* is based on an actual case, and students can find a sample answer at the end of the text. **Suggested answers to the *Business Case Problems with Sample Answers* are provided in Appendix E at the end of the text and in the *Solutions Manual* for this text.**

New Exhibits and Concept Summaries

For this edition, I have spent considerable effort reworking and redesigning all of the exhibits and *Concept Summaries* in the text to achieve better clarity and more visual appeal. In addition, I have added fourteen new exhibits and three new *Concept Summaries*.

Special Case Analysis Questions

For one chapter in every unit of the text, I provide a *Special Case Analysis* question that is based on the *Case Analysis* excerpt in that chapter. These special questions appear in the *Business Case Problems* at the ends of selected chapters.

The *Special Case Analysis* questions are designed to build students' analytical skills. They test students' ability to perform IRAC (Issue, Rule, Application, and Conclusion) case analysis. Students must identify the legal issue presented in the chapter's *Case Analysis Case,* understand the rule of law, determine how the rule applies to the facts of the case, and describe the court's conclusion. Instructors can assign these questions as homework or use them in class to elicit student participation and teach case analysis. **Suggested answers to the *Special Case Analysis* questions can be found in the *Solutions Manual* for this text.**

Reviewing Features in Every Chapter

In the Fourteenth Edition of *Business Law: The First Course,* I continue to offer a *Reviewing* feature at the end of every chapter to help solidify students' understanding of the chapter materials. Each *Reviewing* feature presents a hypothetical scenario and then asks a series of questions that require students to identify the issues and apply the legal concepts discussed in the chapter.

These features are designed to help students review the chapter topics in a simple and interesting way and see how the legal principles discussed in the chapter affect the world in which they live. An instructor can use these features as the basis for in-class discussion or encourage students to use them for self-study prior to completing homework assignments. **Suggested answers to the questions posed in the *Reviewing* features can be found in the *Solutions Manual* for this text.**

Two *Issue Spotters*

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

Legal Reasoning Group Activities

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

Supplements/Digital Learning Systems

Business Law: The First Course, Fourteenth Edition, provides a comprehensive supplements package designed to make the tasks of teaching and learning more enjoyable and efficient. The following supplements and exciting new digital products are offered in conjunction with the text.

MindTap

MindTap for *Business Law: The First Course,* Fourteenth Edition, is a fully online, highly personalized learning experience built upon Cengage Learning content. MindTap combines student learning tools—such as readings, multimedia, activities, and assessments from CengageNOW—into a singular Learning Path that intuitively guides students through their course.

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).

MindTap includes:

- **An Interactive book with Whiteboard Videos and Interactive Cases.**
- **Automatically graded homework** with the following consistent question types:
  - **Worksheets**—Interactive Worksheets prepare students for class by ensuring reading and comprehension.
  - **Video Activities**—Real-world video exercises make business law engaging and relevant.
  - **Brief Hypotheticals**—These applications provide students practice in spotting the issue and applying the law in the context of a short, factual scenario.
  - **Case Problem Analyses**—These promote deeper critical thinking and legal reasoning by guiding students step-by-step through a case problem and then adding in a critical thinking section based on "What If the Facts Were Different?" These now include a third section, a writing component, which requires students to demonstrate their ability to forecast the legal implications of real-world business scenarios.
- **Personalized Student Plan with multimedia study tools and videos.**
- **New Adaptive Test Prep** helps students study for exams.
- **Test Bank.**
- **Reporting and Assessment options.**

By using the MindTap system, students can complete the assignments online and can receive instant feedback on their answers. Instructors can utilize MindTap to upload their course syllabi, create and customize homework assignments, and keep track of their students' progress. By hiding, rearranging, or adding content, instructors control what students see and when they see it to match the Learning Path to their course syllabus exactly. Instructors can also communicate with their students about assignments and due dates, and create reports summarizing the data for an individual student or for the whole class.

Cengage Learning Testing Powered by Cognero

Cengage Learning Testing Powered by Cognero is a flexible, online system that allows you to do the following:

- 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.

Start Right Away! *Cengage Learning Testing Powered by Cognero* works on any operating system or browser.

- No special installs or downloads are needed.
- Create tests from school, home, the coffee shop—anywhere with Internet access.

What Will You Find?

- *Simplicity at every step.* A desktop-inspired interface features drop-down menus and familiar intuitive tools that take you through content creation and management with ease.
- *Full-featured test generator.* Create ideal assessments with your choice of fifteen question types—including true/false, multiple choice, opinion scale/Likert, and essay). Multi-language support, an equation editor, and unlimited metadata help ensure your tests are complete and compliant.
- *Cross-compatible capability.* Import and export content to and from other systems.

Instructor's Companion Web Site

The Web site for the Fourteenth Edition of *Business Law: The First Course,* can be found by going to www.cengagebrain.com and entering ISBN 9781305967267. The Instructor's Companion Web Site contains the following supplements:

- ***Instructor's Manual.*** Includes sections entitled "Additional Cases Addressing This Issue" at the end of selected case synopses.
- ***Solutions Manual.*** Provides answers to all questions presented in the text, including the questions in each case and feature, the *Issue Spotters,* the *Business Scenarios* and *Case Problems,* and the unit-ending features.

- ***Test Bank.*** A comprehensive test bank that contains multiple-choice, true/false, and short essay questions.
- ***Case-Problem Cases.***
- ***Case Printouts.***
- ***PowerPoint Slides.***
- ***Lecture Outlines.***

For Users of the Thirteenth Edition

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

- Chapter 4 (Business and the Constitution)—The chapter has been revised and updated to be more business oriented. It has two new cases, four new *Cases in Point,* a new exhibit, and three new case problems. A *Managerial Strategy* feature on marriage equality and the constitution discusses United States Supreme Court decisions on this issue.
- Chapter 5 (Business Ethics)—This chapter contains two new cases, two new *Issue Spotters,* three new *Cases in Point* (including a case involving Tom Brady's suspension from the NFL as a result of "deflategate"), and three new case problems. The chapter includes a section on business ethics and social media, and discusses stakeholders and corporate social responsibility. The chapter also provides step-by-step guidance on making ethical business decisions and includes materials on global business ethics. A new *Digital Update* feature examines whether employees should have the right to disconnect from their electronic devices after work hours.
- Chapter 8 (Intellectual Property Rights)—The materials on intellectual property rights have been thoroughly revised and updated to reflect the most current laws and trends. The 2016 case involves the Hustler Club and a trademark infringement claim between brothers. A *Digital Update* feature examines the problem of patent trolls. There are eleven new *Cases in Point,* including cases involving FedEx's color and logo, Google's digitalization of books, and how the Sherlock Holmes copyright fell into the public domain.
- Chapter 9 (Internet Law, Social Media, and Privacy)—This chapter, which was new to the last edition and covers legal issues that are unique to the Internet, has been thoroughly revised and updated for the Fourteenth Edition. It includes a new section on cyberstalking, two new cases, and a new *Digital Update* feature on whether employers can monitor employees' social media use.
- Chapter 10 (Criminal Law and Cyber Crime)—This chapter includes three new cases, five new *Cases in Point,* three new examples, and four new case problems. A new *Managerial Strategy* feature discusses the criminalization of American business.
- Chapters 11 through 19 (the Contracts and E-Contracts unit)—In this unit, I have added fifteen new cases (including a *Spotlight Case* and several *Case Analysis* cases), twenty-four new *Cases in Point,* nine new *Examples,* and nineteen new case problems. I have also added new exhibits, graphic concept summaries, numbered lists, a new *Reviewing* feature, and a new *Managerial Strategy* on the commercial use of drones. These updates clarify and enhance an already superb contract law coverage.
- Chapters 20 through 23 (the first three chapters in the Domestic and International Sales and Lease Contracts unit)—I have streamlined and simplified the coverage of the Uniform Commercial Code and added six new cases (including a 2016 *Spotlight Case*). I have added fifteen new *Cases in Point* and five new *Examples* in these chapters to increase student comprehension. New exhibits, new business scenarios, and many new case problems have also been added.
- Chapter 24 (International and Space Law)—The last chapter in the unit on Domestic and International Sales and Lease Contracts has been expanded to include a new section on space law—international and domestic. All three cases presented are new to this edition, including a *Spotlight Case* on a United States Supreme Court decision concerning the Alien Tort Claims Act. The chapter also now covers the Trans-Pacific

Partnership (TPP) and includes an *Ethics Today* feature on the domestic brewing of imported beer brands.

- Chapter 25 (Agency Formation and Duties) and Chapter 26 (Agency Liability and Termination)—These two chapters have been updated to reflect the realities of the gig economy in which many people are working as independent contractors. A new *Ethics Today* feature continues that emphasis with a discussion of whether Uber and Lyft drivers should be considered employees rather than independent contractors. There is also a new *Global Insight* feature in Chapter 26 concerning Islamic law and *respondeat superior.* In addition, new *Examples, Cases in Point,* and case problems have been added to help students comprehend the important issues and liability in agency relationships.
- Chapter 27 (Employment, Immigration, and Labor Law) and Chapter 28 (Employment Discrimination)—These two chapters covering employment law have been thoroughly updated to include discussions of legal issues facing employers today. Chapter 27 has three new cases, three new *Cases in Point,* three new *Examples* (including one involving wage claims of Oakland Raiders cheerleaders), and three new case problems. I have added two new features—an *Ethics Today* on whether employees should receive paid bathroom breaks and a *Managerial Strategy* on union organizing using company e-mail systems. Chapter 28 has a new section discussing discrimination based on military status and new coverage of same-sex discrimination and discrimination against transgender persons. All three cases are new. There are seven new *Cases in Point,* five new *Examples,* a new exhibit, and three new case problems. A *Digital Update* feature discusses hiring discrimination based on social media posts. I discuss relevant United States Supreme Court decisions affecting employment issues throughout both chapters.
- Chapters 29 through 32 (the Business Organizations unit)—This unit has been revised and updated to improve flow and clarity and to provide more practical information and recent examples. I start with small business forms, go on to partnerships, and then cover limited liability companies. I discuss corporations in Chapter 32. There are ten new cases in this unit and thirteen new *Cases in Point.* Each chapter in the unit includes a new feature. For instance, in Chapter 32, a *Global Insight* feature examines whether cloud computing has a nationality. I also discuss crowdfunding and venture capital in that chapter. New exhibits and key terms have been added throughout this unit as well.

Acknowledgments for Previous Editions

Since this project began many years ago, a sizable number of business law professors and others have helped in revising the book, including the following:

Jeffrey E. Allen
University of Miami

Judith Anshin
Sacramento City College

Thomas M. Apke
California State University, Fullerton

Raymond August
Washington State University

William Auslen
San Francisco City College

Mary B. Bader
Moorhead State University

Frank Bagan
County College of Morris

John J. Balek
Morton College, Illinois

Michael G. Barth
University of Phoenix

David L. Baumer
North Carolina State University

Barbara E. Behr
Bloomsburg University of Pennsylvania

Robert B. Bennett, Jr.
Butler University

Robert C. Bird
University of Connecticut

Heidi Boerstler
University of Colorado at Denver

Maria Kathleen Boss
California State University, Los Angeles

Lawrence J. Bradley
University of Notre Dame

Dean Bredeson
University of Texas at Austin

Kylar William Broadus, Esq.
Lincoln University in Missouri

Doug Brown
Montana State University

Kristi K. Brown
University of Texas at Austin

Elizabeth K. Brunn, Esq.
University of Baltimore; University of Maryland University College

William J. Burke
University of Massachusetts, Lowell

Kenneth Burns
University of Miami

Daniel R. Cahoy
Pennsylvania State University

Rita Cain
University of Missouri—Kansas City

Jeanne A. Calderon
New York University

Joseph E. Cantrell
DeAnza College, California

Donald Cantwell
University of Texas at Arlington

Arthur J. Casey
San Jose State University, College of Business, Organization and Management

Thomas D. Cavenagh
North Central College—Naperville, Illinois

Robert Chatov
State University of New York, Buffalo

Corey Ciocchetti
University of Denver

Nanette C. Clinch
San Jose State University, California

Robert J. Cox
Salt Lake Community College

Thomas Crane
University of Miami

Angela Crossin
Purdue University, Calumet

Kenneth S. Culott
University of Texas at Austin

Larry R. Curtis
Iowa State University

Richard Dalebout
Brigham Young University

William H. Daughtrey, Jr.
Virginia Commonwealth University

Michael DeAngelis
University of Rhode Island

James Doering
University of Wisconsin, Green Bay

John V. Dowdy
University of Texas at Arlington

Michele A. Dunkerley
University of Texas at Austin

Julia M. Dunlap, Esq.
University of California, San Diego

Paul Dusseault
Herkimer Community College (SUNY)

Maria Elena Ellison
Florida Atlantic University

Nena Ellison
Florida Atlantic University

O. E. Elmore
Texas A&M University

Robert J. Enders
California State Polytechnic University, Pomona

Michael Engber
Ball State University

David A. Escamilla
University of Texas at Austin

Denise M. Farag
Linfield College

James S. Fargason
Louisiana State University

Frank S. Forbes
University of Nebraska at Omaha

Joe W. Fowler
Oklahoma State University

Stanley G. Freeman
University of South Carolina

Joan Gabel
Florida State University

Christ Gaetanos
State University of New York, Fredonia

Chester S. Galloway
Auburn University

Bob Garrett
American River College, California

Gary L. Giese
University of Colorado at Denver

Thomas Gossman
Western Michigan University

John D. Grigsby
Pennsylvania College of Technology

Dr. J. Keaton Grubbs
Stephen F. Austin State University

Patrick O. Gudridge
University of Miami School of Law

Paul Guymon
William Rainey Harper College

Jacqueline Hagerott
Franklin University

James M. Haine
University of Wisconsin, Stevens Point

Gerard Halpern
University of Arkansas

Christopher L. Hamilton
Golden West College, California

JoAnn W. Hammer
University of Texas at Austin

Charles Hartman
Wright State University, Ohio

Richard A. Hausler
University of Miami School of Law

Harry E. Hicks
Butler University, Indianapolis

Janine S. Hiller
Virginia Polytechnic Institute and State University

Rebecca L. Hillyer
Chemeketa Community College

E. Clayton Hipp, Jr.
Clemson University

Anthony H. Holliday, Jr.
Howard University

Telford Hollman
University of Northern Iowa

June A. Horrigan
California State University, Sacramento

John P. Huggard
North Carolina State University

Terry Hutchins
Pembroke State University, North Carolina

Robert Jesperson
University of Houston

Debra M. Johnson
Montana State University—Billings

Bryce J. Jones
Northeast Missouri State University

Margaret Jones
Southwest Missouri State College

Peter A. Karl III
SUNY Institute of Technology at Utica

Jack E. Karns
East Carolina University

Anne E. Kastle
Edmonds Community College

Tamra Kempf
University of Miami

Judith Kenney
University of Miami

Barbara Kincaid
Southern Methodist University

Carey Kirk
University of Northern Iowa

Nancy P. Klintworth
University of Central Florida

Kurtis P. Klumb
University of Wisconsin at Milwaukee

Kathleen M. Knutson
College of St. Catherine, St. Paul, Minnesota

Lisa Quinn Knych
Syracuse University, Whitman School of Management

Peter Kwiatkowski, Esq.
Baldwin Wallace University

Meg Costello Lambert
Oakland Community College—Auburn Hills Campus

Vonda M. Laughlin
Carson-Newman College

M. Alan Lawson
Mt. San Antonio College

Leslie E. Lenn
St. Edwards University

Susan Liebeler
Loyola University

Robert B. Long
Oakland Community College

Stuart MacDonald
University of Central Oklahoma

Thomas E. Maher
California State University, Fullerton

Sal Marchionna
Triton College, Illinois

Gene A. Marsh
University of Alabama

Michael Martin, J.D., M.B.A., LL.M.
University of Northern Colorado, Monfort College of Business

Karen Kay Matson
University of Texas at Austin

Woodrow J. Maxwell
Hudson Valley Community College, New York

Bruce E. May
University of South Dakota

Diane May
Winona State University, Minnesota

Gail McCracken
University of Michigan, Dearborn

John W. McGee
Southwest Texas State University

Cotton Meagher
University of Nevada at Las Vegas

Christopher Meakin
University of Texas at Austin

Roger E. Meiners
University of Texas at Arlington

Gerald S. Meisel
Bergen Community College, New Jersey

Jennifer Merton, J.D.
University of Massachusetts at Amherst

Richard Mills
Cypress College

David Minars
City University of New York, Brooklyn

Leo Moersen
The George Washington University

Alan Moggio
Illinois Central College

Violet E. Molnar
Riverside City College

James E. Moon
Meyer, Johnson & Moon, Minneapolis

Melinda Ann Mora
University of Texas at Austin

Bob Morgan
Eastern Michigan University

Barry S. Morinaka
Baker College—Michigan

Melanie Morris
Raritan Valley Community College

Joan Ann Mrava
Los Angeles Southwest College

Dwight D. Murphey
Wichita State University

Daniel E. Murray
University of Miami School of Law

Paula C. Murray
University of Texas

Gregory J. Naples
Marquette University

George A. Nation III
Lehigh University

Caleb L. Nichols
Western Connecticut State University

John M. Norwood
University of Arkansas

Jamie O'Brien
University of Notre Dame

Dr. Kelly E. O'Donnell, J.C.D
California Lutheran University, Thousand Oaks, California

Michael J. O'Hara
University of Nebraska at Omaha

Rick F. Orsinger
College of DuPage, Illinois

Daniel J. O'Shea
Hillsborough Community College

Thomas L. Palmer
Northern Arizona University

Charles M. Patten
University of Wisconsin, Oshkosh

Patricia Pattison
Texas State University, San Marcos

Peyton J. Paxson
University of Texas at Austin

Carlton Perkins
Texas Southern University

Darren A. Prum
The Florida State University

Ralph L. Quinones
University of Wisconsin, Oshkosh

Carol D. Rasnic
Virginia Commonwealth University

Marvin H. Robertson
Harding University

Bert K. Robinson
Kennesaw State University

Norberto Ruiz
Chabot College

Gary K. Sambol
Rutgers State University

Rudy Sandoval
University of Texas, San Antonio

Sidney S. Sappington
York College of Pennsylvania

Martha Sartoris
North Hennepin Community College

Barbara P. Scheller
Temple University

S. Alan Schlact
Kennesaw State University, Georgia

Lorne H. Seidman
University of Nevada at Las Vegas

Ira Selkowitz
University of Colorado at Denver

Roscoe B. Shain
Austin Peay University

Bennett D. Shulman
Lansing Community College, Michigan

S. Jay Sklar
Temple University

Dana Blair Smith
University of Texas at Austin

Michael Smydra
Oakland Community College—Royal Oak

Arthur Southwick
University of Michigan

Sylvia A. Spade
University of Texas at Austin

John A. Sparks
Grove City College, Pennsylvania

Robert D. Sprague
University of Wyoming

Elisabeth Sperow
California Polytechnic University, San Luis Obispo

Brenda Steuer
North Harris College, Houston

Craig Stilwell
Michigan State University

Irwin Stotsky
University of Miami School of Law

Larry Strate
University of Nevada at Las Vegas

Charles R. B. Stowe
Sam Houston State University

Raymond Mason Taylor
North Carolina State University

Thomas F. Taylor
Campbell University

Ray Teske
University of Texas at San Antonio

H. Allan Tolbert
Central Texas College

Jesse C. Trentadue
University of North Dakota

Edwin Tucker
University of Connecticut

Gary Victor
Eastern Michigan University

William H. Volz
Wayne State University

David Vyncke
Scott Community College, Iowa

William H. Walker,
Indiana University–Purdue University, Fort Wayne

Diana Walsh
County College of Morris

Robert J. Walter
University of Texas at El Paso

Gary Watson
California State University, Los Angeles

Katherine Hannan Wears, J.D.
Clarkson University School of Business

John L. Weimer
Nicholls State University, Louisiana

Marshall Wilkerson
University of Texas at Austin

Melanie Stallings Williams
California State University—Northridge

Arthur D. Wolfe
Michigan State University

Elizabeth A. Wolfe
University of Texas at Austin

Daniel R. Wrentmore
Santa Barbara City College

Eric D. Yordy
Northern Arizona University

Norman Gregory Young
California State Polytechnic University, Pomona

Ronald C. Young
Kalamazoo Valley Community College, Michigan

Bob Zaffram
Erie Community College, Buffalo, New York

As in all past editions, I owe a debt of extreme gratitude to the numerous individuals who worked directly with me or at Cengage Learning. In particular, I wish to thank Vicky True-Baker, senior product manager; Suzanne Wilder, managing content developer; Sarah Huber, content developer; and Ann Borman, senior content project manager. I also thank Katie Jergens in marketing and Michelle Kunkler, art director. I am indebted as well to the staff at Lachina, the compositor, for accurately generating pages for this text and making it possible for me to meet an ambitious printing schedule.

I especially wish to thank Katherine Marie Silsbee for her management of the entire project, as well as for the application of her superb research and editorial skills. I also wish to thank William Eric Hollowell, who co-authored the *Instructor's Manual* and the *Test Bank,* for his excellent research efforts. I was fortunate enough to have the copyediting of Beverly Peavler and the proofreading services of Jeanne Yost. I am grateful for the efforts of Vickie Reierson and Roxanna Lee for their proofreading and other assistance, which helped to ensure an error-free text. Finally, I thank Suzanne Jasin of K & M Consulting for her many special efforts on this project.

Through the years, I have enjoyed an ongoing correspondence with many of you who have found points on which you wish to comment. I continue to welcome all comments and promise to respond promptly. By incorporating your ideas, I can continue to write a business law text that is best for you and best for your students.

R.L.M.

To Linda and Jim,

I will always be
chasing you, but
that doesn't mean
you should slow down.

R.L.M.

Unit One

The Legal Environment of Business

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

CHAPTER 1

Law and Legal Reasoning

One of the most important functions of law in any society is to provide stability, predictability, and continuity so that people can know how to order their affairs. If any society is to survive, its citizens must be able to determine what is legally right and legally wrong. They must know what sanctions will be imposed on them if they commit wrongful acts. If they suffer harm as a result of others' wrongful acts, they must know how they can seek compensation. By setting forth the rights, obligations, and privileges of citizens, the law enables individuals to go about their business with confidence and a certain degree of predictability.

Although law has various definitions, they all are based on the general observation that **law** consists of *enforceable rules governing relationships among individuals and between individuals and their society*. These "enforceable rules" may consist of unwritten principles of behavior established by a nomadic tribe. They may be set forth in a law code, such as the Code of Hammurabi in ancient Babylon (c. 1780 B.C.E.) or the law code of one of today's European nations. They may consist of written laws and court decisions created by modern legislative and judicial bodies, as in the United States. Regardless of how such rules are created, they all have one thing in common: they establish rights, duties, and privileges that are consistent with the values and beliefs of their society or its ruling group.

In this introductory chapter, we first look at an important question for any student reading this text: How does the legal environment affect business decision making? We next describe the major sources of American law, the common law tradition, and some basic schools of legal thought. We conclude the chapter with sections offering practical guidance on several topics, including how to find the sources of law discussed in this chapter (and referred to throughout the text) and how to read and understand court opinions.

1–1 Business Activities and the Legal Environment

Laws and government regulations affect almost all business activities—from hiring and firing decisions to workplace safety, the manufacturing and marketing of products, business financing, and more. To make good business decisions, a basic knowledge of the laws and regulations governing these activities is beneficial—if not essential.

Realize also that in today's business world, a knowledge of "black-letter" law and what conduct can lead to legal **liability** is not enough. Businesspersons must develop critical thinking and legal reasoning skills so that they can evaluate how various laws might apply to a given situation and determine the best course of action. Businesspersons are also expected to make ethical decisions. Thus, the study of business law necessarily involves an ethical dimension.

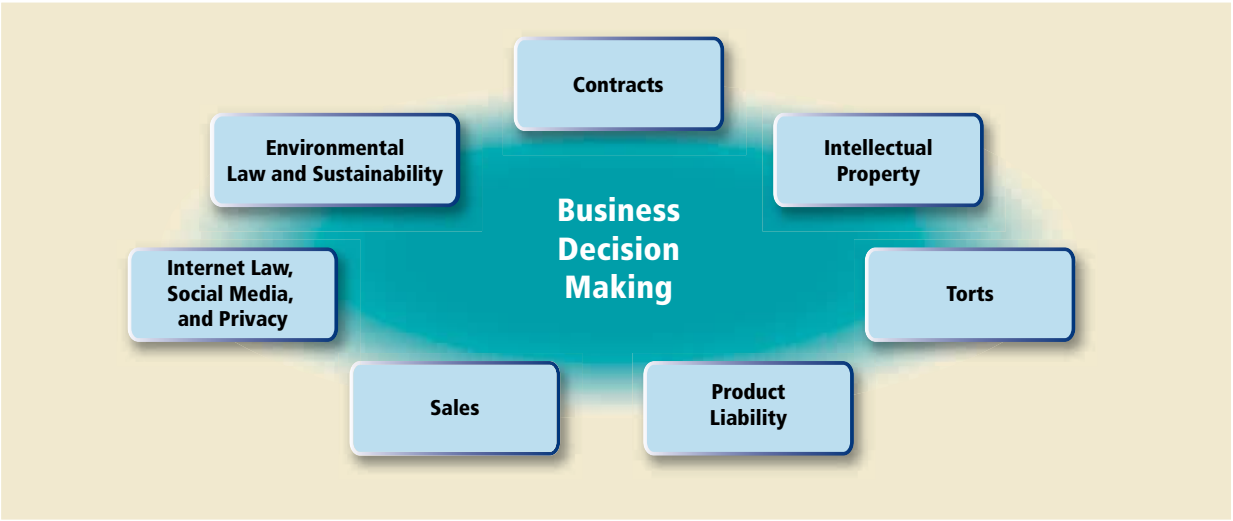
1–1a Many Different Laws May Affect a Single Business Decision

As you will note, each chapter in this text covers specific areas of the law and shows how the legal rules in each area affect business activities. Although compartmentalizing the law in this fashion promotes conceptual clarity, it does not indicate the extent to which a number of different laws may apply to just one decision. Exhibit 1–1 illustrates the various areas of the law that may influence business decision making.

■ **EXAMPLE 1.1** When Mark Zuckerberg started Facebook as a Harvard student, he probably did not imagine all the legal challenges his company would face as a result of his business decisions.

- Shortly after Facebook was launched, others claimed that Zuckerberg had stolen their ideas for a social networking site. Their claims involved alleged theft of intellectual property, fraudulent misrepresentation, and

EXHIBIT 1–1 Areas of the Law That Can Affect Business Decision Making



violations of partnership law and securities law. Facebook ultimately paid $65 million to settle those claims out of court.

- Facebook has been sued repeatedly for violating users' privacy (and federal laws) by tracking their Web site usage and by scanning private messages for purposes of data mining and user profiling. A class-action suit filed in Europe alleges that Facebook's data-use policies violate the law of the European Union. Facebook might have to pay millions in damages in this case.
- Facebook's business decisions have also come under scrutiny by federal regulators, such as the Federal Trade Commission (FTC). The company settled a complaint filed by the FTC alleging that Facebook had failed to keep "friends" lists and other user information private. ■

1–1b Ethics and Business Decision Making

Merely knowing the areas of law that may affect a business decision is not sufficient in today's business world. Today, business decision makers need to consider not just whether a decision is legal, but also whether it is ethical.

Ethics generally is defined as the principles governing what constitutes right or wrong behavior. Often, as in several of the claims against Facebook discussed above, disputes arise in business because one party feels that he or she has been treated unfairly. Thus, the underlying reason for bringing some lawsuits is a breach of ethical duties (such as when a partner or employee attempts to secretly take advantage of a business opportunity).

Throughout this text, you will learn about the relationship between the law and ethics, as well as about some of the types of ethical questions that arise in business. For instance, all of the new unit-ending *Unit Application and Ethics* features include an *Ethical Connection* section that explores the ethical dimensions of a topic treated within the unit. We have also included *Ethical Questions* for each unit, as well as within the critical thinking sections of many of the cases presented in this text. *Ethics Today* features, which focus on ethical considerations in today's business climate, appear in selected chapters, including this chapter. *A Question of Ethics* case problem is included at the end of every chapter to introduce you to the ethical aspects of specific cases involving real-life situations.

1–2 Sources of American Law

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

Primary sources of law, or sources that establish the law, include the following:

1. The U.S. Constitution and the constitutions of the various states.
2. Statutory law—including laws passed by Congress, state legislatures, or local governing bodies.
3. Regulations created by administrative agencies, such as the Federal Trade Commission.
4. Case law and common law doctrines.

We describe each of these important sources of law in the following pages.

Secondary sources of law are books and articles that summarize and clarify the primary sources of law. Examples include legal encyclopedias, treatises, articles in law reviews, and compilations of law, such as the *Restatements of the Law* (which will be discussed later). Courts often refer to secondary sources of law for guidance in interpreting and applying the primary sources of law discussed here.

1–2a Constitutional Law

The federal government and the states have separate written constitutions that set forth the general organization, powers, and limits of their respective governments. **Constitutional law** is the law as expressed in these constitutions.

According to Article VI of the U.S. Constitution, the Constitution is the supreme law of the land. As such, it is the basis of all law in the United States. A law in violation of the Constitution, if challenged, will be declared unconstitutional and will not be enforced, no matter what its source. Because of its importance in the American legal system, we present the complete text of the U.S. Constitution in Appendix B.

The Tenth Amendment to the U.S. Constitution reserves to the states all powers not granted to the federal government. Each state in the union has its own constitution. Unless it conflicts with the U.S. Constitution or a federal law, a state constitution is supreme within the state's borders.

1–2b Statutory Law

Laws enacted by legislative bodies at any level of government, such as statutes passed by Congress or by state legislatures, make up the body of law known as **statutory law.** When a legislature passes a statute, that statute ultimately is included in the federal code of laws or the relevant state code of laws.

Statutory law also includes local **ordinances**—regulations passed by municipal or county governing units to deal with matters not covered by federal or state law. Ordinances commonly have to do with city or county land use (zoning ordinances), building and safety codes, and other matters affecting the local community.

A federal statute, of course, applies to all states. A state statute, in contrast, applies only within the state's borders. State laws thus may vary from state to state. No federal statute may violate the U.S. Constitution, and no state statute or local ordinance may violate the U.S. Constitution or the relevant state constitution.

Uniform Laws During the 1800s, the differences among state laws frequently created difficulties for businesspersons conducting trade and commerce among the states. To counter these problems, a group of legal scholars and lawyers formed the National Conference of Commissioners on Uniform State Laws, or NCCUSL (**www.uniformlaws.org**), in 1892. The NCCUSL still exists today. Its object is to draft **uniform laws** (model statutes) for the states to consider adopting.

Each state has the option of adopting or rejecting a uniform law. *Only if a state legislature adopts a uniform law does that law become part of the statutory law of that state.* Note that a state legislature may adopt all or part of a uniform law as it is written, or the legislature may rewrite the law however the legislature wishes. Hence, even though many states may have adopted a uniform law, those states' laws may not be entirely "uniform."

The earliest uniform law, the Uniform Negotiable Instruments Law, was completed by 1896 and adopted in every state by the 1920s (although not all states used exactly the same wording). Over the following decades, other acts were drawn up in a similar manner. In all, more than two hundred uniform acts have been issued by the NCCUSL since its inception. The most ambitious uniform act of all, however, was the Uniform Commercial Code.

The Uniform Commercial Code One of the most important uniform acts is the Uniform Commercial Code (UCC), which was created through the joint efforts of the NCCUSL and the American Law Institute.[1] The UCC was first issued in 1952 and has been adopted in all fifty states,[2] the District of Columbia, and the Virgin Islands.

The UCC facilitates commerce among the states by providing a uniform, yet flexible, set of rules governing commercial transactions. Because of its importance in the area of commercial law, we cite the UCC frequently in this text. We also present the full UCC in Appendix C. From time to time, the NCCUSL revises the articles contained in the UCC and submits the revised versions to the states for adoption.

1–2c Administrative Law

Another important source of American law is **administrative law,** which consists of the rules, orders, and decisions of administrative agencies. An **administrative agency** is a federal, state, or local government agency established to perform a specific function. Administrative law and procedures constitute a dominant element in the regulatory environment of business.

1. This institute was formed in the 1920s and consists of practicing attorneys, legal scholars, and judges.
2. Louisiana has not adopted Articles 2 and 2A (covering contracts for the sale and lease of goods), however.

Rules issued by various administrative agencies now affect almost every aspect of a business's operations. Regulations govern a business's capital structure and financing, its hiring and firing procedures, its relations with employees and unions, and the way it manufactures and markets its products. Regulations enacted to protect the environment also often play a significant role in business operations.

Federal Agencies At the national level, the cabinet departments of the executive branch include numerous **executive agencies.** The U.S. Food and Drug Administration, for instance, is an agency within the U.S. Department of Health and Human Services. Executive agencies are subject to the authority of the president, who has the power to appoint and remove their officers.

There are also major **independent regulatory agencies** at the federal level, such as the Federal Trade Commission, the Securities and Exchange Commission, and the Federal Communications Commission. The president's power is less pronounced in regard to independent agencies, whose officers serve for fixed terms and cannot be removed without just cause.

State and Local Agencies There are administrative agencies at the state and local levels as well. Commonly, a state agency (such as a state pollution-control agency) is created as a parallel to a federal agency (such as the Environmental Protection Agency). Just as federal statutes take precedence over conflicting state statutes, federal agency regulations take precedence over conflicting state regulations.

1–2d Case Law and Common Law Doctrines

The rules of law announced in court decisions constitute another basic source of American law. These rules include interpretations of constitutional provisions, of statutes enacted by legislatures, and of regulations created by administrative agencies.

Today, this body of judge-made law is referred to as **case law.** Case law—the doctrines and principles announced in cases—governs all areas not covered by statutory law or administrative law and is part of our common law tradition. We look at the origins and characteristics of the common law tradition in some detail in the pages that follow.

See Concept Summary 1.1 for a review of the sources of American law.

Concept Summary 1.1

Sources of American Law

Constitutional Law	• Law as expressed in the U.S. Constitution or state constitutions. • The U.S. Constitution is the supreme law of the land. • State constitutions are supreme within state borders to the extent that they do not conflict with the U.S. Constitution.
Statutory Law	• Statutes (including uniform laws) and ordinances enacted by federal, state, and local legislatures. • Federal statutes may not violate the U.S. Constitution. • State statutes and local ordinances may not violate the U.S. Constitution or the relevant state constitution.
Administrative Law	• The rules, orders, and decisions of federal, state, and local administrative agencies.
Case Law and Common Law Doctrines	• Judge-made law, including interpretations of constitutional provisions, of statutes enacted by legislatures, and of regulations created by administrative agencies.

1–3 The Common Law Tradition

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

1–3a Early English Courts

After the Normans conquered England in 1066, William the Conqueror and his successors began the process of unifying the country under their rule. One of the means they used to do this was the establishment of the king's courts, or *curiae regis*.

Before the Norman Conquest, disputes had been settled according to the local legal customs and traditions in various regions of the country. The king's courts sought to establish a uniform set of customs for the country as a whole. What evolved in these courts was the beginning of the **common law**—a body of general rules that applied throughout the entire English realm. Eventually, the common law tradition became part of the heritage of all nations that were once British colonies, including the United States.

Courts of Law and Remedies at Law The early English king's courts could grant only very limited kinds of **remedies** (the legal means to enforce a right or redress a wrong). If one person wronged another in some way, the king's courts could award as compensation one or more of the following: (1) land, (2) items of value, or (3) money.

The courts that awarded this compensation became known as **courts of law,** and the three remedies were called **remedies at law.** (Today, the remedy at law normally takes the form of monetary **damages**—an amount given to a party whose legal interests have been injured.) This system made the procedure for settling disputes more uniform. When a complaining party wanted a remedy other than economic compensation, however, the courts of law could do nothing, so "no remedy, no right."

Courts of Equity When individuals could not obtain an adequate remedy in a court of law, they petitioned the king for relief. Most of these petitions were decided by an adviser to the king, called a *chancellor,* who had the power to grant new and unique remedies. Eventually, formal chancery courts, or **courts of equity,** were established. *Equity* is a branch of law—founded on notions of justice and fair dealing—that seeks to supply a remedy when no adequate remedy at law is available.

Remedies in Equity The remedies granted by the equity courts became known as **remedies in equity,** or equitable remedies. These remedies include specific performance, injunction, and rescission. *Specific performance* involves ordering a party to perform an agreement as promised. An *injunction* is an order to a party to cease engaging in a specific activity or to undo some wrong or injury. *Rescission* is the cancellation of a contractual obligation. We will discuss these and other equitable remedies in more detail in later chapters.

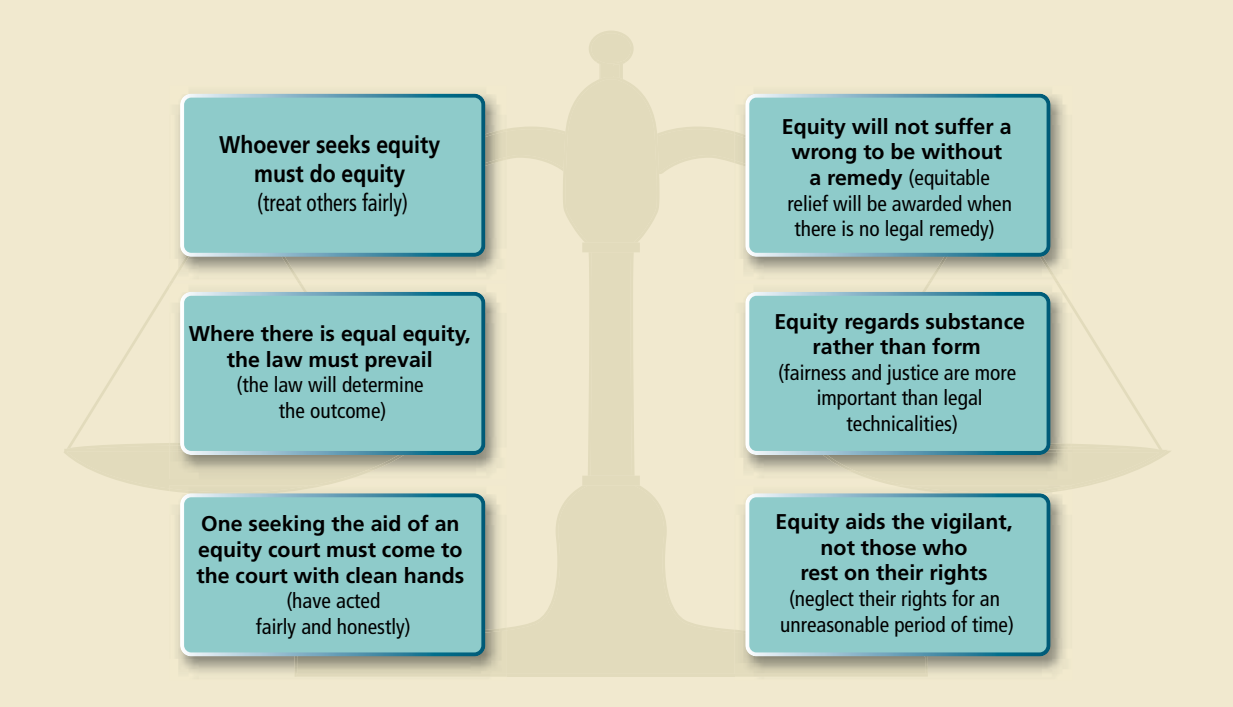
As a general rule, today's courts, like the early English courts, will not grant equitable remedies unless the remedy at law—monetary damages—is inadequate. ■ **EXAMPLE 1.2** Ted forms a contract (a legally binding agreement) to purchase a parcel of land that he thinks will be perfect for his future home. The seller **breaches** (fails to fulfill) this agreement. Ted could sue the seller for the return of any deposits or down payment he might have made on the land, but this is not the remedy he really wants. What Ted wants is to have a court order the seller to perform the contract. In other words, Ted will seek the equitable remedy of specific performance because monetary damages are inadequate in this situation. ■

Equitable Maxims In fashioning appropriate remedies, judges often were (and continue to be) guided by so-called **equitable maxims**—propositions or general statements of equitable rules. Exhibit 1–2 lists some important equitable maxims.

The last maxim listed in the exhibit—"Equity aids the vigilant, not those who rest on their rights"—merits special attention. It has become known as the equitable doctrine of **laches** (a term derived from the Latin *laxus*, meaning "lax" or "negligent"), and it can be used as a defense. A **defense** is an argument raised by the **defendant** (the party being sued) indicating why the **plaintiff** (the suing party) should not obtain the remedy sought. (Note that in equity proceedings, the party bringing a lawsuit is called the **petitioner,** and the party being sued is referred to as the **respondent.**)

The doctrine of laches arose to encourage people to bring lawsuits while the evidence was fresh. What constitutes a reasonable time, of course, varies according to the circumstances of the case. Time periods for different types of cases are now usually fixed by **statutes of limitations.** After the time allowed under a statute of limitations has expired, no action (lawsuit) can be brought, no matter how strong the case was originally.

EXHIBIT 1–2 Equitable Maxims



1–3b Legal and Equitable Remedies Today

The establishment of courts of equity in medieval England resulted in two distinct court systems: courts of law and courts of equity. The courts had different sets of judges and granted different types of remedies. During the nineteenth century, however, most states in the United States adopted rules of procedure that resulted in the combining of courts of law and equity. A party now may request both legal and equitable remedies in the same action, and the trial court judge may grant either or both forms of relief.

The distinction between legal and equitable remedies remains relevant to students of business law, however, because these remedies differ. To seek the proper remedy for a wrong, you must know what remedies are available. Additionally, certain vestiges of the procedures used when there were separate courts of law and equity still exist. For instance, a party has the right to demand a jury trial in an action at law, but not in an action in equity. Exhibit 1–3 summarizes the procedural differences (applicable in most states) between an action at law and an action in equity.

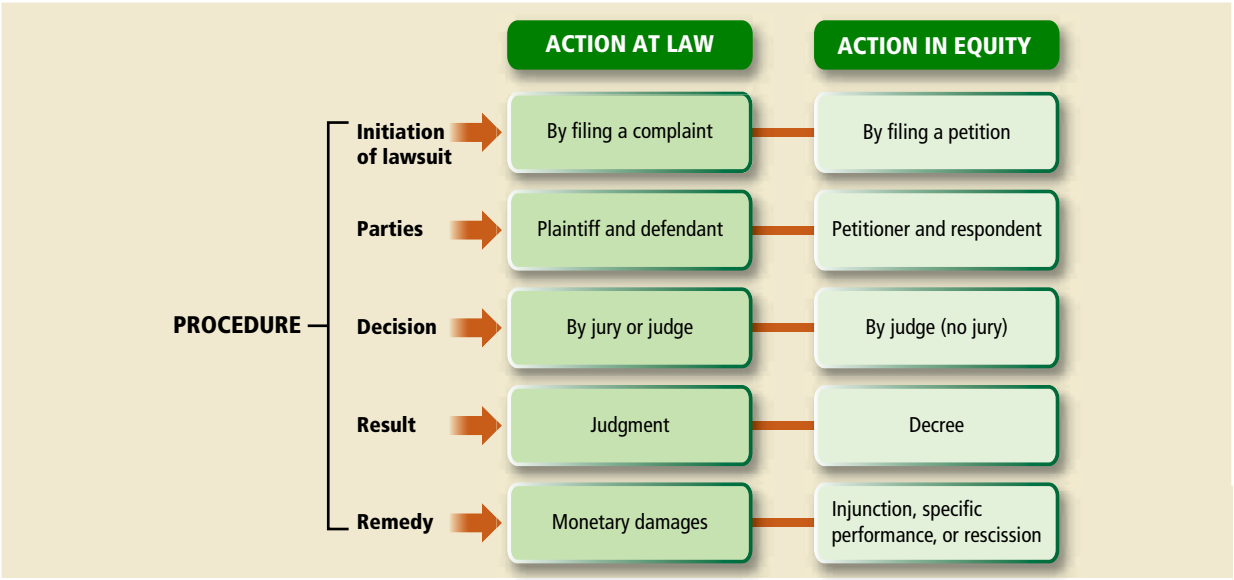
1–3c The Doctrine of *Stare Decisis*

One of the unique features of the common law is that it is *judge-made* law. The body of principles and doctrines that form the common law emerged over time as judges decided legal controversies.

Case Precedents and Case Reporters When possible, judges attempted to be consistent and to base their decisions on the principles suggested by earlier cases. They sought to decide similar cases in a similar way, and they considered new cases with care because they knew that their decisions would make new law. Each interpretation became part of the law on the subject and thus served as a legal **precedent.** A precedent is a decision that furnishes an example or authority for deciding subsequent cases involving identical or similar legal principles or facts.

In the early years of the common law, there was no single place or publication where court opinions, or written decisions, could be found. By the fourteenth century, portions of the most important decisions from each year were being gathered together and recorded in *Year Books*, which became useful references for lawyers and judges. In the

EXHIBIT 1–3 Procedural Differences between Actions at Law and Actions in Equity



sixteenth century, the *Year Books* were discontinued, and other forms of case publication became available. Today, cases are published, or "reported," in volumes called **reporters,** or *reports*—and are also posted online. We describe today's case reporting system in detail later in this chapter.

Stare Decisis and the Common Law Tradition

The practice of deciding new cases with reference to former decisions, or precedents, became a cornerstone of the English and American judicial systems. The practice formed a doctrine known as ***stare decisis,***[3] a Latin phrase meaning "to stand on decided cases."

Under the doctrine of *stare decisis*, judges are obligated to follow the precedents established within their jurisdictions. The term *jurisdiction* refers to a geographic area in which a court or courts have the power to apply the law. Once a court has set forth a principle of law as being applicable to a certain set of facts, that court must apply the principle in future cases involving similar facts. Courts of lower rank (within the same jurisdiction) must do likewise. Thus, *stare decisis* has two aspects:

1. A court should not overturn its own precedents unless there is a compelling reason to do so.
2. Decisions made by a higher court are binding on lower courts.

Controlling Precedents Precedents that must be followed within a jurisdiction are called *controlling precedents*. Controlling precedents are a type of binding authority. A **binding authority** is any source of law that a court must follow when deciding a case. Binding authorities include constitutions, statutes, and regulations that govern the issue being decided, as well as court decisions that are controlling precedents within the jurisdiction. United States Supreme Court case decisions, no matter how old, remain controlling until they are overruled by a subsequent decision of the Supreme Court or changed by further legislation or a constitutional amendment.

Stare Decisis and Legal Stability The doctrine of *stare decisis* helps the courts to be more efficient because, if other courts have analyzed a similar case, their legal reasoning and opinions can serve as guides. *Stare decisis* also makes the law more stable and predictable. If the law on a subject is well settled, someone bringing a case can usually rely on the court to rule based on what the law has been in the past. See this chapter's *Ethics Today* feature for a discussion of how courts often defer to case precedent even when they disagree with the reasoning in the case.

Although courts are obligated to follow precedents, sometimes a court will depart from the rule of precedent if it decides that the precedent should no longer be followed. If a court decides that a ruling precedent is simply incorrect or that technological or social changes have rendered the precedent inapplicable, the court might rule contrary to the precedent. Cases that overturn precedent often receive a great deal of publicity.

■ **CASE IN POINT 1.3** The United States Supreme Court expressly overturned precedent in the case of

3. Pronounced *ster*-ay dih-*si*-ses.

ETHICS TODAY

Stare Decisis versus Spider-Man

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

Can a Patent Involving Spider-Man Last Super Long?

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

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

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

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

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

The Ethical Side

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

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

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

a. "Spider-Man," Amazing Fantasy No. 15 (1962), p. 13.
b. 576 U.S. __, 135 S.Ct. 2401, 192 L.Ed.2d 463 (2015).
c. *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176 (1964).

Brown v. Board of Education of Topeka.[4] The Court concluded that separate educational facilities for whites and blacks, which it had previously upheld as constitutional,[5] were inherently unequal. The Supreme Court's departure from precedent in this case received a tremendous amount of publicity as people began to realize the ramifications of this change in the law. ■

Note that a lower court will sometimes avoid applying a precedent set by a higher court in its jurisdiction by

4. 347 U.S. 483, 74 S.Ct. 686, 98 L.Ed. 873 (1954).
5. See *Plessy v. Ferguson,* 163 U.S. 537, 16 S.Ct. 1138, 41 L.Ed. 256 (1896).

distinguishing the two cases based on their facts. When this happens, the lower court's ruling stands unless it is appealed to a higher court and that court overturns the decision.

When There Is No Precedent Occasionally, courts must decide cases for which no precedents exist, called *cases of first impression*. For instance, as you will read throughout this text, the Internet and certain other technologies have presented many new and challenging issues for the courts to decide.

■ **EXAMPLE 1.4** Google Glass is a Bluetooth-enabled, hands-free, wearable computer. A person using Google Glass can take photos and videos, surf the Internet, and do other things through voice commands. Many people expressed concerns about this new technology. Privacy advocates claimed that it is much easier to secretly film or photograph others with wearable video technology than with a camera or a smartphone. Indeed, numerous bars and restaurants, among others, banned the use of Google Glass to protect their patrons' privacy. Police officers were concerned about driver safety. A California woman was ticketed for wearing Google Glass while driving. But the court dismissed this case of first impression because it was not clear whether the device had been in operation at the time of the offense. ■

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

1–3d *Stare Decisis* and Legal Reasoning

In deciding what law applies to a given dispute and then applying that law to the facts or circumstances of the case, judges rely on the process of **legal reasoning.** Through the use of legal reasoning, judges harmonize their decisions with those that have been made before, as the doctrine of *stare decisis* requires.

Students of business law and the legal environment also engage in legal reasoning. For instance, you may be asked to provide answers for some of the case problems that appear at the end of every chapter in this text. Each problem describes the facts of a particular dispute and the legal question at issue. If you are assigned a case problem, you will be asked to determine how a court would answer that question, and why. In other words, you will need to give legal reasons for whatever conclusion you reach.[7] We look next at the basic steps involved in legal reasoning and then describe some forms of reasoning commonly used by the courts in making their decisions.

Basic Steps in Legal Reasoning At times, the legal arguments set forth in court opinions are relatively simple and brief. At other times, the arguments are complex and lengthy. Regardless of the length of a legal argument, however, the basic steps of the legal reasoning process remain the same. These steps, which you can also follow when analyzing cases and case problems, form what is commonly referred to as the *IRAC method* of legal reasoning. IRAC is an acronym formed from the first letters of the words *Issue, Rule, Application*, and *Conclusion*. To apply the IRAC method, you ask the following questions:

1. **Issue**—*What are the key facts and issues?* Suppose that a plaintiff comes before the court claiming *assault* (words or acts that wrongfully and intentionally make another person fearful of immediate physical harm). The plaintiff claims that the defendant threatened her while she was sleeping. Although the plaintiff was unaware that she was being threatened, her roommate heard the defendant make the threat. The legal issue is whether the defendant's action constitutes the tort of assault, given that the plaintiff was unaware of that action at the time it occurred. (A tort is a wrongful act. As you will see later, torts fall under the governance of civil law rather than criminal law.)
2. **Rule**—*What rule of law applies to the case?* A rule of law may be a rule stated by the courts in previous decisions, a state or federal statute, or a state or federal administrative agency regulation. In our hypothetical case, the plaintiff **alleges** (claims) that the defendant committed a tort. Therefore, the applicable law is the common law of torts—specifically, tort law governing assault. Case precedents involving similar facts and issues thus would be relevant. Often, more than one rule of law will be applicable to a case.
3. **Application**—*How does the rule of law apply to the particular facts and circumstances of this case?* This step is often the most difficult because each case presents a unique set of facts, circumstances, and parties.

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

7. See Appendix A for further instructions on how to analyze case problems.

Although cases may be similar, no two cases are ever identical in all respects. Normally, judges (and lawyers and law students) try to find **cases on point**—previously decided cases that are as similar as possible to the one under consideration.

4. **Conclusion**—*What conclusion should be drawn?* This step normally presents few problems. Usually, the conclusion is evident if the previous three steps have been followed carefully.

There Is No One "Right" Answer Many people believe that there is one "right" answer to every legal question. In most legal controversies, however, there is no single correct result. Good arguments can usually be made to support either side of a legal controversy. Quite often, a case does not involve a "good" person suing a "bad" person. In many cases, both parties have acted in good faith in some measure or in bad faith to some degree. Additionally, each judge has her or his own personal beliefs and philosophy. At least to some extent, these personal factors shape the legal reasoning process. In short, the outcome of a particular lawsuit before a court cannot be predicted with certainty.

1–3e The Common Law Today

Today, the common law derived from judicial decisions continues to be applied throughout the United States. Common law doctrines and principles, however, govern only areas *not* covered by statutory or administrative law. In a dispute concerning a particular employment practice, for instance, if a statute regulates that practice, the statute will apply rather than the common law doctrine that applied before the statute was enacted. The common law tradition and its application are reviewed in Concept Summary 1.2.

Courts Interpret Statutes Even in areas governed by statutory law, judge-made law continues to be important because there is a significant interplay between statutory law and the common law. For instance, many statutes essentially codify existing common law rules, and regulations issued by various administrative agencies usually are based, at least in part, on common law principles. Additionally, the courts, in interpreting statutory law, often rely on the common law as a guide to what the legislators intended. Frequently, the applicability of a newly enacted statute does not become clear until a body of case law develops to clarify how, when, and to whom the statute applies.

Concept Summary 1.2

The Common Law Tradition

Origins of Common Law	The American legal system is based on the common law tradition, which originated in medieval England.
Legal and Equitable Remedies	Remedies at law (land, items of value, or money) and remedies in equity (including specific performance, injunction, and rescission of a contractual obligation) originated in the early English courts of law and courts of equity, respectively.
Case Precedents and the Doctrine of *Stare Decisis*	In the king's courts, judges attempted to make their decisions consistent with previous decisions, called precedents. This practice gave rise to the doctrine of *stare decisis*. This doctrine, which became a cornerstone of the common law tradition, obligates judges to abide by precedents established in their jurisdictions.
Common Law Today	The common law governs all areas not covered by statutory law or administrative laws. Courts interpret statutes and regulations.

Clearly, a judge's function is not to *make* the laws—that is the function of the legislative branch of government—but to interpret and apply them. From a practical point of view, however, the courts play a significant role in defining the laws enacted by legislative bodies, which tend to be expressed in general terms. Judges thus have some flexibility in interpreting and applying the law. It is because of this flexibility that different courts can, and often do, arrive at different conclusions in cases that involve nearly identical issues, facts, and applicable laws.

***Restatements of the Law* Clarify and Illustrate the Common Law** The American Law Institute (ALI) has published compilations of the common law called *Restatements of the Law*, which generally summarize the common law rules followed by most states. There are *Restatements of the Law* in the areas of contracts, torts, agency, trusts, property, restitution, security, judgments, and conflict of laws. The *Restatements,* like other secondary sources of law, do not in themselves have the force of law, but they are an important source of legal analysis and opinion. Hence, judges often rely on them in making decisions.

Many of the *Restatements* are now in their second, third, or fourth editions. We refer to the *Restatements* frequently in subsequent chapters of this text, indicating in parentheses the edition to which we are referring. For instance, we refer to the third edition of the *Restatement of the Law of Contracts* as simply the *Restatement (Third) of Contracts*.

1–4 Schools of Legal Thought

How judges apply the law to specific cases, including disputes relating to the business world, depends in part on their philosophical approaches to law. Thus, the study of law, or **jurisprudence,** involves learning about different schools of legal thought and how the approaches to law characteristic of each school can affect judicial decision making.

1–4a The Natural Law School

An age-old question about the nature of law has to do with the finality of a nation's laws. What if a particular law is deemed to be a "bad" law by a substantial number of the nation's citizens? Must they obey that law? According to the **natural law** theory, a higher, or universal, law exists that applies to all human beings. Each written law should reflect the principles inherent in natural law. If it does not, then it loses its legitimacy and need not be obeyed.

The natural law tradition is one of the oldest and most significant schools of jurisprudence. It dates back to the days of the Greek philosopher Aristotle (384–322 B.C.E.), who distinguished between natural law and the laws governing a particular nation. According to Aristotle, natural law applies universally to all humankind.

The notion that people have "natural rights" stems from the natural law tradition. Those who claim that a specific foreign government is depriving certain citizens of their human rights, for instance, are implicitly appealing to a higher law that has universal applicability.

The question of the universality of basic human rights also comes into play in the context of international business operations. U.S. companies that have operations abroad often hire foreign workers as employees. Should the same laws that protect U.S. employees apply to these foreign employees? This question is rooted implicitly in a concept of universal rights that has its origins in the natural law tradition.

1–4b The Positivist School

Positive law, or national law, is the written law of a given society at a particular time. In contrast to natural law, it applies only to the citizens of that nation or society. Those who adhere to **legal positivism** believe that there can be no higher law than a nation's positive law.

According to the positivist school, there are no "natural rights." Rather, human rights exist solely because of laws. If the laws are not enforced, anarchy will result. Thus, whether a law is "bad" or "good" is irrelevant. The law is the law and must be obeyed until it is changed—in an orderly manner through a legitimate lawmaking process. A judge who takes this view will probably be more inclined to defer to an existing law than would a judge who adheres to the natural law tradition.

1–4c The Historical School

The **historical school** of legal thought emphasizes the evolutionary process of law by concentrating on the origin and history of the legal system. This school looks to the past to discover what the principles of contemporary law should be. The legal doctrines that have withstood the passage of time—those that have worked in the past—are deemed best suited for shaping present laws. Hence, law derives its legitimacy and authority from adhering to the standards that historical development has shown to be workable. Followers of the historical school are more likely than those of other schools to strictly follow decisions made in past cases.

1–4d Legal Realism

In the 1920s and 1930s, a number of jurists and scholars, known as *legal realists*, rebelled against the historical approach

to law. **Legal realism** is based on the idea that law is just one of many institutions in society and that it is shaped by social forces and needs. Because the law is a human enterprise, this school reasons that judges should take social and economic realities into account when deciding cases.

Legal realists also believe that the law can never be applied with total uniformity. Given that judges are human beings with unique personalities, value systems, and intellects, different judges will obviously bring different reasoning processes to the same case. Female judges, for instance, might be more inclined than male judges to consider whether a decision might have a negative impact on the employment of women or minorities.

Legal realism strongly influenced the growth of what is sometimes called the **sociological school,** which views law as a tool for promoting justice in society. In the 1960s, for instance, the justices of the United States Supreme Court helped advance the civil rights movement by upholding long-neglected laws calling for equal treatment for all Americans, including African Americans and other minorities. Generally, jurists who adhere to this philosophy of law are more likely to depart from past decisions than are jurists who adhere to other schools of legal thought.

Concept Summary 1.3 reviews the schools of jurisprudential thought.

1–5 Classifications of Law

The law may be broken down according to several classification systems. One system, for instance, divides law into substantive law and procedural law. **Substantive law** consists of all laws that define, describe, regulate, and create legal rights and obligations. **Procedural law** consists of all laws that outline the methods of enforcing the rights established by substantive law.

Note that many statutes contain both substantive and procedural provisions. ■ **EXAMPLE 1.5** A state law that provides employees with the right to *workers' compensation benefits* for on-the-job injuries is a substantive law because it creates legal rights. Procedural laws establish the method by which an employee must notify the employer about an on-the-job injury, prove the injury, and periodically submit additional proof to continue receiving workers' compensation benefits. ■

Other classification systems divide law into federal law and state law, private law (dealing with relationships between private entities) and public law (addressing the relationship between persons and their governments), and national law and international law. Here we look at still another classification system, which divides law into

Concept Summary 1.3

Schools of Jurisprudential Thought

Natural Law School	One of the oldest and most significant schools of legal thought. Those who believe in natural law hold that there is a universal law applicable to all human beings.
Positivist School	A school of legal thought centered on the assumption that there is no law higher than the laws created by the government.
Historical School	A school of legal thought that stresses the evolutionary nature of law and looks to doctrines that have withstood the passage of time for guidance in shaping present laws.
Legal Realism	A school of legal thought that advocates a less abstract and more realistic and pragmatic approach to the law and takes into account customary practices and the circumstances surrounding the particular transaction.

civil law and criminal law. We also explain what is meant by the term *cyberlaw*.

1–5a Civil Law and Criminal Law

Civil law spells out the rights and duties that exist between persons and between persons and their governments, as well as the relief available when a person's rights are violated. Typically, in a civil case, a private party sues another private party who has failed to comply with a duty. (Note that the government can also sue a party for a civil law violation.) Much of the law that we discuss in this text is civil law, including contract law and tort law.

Criminal law, in contrast, is concerned with wrongs committed *against the public as a whole.* Criminal acts are defined and prohibited by local, state, or federal government statutes. Criminal defendants are thus prosecuted by public officials, such as a district attorney (D.A.), on behalf of the state, not by their victims or other private parties. Some statutes, such as those protecting the environment or investors, have both civil and criminal provisions.

1–5b Cyberlaw

The use of the Internet to conduct business has led to new types of legal issues. In response, courts have had to adapt traditional laws to situations that are unique to our age. Additionally, legislatures at both the federal and the state levels have created laws to deal specifically with such issues.

Frequently, people use the term **cyberlaw** to refer to the emerging body of law that governs transactions conducted via the Internet. Cyberlaw is not really a classification of law, though, nor is it a new *type* of law. Rather, it is an informal term used to refer to both new laws and modifications of traditional laws that relate to the online environment. Throughout this book, you will read how the law in a given area is evolving to govern specific legal issues that arise in the online context.

1–6 How to Find Primary Sources of Law

This text includes numerous references, or *citations,* to primary sources of law—federal and state statutes, the U.S. Constitution and state constitutions, regulations issued by administrative agencies, and court cases. A **citation** identifies the publication in which a legal authority—such as a statute or a court decision or other source—can be found. In this section, we explain how you can use citations to find primary sources of law. Note that in addition to being published in sets of books, as described next, most federal and state laws and case decisions are available online.

1–6a Finding Statutory and Administrative Law

When Congress passes laws, they are collected in a publication titled *United States Statutes at Large.* When state legislatures pass laws, they are collected in similar state publications. Most frequently, however, laws are referred to in their codified form—that is, the form in which they appear in the federal and state codes. In these codes, laws are compiled by subject.

United States Code The *United States Code* (U.S.C.) arranges all existing federal laws by broad subject. Each of the fifty-two subjects is given a title and a title number. For instance, laws relating to commerce and trade are collected in Title 15, "Commerce and Trade." Each title is subdivided by sections. A citation to the U.S.C. includes both title and section numbers. Thus, a reference to "15 U.S.C. Section 1" means that the statute can be found in Section 1 of Title 15. ("Section" may be designated by the symbol §, and "Sections," by §§.)

In addition to the print publication, the federal government provides a searchable online database at **www.gpo.gov**. It includes the *United States Code,* the U.S. Constitution, and many other federal resources. (Click on "Libraries" and then "Core Documents of Our Democracy" to find these resources.)

Commercial publications of federal laws and regulations are also available. For instance, Thomson Reuters publishes the *United States Code Annotated* (U.S.C.A.). The U.S.C.A. contains the official text of the U.S.C., plus notes (annotations) on court decisions that interpret and apply specific sections of the statutes. The U.S.C.A. also includes additional research aids, such as cross-references to related statutes, historical notes, and library references. A citation to the U.S.C.A. is similar to a citation to the U.S.C.: "15 U.S.C.A. Section 1."

State Codes State codes follow the U.S.C. pattern of arranging law by subject. They may be called codes, revisions, compilations, consolidations, general statutes, or statutes, depending on the preferences of the states.

In some codes, subjects are designated by number. In others, they are designated by name. ■ **EXAMPLE 1.6** "13 Pennsylvania Consolidated Statutes Section 1101" means that the statute can be found in Title 13, Section 1101, of the Pennsylvania code. "California Commercial Code Section 1101" means that the statute can be found

under the subject heading "Commercial Code" of the California code in Section 1101. Abbreviations are often used. For example, "13 Pennsylvania Consolidated Statutes Section 1101" is abbreviated "13 Pa. C.S. § 1101," and "California Commercial Code Section 1101" is abbreviated "Cal. Com. Code § 1101." ■

Administrative Rules Rules and regulations adopted by federal administrative agencies are initially published in the *Federal Register,* a daily publication of the U.S. government. Later, they are incorporated into the *Code of Federal Regulations* (C.F.R.). The C.F.R. is available online on the government database (**www.gpo.gov**).

Like the U.S.C., the C.F.R. is divided into titles. Rules within each title are assigned section numbers. A full citation to the C.F.R. includes title and section numbers. ■ **EXAMPLE 1.7** A reference to "17 C.F.R. Section 230.504" means that the rule can be found in Section 230.504 of Title 17. ■

1–6b Finding Case Law

Before discussing the case reporting system, we need to look briefly at the court system. There are two types of courts in the United States, federal courts and state courts. Both systems consist of several levels, or tiers, of courts. *Trial courts*, in which evidence is presented and testimony given, are on the bottom tier. Decisions from a trial court can be appealed to a higher court, which commonly is an intermediate *court of appeals*, or *appellate court*. Decisions from these intermediate courts of appeals may be appealed to an even higher court, such as a state supreme court or the United States Supreme Court.

State Court Decisions Most state trial court decisions are not published in books (except in New York and a few other states, which publish selected trial court opinions). Decisions from state trial courts are typically filed in the office of the clerk of the court, where the decisions are available for public inspection. (Increasingly, they can be found online as well.)

Written decisions of the appellate, or reviewing, courts, however, are published and distributed (in print and online). As you will note, most of the state court cases presented in this textbook are from state appellate courts. The reported appellate decisions are published in volumes called *reports* or *reporters,* which are numbered consecutively. State appellate court decisions are found in the state reporters of that particular state. Official reports are published by the state, whereas unofficial reports are published by nongovernment entities.

Regional Reporters. State court opinions appear in regional units of the West's National Reporter System, published by Thomson Reuters. Most lawyers and libraries have these reporters because they report cases more quickly and are distributed more widely than the state-published reporters. In fact, many states have eliminated their own reporters in favor of the National Reporter System.

The National Reporter System divides the states into the following geographic areas: *Atlantic* (A., A.2d, or A.3d), *North Eastern* (N.E. or N.E.2d), *North Western* (N.W. or N.W.2d), *Pacific* (P., P.2d, or P.3d), *South Eastern* (S.E. or S.E.2d), *South Western* (S.W., S.W.2d, or S.W.3d), and *Southern* (So., So.2d, or So.3d). (The *2d* and *3d* in the preceding abbreviations refer to *Second Series* and *Third Series*, respectively.) The states included in each of these regional divisions are indicated in Exhibit 1–4, which illustrates the National Reporter System.

Case Citations. After appellate decisions have been published, they are normally referred to (cited) by the name of the case and the volume, name, and page number of the reporter(s) in which the opinion can be found. The citation first lists the state's official reporter (if different from the National Reporter System), then the National Reporter, and then any other selected reporter. (Citing a reporter by volume number, name, and page number, in that order, is common to all citations. The year that the decision was issued is often included at the end in parentheses.) When more than one reporter is cited for the same case, each reference is called a *parallel citation.*

Note that some states have adopted a "public domain citation system" that uses a somewhat different format for the citation. For instance, in Wisconsin, a Wisconsin Supreme Court decision might be designated "2016 WI 40," meaning that the case was decided in the year 2016 by the Wisconsin Supreme Court and was the fortieth decision issued by that court during that year. Parallel citations to the *Wisconsin Reports* and the *North Western Reporter* are still included after the public domain citation.

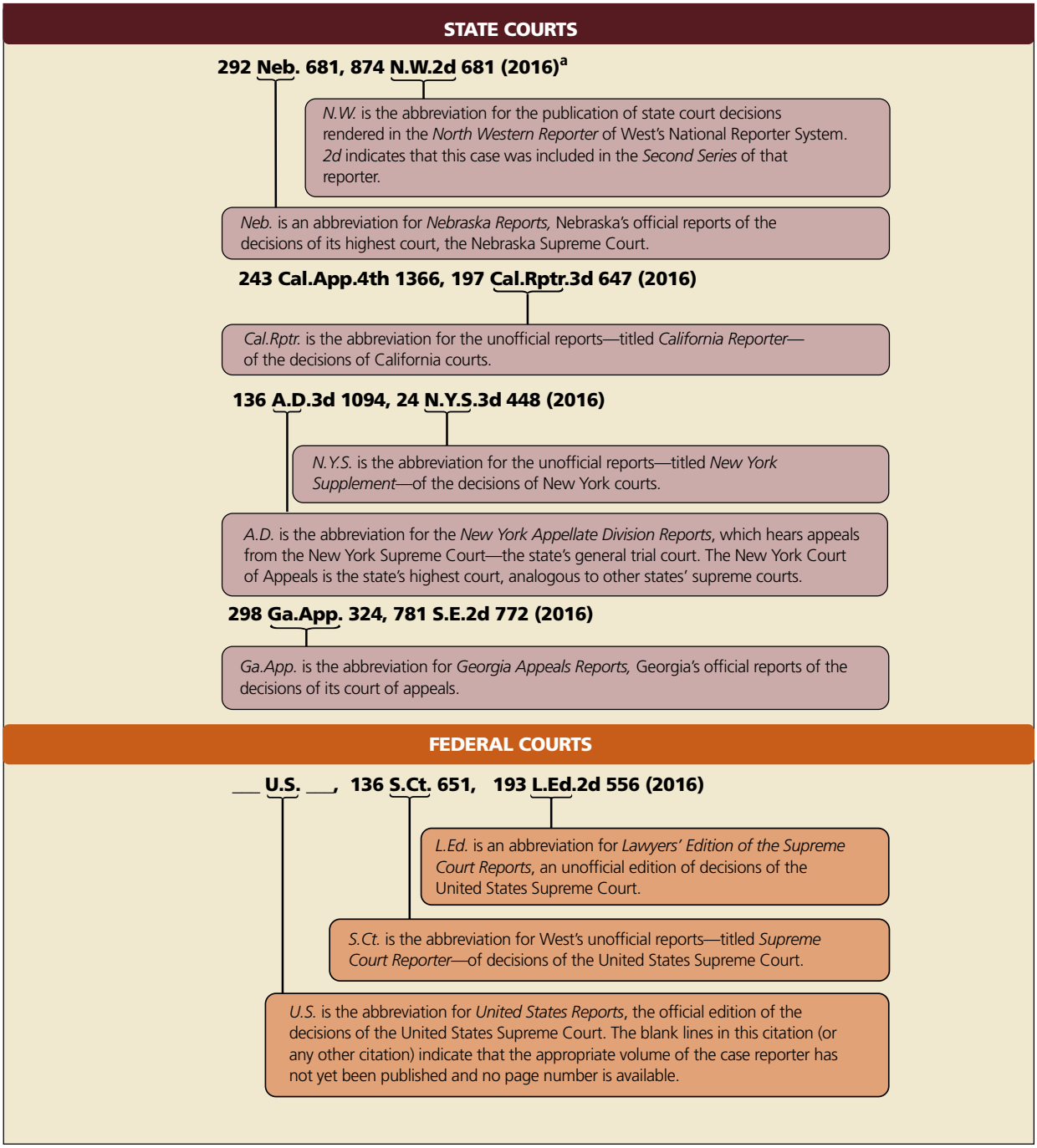
■ **EXAMPLE 1.8** Consider the following case citation: *Summerhill, LLC v. City of Meridan,* 162 Conn.App. 469, 131 A.3d. 1225 (2016). We see that the opinion in this case can be found in Volume 162 of the official *Connecticut Appellate Court Reports*, on page 469. The parallel citation is to Volume 131 of the *Atlantic Reporter, Third Series*, page 1225. ■

When we present opinions in this text, in addition to the reporter, we give the name of the court hearing the case and the year of the court's decision. Sample citations to state court decisions are explained in Exhibit 1–5.

EXHIBIT 1–4 National Reporter System—Regional/Federal

Regional Reporters	Coverage Beginning	Coverage
Atlantic Reporter (A., A.2d, or A.3d)	1885	Connecticut, Delaware, District of Columbia, Maine, Maryland, New Hampshire, New Jersey, Pennsylvania, Rhode Island, and Vermont.
North Eastern Reporter (N.E. or N.E.2d)	1885	Illinois, Indiana, Massachusetts, New York, and Ohio.
North Western Reporter (N.W. or N.W.2d)	1879	Iowa, Michigan, Minnesota, Nebraska, North Dakota, South Dakota, and Wisconsin.
Pacific Reporter (P., P.2d, or P.3d)	1883	Alaska, Arizona, California, Colorado, Hawaii, Idaho, Kansas, Montana, Nevada, New Mexico, Oklahoma, Oregon, Utah, Washington, and Wyoming.
South Eastern Reporter (S.E. or S.E.2d)	1887	Georgia, North Carolina, South Carolina, Virginia, and West Virginia.
South Western Reporter (S.W., S.W.2d, or S.W.3d)	1886	Arkansas, Kentucky, Missouri, Tennessee, and Texas.
Southern Reporter (So., So.2d, or So.3d)	1887	Alabama, Florida, Louisiana, and Mississippi.
Federal Reporters		
Federal Reporter (F., F.2d, or F.3d)	1880	U.S. Circuit Courts from 1880 to 1912; U.S. Commerce Court from 1911 to 1913; U.S. District Courts from 1880 to 1932; U.S. Court of Claims (now called U.S. Court of Federal Claims) from 1929 to 1932 and since 1960; U.S. Courts of Appeals since 1891; U.S. Court of Customs and Patent Appeals since 1929; U.S. Emergency Court of Appeals since 1943.
Federal Supplement (F.Supp., F.Supp.2d, or F.Supp.3d)	1932	U.S. Court of Claims from 1932 to 1960; U.S. District Courts since 1932; U.S. Customs Court since 1956.
Federal Rules Decisions (F.R.D.)	1939	U.S. District Courts involving the Federal Rules of Civil Procedure since 1939 and Federal Rules of Criminal Procedure since 1946.
Supreme Court Reporter (S.Ct.)	1882	United States Supreme Court since the October term of 1882.
Bankruptcy Reporter (Bankr.)	1980	Bankruptcy decisions of U.S. Bankruptcy Courts, U.S. District Courts, U.S. Courts of Appeals, and the United States Supreme Court.
Military Justice Reporter (M.J.)	1978	U.S. Court of Military Appeals and Courts of Military Review for the Army, Navy, Air Force, and Coast Guard.

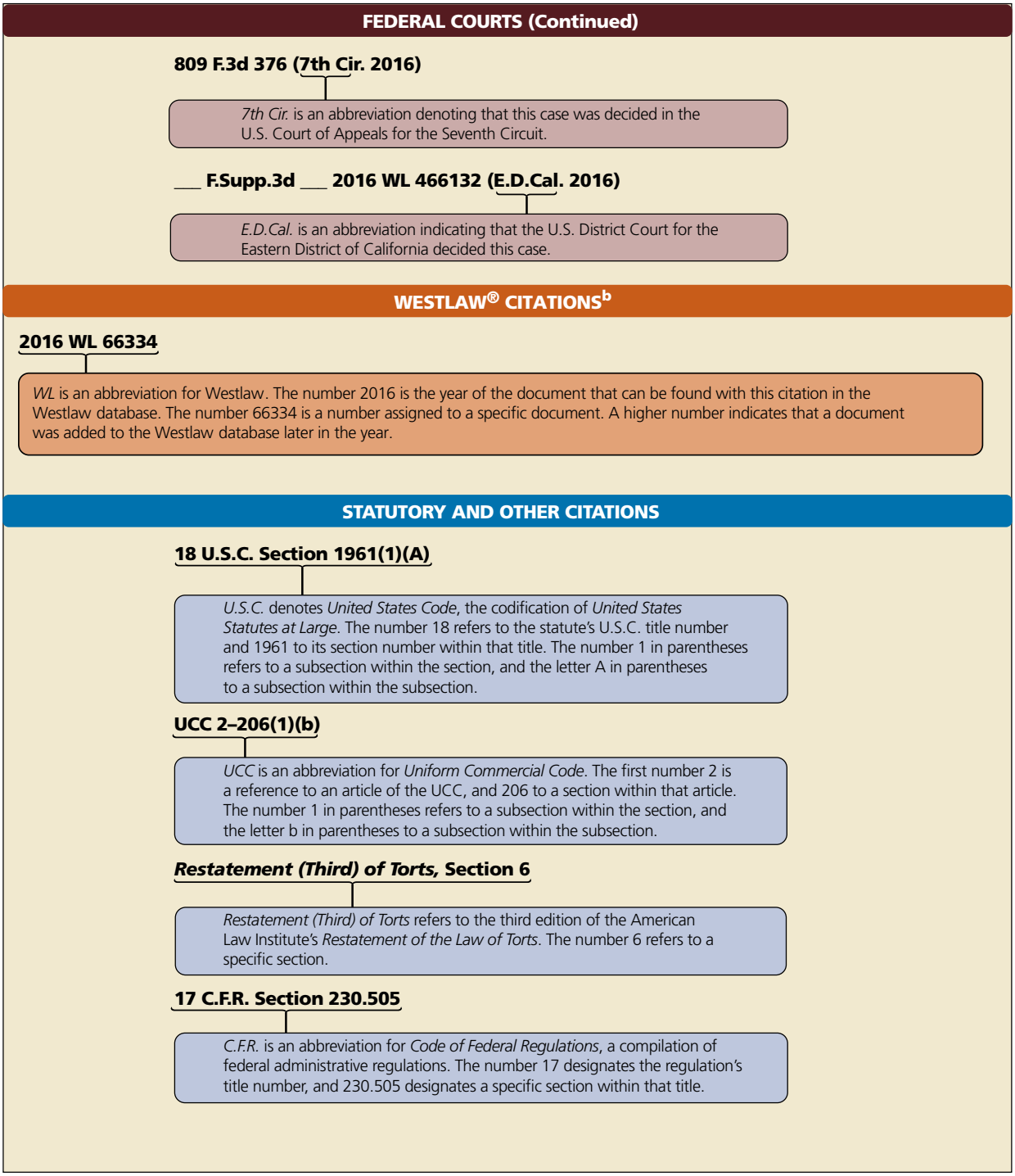
EXHIBIT 1–5 How to Read Citations



a. The case names have been deleted from these citations to emphasize the publications. It should be kept in mind, however, that the name of a case is as important as the specific page numbers in the volumes in which it is found. If a citation is incorrect, the correct citation may be found in a publication's index of case names. In addition to providing a check on errors in citations, the date of a case is important because the value of a recent case as an authority is likely to be greater than that of older cases from the same court.

Continued

EXHIBIT 1–5 How to Read Citations—Continued



b. Many court decisions that are not yet published or that are not intended for publication can be accessed through Westlaw, an online legal database.

Federal Court Decisions Federal district (trial) court decisions are published unofficially in the *Federal Supplement* (F.Supp. or F.Supp.2d), and opinions from the circuit courts of appeals (reviewing courts) are reported unofficially in the *Federal Reporter* (F., F.2d, or F.3d). Cases concerning federal bankruptcy law are published unofficially in the *Bankruptcy Reporter* (Bankr. or B.R.).

The official edition of the United States Supreme Court decisions is the *United States Reports* (U.S.), which is published by the federal government. Unofficial editions of Supreme Court cases include the *Supreme Court Reporter* (S.Ct.) and the *Lawyers' Edition of the Supreme Court Reports* (L.Ed. or L.Ed.2d). Sample citations for federal court decisions are also listed and explained in Exhibit 1–5.

Unpublished Opinions Many court opinions that are not yet published or that are not intended for publication can be accessed through Thomson Reuters Westlaw® (abbreviated in citations as "WL"), an online legal database. When no citation to a published reporter is available for cases cited in this text, we give the WL citation (such as 2016 WL 145734, which means it was case number 145734 decided in the year 2016). In addition, federal appellate court decisions that are designated as unpublished may appear in the *Federal Appendix* (Fed. Appx.) of the National Reporter System.

Old Case Law On a few occasions, this text cites opinions from old, classic cases dating to the nineteenth century or earlier. Some of these are from the English courts. The citations to these cases may not conform to the descriptions just presented because the reporters in which they were originally published were often known by the names of the persons who compiled the reporters.

1–7 How to Read and Understand Case Law

The decisions made by the courts establish the boundaries of the law as it applies to almost all business relationships. It thus is essential that businesspersons know how to read and understand case law.

The cases that we present in this text have been condensed from the full text of the courts' opinions and are presented in a special format. In approximately two-thirds of the cases (including the cases designated as *Classic* and *Spotlight*), we have summarized the background and facts, as well as the court's decision and remedy, in our own words. In those cases, we have included only selected excerpts from the court's opinion ("In the Language of the Court"). In the remaining one-third of the cases (labeled "Case Analysis"), we have provided a longer excerpt from the court's opinion without summarizing the background and facts or decision and remedy.

The following sections provide useful insights into how to read and understand case law.

1–7a Case Titles and Terminology

The title of a case, such as *Adams v. Jones*, indicates the names of the parties to the lawsuit. The *v.* in the case title stands for *versus*, which means "against." In the trial court, Adams was the plaintiff—the person who filed the suit. Jones was the defendant.

If the case is appealed, however, the appellate court will sometimes place the name of the party appealing the decision first, so the case may be called *Jones v. Adams* if Jones appealed. Because some appellate courts retain the trial court order of names, it is often impossible to distinguish the plaintiff from the defendant in the title of a reported appellate court decision. You must carefully read the facts of each case to identify the parties.

The following terms, phrases, and abbreviations are frequently encountered in court opinions and legal publications.

Parties to Lawsuits The party initiating a lawsuit is referred to as the *plaintiff* or *petitioner*, depending on the nature of the action. The party against whom a lawsuit is brought is the *defendant* or *respondent*. Lawsuits frequently involve more than one plaintiff and/or defendant.

When a case is appealed from the original court or jurisdiction to another court or jurisdiction, the party appealing the case is called the **appellant.** The **appellee** is the party against whom the appeal is taken. (In some appellate courts, the party appealing a case is referred to as the *petitioner*, and the party against whom the suit is brought or appealed is called the *respondent*.)

Judges and Justices The terms *judge* and *justice* are usually synonymous and represent two designations given to judges in various courts. All members of the United States Supreme Court, for instance, are referred to as justices. Justice is the formal title often given to judges of appellate courts, although this is not always true. In New York, a justice is a judge of the trial court (called the Supreme Court), and a member of the Court of Appeals (the state's highest court) is called a judge.

The term *justice* is commonly abbreviated to J., and *justices*, to JJ. A United States Supreme Court case might refer to Justice Sotomayor as Sotomayor, J., or to Chief Justice Roberts as Roberts, C.J.

Decisions and Opinions Most decisions reached by reviewing, or appellate, courts are explained in written **opinions.** The opinion contains the court's reasons for its decision, the rules of law that apply, and the judgment. You may encounter several types of opinions as you read appellate cases, including the following:

- When all the judges (or justices) agree, a *unanimous opinion* is written for the entire court.
- When there is not unanimous agreement, a **majority opinion** is generally written. It outlines the views of the majority of the judges deciding the case.
- A judge who agrees (concurs) with the majority opinion as to the result but not as to the legal reasoning often writes a **concurring opinion.** In it, the judge sets out the reasoning that he or she considers correct.
- A **dissenting opinion** presents the views of one or more judges who disagree with the majority view.
- Sometimes, no single position is fully supported by a majority of the judges deciding a case. In this situation, we may have a **plurality opinion.** This is the opinion that has the support of the largest number of judges, but the group in agreement is less than a majority.
- Finally, a court occasionally issues a ***per curiam* opinion** (*per curiam* is Latin for "of the court"), which does not indicate which judge wrote the opinion.

1–7b Sample Court Case

To illustrate the various elements contained in a court opinion, we present an annotated court opinion in Exhibit 1–6. The opinion is from an actual case that the United States Court of Appeals for the Eleventh Circuit decided in 2016.

Background of the Case In December 1955, on a bus in Montgomery, Alabama, Rosa Parks refused to give up her seat to a white man in violation of the city's segregation law. This "courageous act" sparked the modern civil rights movement. Parks's role in "the most significant social movement in the history of the United States" has been chronicled in books and movies, and featured on mementoes, some of which are offered for sale by Target Corp. The Rosa and Raymond Parks Institute for Self Development is a Michigan firm that owns the right to use Parks's name and likeness for commercial purposes. The Institute filed a suit in a federal district court against Target, alleging misappropriation in violation of the Institute's right of publicity. The court dismissed the complaint. The Institute appealed to the U.S. Court of Appeals for the Eleventh Circuit, arguing that Target's sales of books, movies, and other items that depict or discuss Rosa Parks and the modern civil rights movement violated Michigan law.

Editorial Practice You will note that triple asterisks (* * *) and quadruple asterisks (* * * *) frequently appear in the opinion. The triple asterisks indicate that we have deleted a few words or sentences from the opinion for the sake of readability or brevity. Quadruple asterisks mean that an entire paragraph (or more) has been omitted.

Additionally, when the opinion cites another case or legal source, the citation to the case or source has been omitted, again for the sake of readability and brevity. These editorial practices are continued in the other court opinions presented in this book. In addition, whenever we present a court opinion that includes a term or phrase that may not be readily understandable, a bracketed definition or paraphrase has been added.

Briefing Cases Knowing how to read and understand court opinions and the legal reasoning used by the courts is an essential step in undertaking accurate legal research. A further step is "briefing," or summarizing, the case.

Legal researchers routinely brief cases by reducing the texts of the opinions to their essential elements. Generally, when you brief a case, you first summarize the background and facts of the case, as the authors have done for most of the cases presented in this text. You then indicate the issue (or issues) before the court. An important element in the case brief is, of course, the court's decision on the issue and the legal reasoning used by the court in reaching that decision.

Detailed instructions on how to brief a case are given in Appendix A, which also includes a briefed version of the sample court case presented in Exhibit 1–6.

EXHIBIT 1–6 A Sample Court Case

This section contains the citation—the name of the case, the name of the court that heard the case, the year of the decision, and reporters in which the court's opinion can be found.

Rosa and Raymond Parks Institute for Self Development v. Target Corporation

United States Court of Appeals, Eleventh Circuit,

812 F.3d 824 (2016).

This line provides the name of the judge (or justice) who authored the court's opinion.

ROSENBAUM, Circuit Judge:

* * * *

In December 1955, on a bus in Montgomery, Alabama, Parks refused to give up her seat to a white man in violation of the city's segregation law.

An *impetus* is a stimulus or a spark.

The *modern civil rights movement* (1954–1964) included mass demonstrations in which participants sought equality in public and private life at national, state, and local levels, as well as an end to state and local segregation and discrimination in schools, in the workplace and at the polls. The movement culminated in the enactment of two federal Civil Rights acts in 1957 and 1964.

To *cede* is to yield or surrender.

A *right of publicity* is a person's right to the use of his or her name and likeness for a commercial purpose.

The court divides the opinion into three sections. The first section summarizes the factual background of the case.

[Rosa] **Parks's courageous act** inspired the Montgomery Bus Boycott and served as the **impetus** for the **modern Civil Rights Movement,** transforming the nation. In response to Parks's arrest, for 381 days, 42,000 African–Americans boycotted Montgomery buses, until the United States Supreme Court held the Montgomery segregation law unconstitutional and ordered desegregation of the buses.

Parks's refusal to **cede** ground in the face of continued injustice has made her among the most revered heroines of our national story; her role in American history cannot be over-emphasized. Indeed, the United States Congress * * * has credited Parks with "igniting the most significant social movement in the history of the United States."

So it is not surprising that authors would write about Parks's story and artists would celebrate it with their works. The commemoration and dissemination of Parks's journey continues to entrench and embolden our pursuit of justice. And it is in the general public interest to relentlessly preserve, spotlight, and recount the story of Rosa Parks and the Civil Rights Movement—even when that interest allegedly conflicts with an individual **right of publicity.**

I.

The Rosa and Raymond Parks Institute for Self Development (the "Institute") is a Michigan * * * corporation that owns the name and likeness of the late Rosa Parks * * * .

Continued

EXHIBIT 1–6 A Sample Court Case—Continued

Target Corporation ("Target"), a national retail corporation headquartered in Minneapolis, Minnesota, operates more than 1,800 retail stores across the United States.

Target offered [for sale] seven books about Parks * * * , the * * * movie *The Rosa Parks Story,* and a * * * plaque that included * * * a picture of Parks.

* * * *

* * * The Institute filed the underlying complaint in [a federal district court]. The Institute alleged claims for * * * **misappropriation** * * * for Target's sales of all items using the name and likeness of Rosa Parks.

Misappropriation is the use of a person's name or likeness without his or her consent for a commercial purpose. This is commonly referred to as a violation of the individual's right of publicity.

Generally, the Institute complained that * * * Target had unfairly and "without the Institute's prior knowledge, or consent, used Parks's name, likeness, and image to sell products * * * for Target's own commercial advantage." * * * The district court dismissed the complaint, and this appeal followed.

II.

The second major section of the opinion responds to the plaintiff's appeal.

* * * In this case we apply * * * the **substantive law** of Michigan.

* * * *

Substantive law is law that defines the rights and duties of persons with respect to each other. A federal court exercising jurisdiction based on diversity of citizenship—as in this case, where the two corporate parties are "citizens" of different states—applies the substantive law of the state in which the court sits (except in cases governed by federal law or the United States Constitution).

Michigan's common-law right of publicity is founded upon the interest of the individual in the exclusive use of his own identity, in so far as it is represented by his name or likeness, and in so far as the use may be of benefit to him or to others. This * * * privacy right guards against the appropriation of the commercial value of a person's identity by using without consent the person's name, likeness, or other ***indicia*** of identity for the purpose of trade.

Indicia is a synonym for indications or signs.

Privacy rights, however, are not absolute. * * * Individual rights must yield to the **qualified privilege** to communicate on matters of public interest.

Qualified privilege gives someone a limited right to act contrary to another person's right without the other person's having legal recourse for the act.

* * * *

* * * The privilege attaches to matters of general public interest and extends to all communications made ***bona fide*** upon any subject matter where the party

In this context, *bona fide* means sincerely and honestly.

EXHIBIT 1–6 A Sample Court Case—Continued

communicating has an interest or a [legal, moral, or social] duty to a person having a corresponding interest or duty.

* * * *

Of course, it is beyond dispute that Rosa Parks is a figure of great historical significance and the Civil Rights Movement a matter of legitimate and important public interest. And it is **uncontested** that * * * the * * * books * * * and the movie are all *bona fide* works * * * discussing Parks and her role in the Civil Rights Movement.

Here, *uncontested* can mean unchallenged or accepted, as well as evident or obvious.

Similarly, the plaque depicts images and mentions dates and statements related to Parks and the Civil Rights Movement, in an effort to convey a message concerning Parks, her courage, and the results of her strength. Indeed, all of the works in question communicate information, express opinions, recite grievances, and protest claimed abuses on behalf of a movement whose existence and objectives continue to be of the highest public interest and concern.

* * * *

* * * The Institute has not articulated any argument as to why Michigan's qualified privilege for matters of public concern would not apply to these works, in light of the conspicuous historical importance of Rosa Parks. Nor can we conceive of any.

* * * Indeed, it is difficult to conceive of a discussion of the Civil Rights Movement without reference to Parks and her role in it. And Michigan law does not make discussion of these topics of public concern contingent on paying a fee. As a result, [the] books, the movie, and the plaque find protection in Michigan's qualified privilege protecting matters of public interest.

[III.]

In the third major section of the opinion, the court states its decision.

In short, the district court did not err in dismissing the Institute's complaint. The district court's order is **AFFIRMED.**

To *affirm* is to validate, to give legal force to.

Reviewing: Law and Legal Reasoning

Suppose that the California legislature passes a law that severely restricts carbon dioxide emissions from automobiles in that state. A group of automobile manufacturers files suit against the state of California to prevent the enforcement of the law. The automakers claim that a federal law already sets fuel economy standards nationwide and that fuel economy standards are essentially the same as carbon dioxide emission standards. According to the automobile manufacturers, it is unfair to allow California to impose more stringent regulations than those set by the federal law. Using the information presented in the chapter, answer the following questions.

1. Who are the parties (the plaintiffs and the defendant) in this lawsuit?
2. Are the plaintiffs seeking a legal remedy or an equitable remedy?
3. What is the primary source of the law that is at issue here?
4. Where would you look to find the relevant California and federal laws?

Debate This . . . *Under the doctrine of* stare decisis, *courts are obligated to follow the precedents established in their jurisdiction unless there is a compelling reason not to. Should U.S. courts continue to adhere to this common law principle, given that our government now regulates so many areas by statute?*

Terms and Concepts

administrative agency 4
administrative law 4
allege 10
appellant 19
appellee 19
binding authority 8
breach 6
case law 5
case on point 11
citation 14
civil law 14
common law 6
concurring opinion 20
constitutional law 4
court of equity 6
court of law 6
criminal law 14
cyberlaw 14
damages 6
defendant 6
defense 6
dissenting opinion 20
equitable maxims 6
executive agency 5
historical school 12
independent regulatory agency 5
jurisprudence 12
laches 6
law 2
legal positivism 12
legal realism 13
legal reasoning 10
liability 2
majority opinion 20
natural law 12
opinion 20
ordinance 4
persuasive authority 10
***per curiam* opinion** 20
petitioner 6
plaintiff 6
plurality opinion 20
precedent 7
procedural law 13
remedy 6
remedy at law 6
remedy in equity 6
reporter 8
respondent 6
sociological school 13
stare decisis 8
statute of limitations 6
statutory law 4
substantive law 13
uniform law 4

Issue Spotters

1. Under what circumstances might a judge rely on case law to determine the intent and purpose of a statute? (See *Sources of American Law.*)
2. After World War II, several Nazis were convicted of "crimes against humanity" by an international court. Assuming that these convicted war criminals had not disobeyed any law of their country and had merely been following their government's orders, what law had they violated? Explain. (See *Schools of Legal Thought.*)

- **Check your answers to the Issue Spotters against the answers provided in Appendix D at the end of this text.**

Business Scenarios

1–1. Binding versus Persuasive Authority. A county court in Illinois is deciding a case involving an issue that has never been addressed before in that state's courts. The Iowa Supreme Court, however, recently decided a case involving a very similar fact pattern. Is the Illinois court obligated to follow the Iowa Supreme Court's decision on the issue? If the United States Supreme Court had decided a similar case, would that decision be binding on the Illinois court? Explain. (See *The Common Law Tradition*.)

1–2. Sources of Law. This chapter discussed a number of sources of American law. Which source of law takes priority in the following situations, and why? (See *Sources of American Law*.)

(a) A federal statute conflicts with the U.S. Constitution.

(b) A federal statute conflicts with a state constitutional provision.

(c) A state statute conflicts with the common law of that state.

(d) A state constitutional amendment conflicts with the U.S. Constitution.

1–3. *Stare Decisis*. In this chapter, we stated that the doctrine of *stare decisis* "became a cornerstone of the English and American judicial systems." What does *stare decisis* mean, and why has this doctrine been so fundamental to the development of our legal tradition? (See *The Common Law Tradition*.)

Business Case Problems

1–4. Spotlight on AOL—Common Law. AOL, LLC, mistakenly made public the personal information of 650,000 of its members. The members filed a suit, alleging violations of California law. AOL asked the court to dismiss the suit on the basis of a "forum-selection clause" in its member agreement that designates Virginia courts as the place where member disputes will be tried. Under a decision of the United States Supreme Court, a forum-selection clause is unenforceable "if enforcement would contravene a strong public policy of the forum in which suit is brought." California courts have declared in other cases that the AOL clause contravenes a strong public policy. If the court applies the doctrine of *stare decisis*, will it dismiss the suit? Explain. [*Doe 1 v. AOL LLC*, 552 F.3d 1077 (9th Cir. 2009)] (See *The Common Law Tradition*.)

1–5. Business Case Problem with Sample Answer—Reading Citations. Assume that you want to read the entire court opinion in the case of *Equal Employment Opportunity Commission v. Autozone, Inc.*, 809 F.3d 916 (7th Cir. 2016). Refer to the subsection entitled "Finding Case Law" in this chapter, and then explain specifically where you would find the court's opinion. (See *How to Find Primary Sources of Law.*)

- **For a sample answer to Problem 1–5, go to Appendix E at the end of this text.**

1–6. A Question of Ethics—The Common Law Tradition. *On July 5, 1884, Dudley, Stephens, and Brooks—"all able-bodied English seamen"—and a teenage English boy were cast adrift in a lifeboat following a storm at sea. They had no water with them in the boat, and all they had for sustenance were two one-pound tins of turnips. On July 24, Dudley proposed that one of the four in the lifeboat be sacrificed to save the others. Stephens agreed with Dudley, but Brooks refused to consent—and the boy was never asked for his opinion. On July 25, Dudley killed the boy, and the three men then fed on the boy's body and blood. Four days later, a passing vessel rescued the men. They were taken to England and tried for the murder of the boy. If the men had not fed on the boy's body, they would probably have died of starvation within the four-day period. The boy, who was in a much weaker condition, would likely have died before the rest. [*Regina v. Dudley and Stephens, 14 Q.B.D. *(Queen's Bench Division, England) 273 (1884)]* (See *The Common Law Tradition*.)

(a) The basic question in this case is whether the survivors should be subject to penalties under English criminal law, given the men's unusual circumstances. Were the defendants' actions necessary but unethical? Explain your reasoning. What ethical issues might be involved here?

(b) Should judges ever have the power to look beyond the written "letter of the law" in making their decisions? Why or why not?

Legal Reasoning Group Activity

1–7. Court Opinions. Read through the subsection in this chapter entitled "Decisions and Opinions." (See *How to Read and Understand Case Law*.)

(a) One group will explain the difference between a concurring opinion and a majority opinion.

(b) Another group will outline the difference between a concurring opinion and a dissenting opinion.

(c) A third group will explain why judges and justices write concurring and dissenting opinions, given that these opinions will not affect the outcome of the case at hand, which has already been decided by majority vote.

CHAPTER 2

Courts and Alternative Dispute Resolution

The United States has fifty-two court systems—one for each of the fifty states, one for the District of Columbia, and a federal system. Keep in mind that the federal courts are not superior to the state courts. They are simply an independent system of courts, which derives its authority from Article III, Section 2, of the U.S. Constitution. By the power given to it under the U.S. Constitution, Congress has extended the federal court system to U.S. territories such as Guam, Puerto Rico, and the Virgin Islands.[1]

1. In Guam and the Virgin Islands, territorial courts serve as both federal courts and state courts. In Puerto Rico, they serve only as federal courts.

As we shall see, the United States Supreme Court is the final controlling voice over all of these fifty-two systems, at least when questions of federal law are involved. The Supreme Court's decisions—whether on free speech and social media, health-care subsidies, environmental regulation, or same-sex marriage—represent the last word in the most controversial legal debates in our society. Nevertheless, many of the legal issues that arise in our daily lives, such as the use of social media by courts, employers, and law enforcement, have not yet come before the nation's highest court. The lower courts usually resolve such pressing matters, making these courts equally important in our legal system.

Although an understanding of our nation's court systems is beneficial for anyone, it is particularly crucial for businesspersons, who will likely face a lawsuit at some time during their careers. Anyone involved in business should be familiar with the basic requirements that must be met before a party can bring a lawsuit before a particular court.

2–1 The Judiciary's Role in American Government

The body of American law includes the federal and state constitutions, statutes passed by legislative bodies, administrative law, and the case decisions and legal principles that form the common law. These laws would be meaningless, however, without the courts to interpret and apply them. The essential role of the judiciary—the courts—in the American governmental system is to interpret the laws and apply them to specific situations.

2–1a Judicial Review

As the branch of government entrusted with interpreting the laws, the judiciary can decide, among other things, whether the laws or actions of the other two branches are constitutional. The process for making such a determination is known as **judicial review.** The power of judicial review enables the judicial branch to act as a check on the other two branches of government, in line with the system of checks and balances established by the U.S. Constitution.[2]

2–1b The Origins of Judicial Review in the United States

The power of judicial review is not mentioned in the U.S. Constitution (although many constitutional scholars believe that the founders intended the judiciary to have this power). The United States Supreme Court explicitly established this power in 1803 in the case *Marbury v. Madison*.[3] In that decision, the Court stated, "It is emphatically the province [authority] and duty of the Judicial Department to say what the law is. . . . If two laws conflict with each other, the courts must decide

2. In a broad sense, judicial review occurs whenever a court "reviews" a case or legal proceeding—as when an appellate court reviews a lower court's decision. When discussing the judiciary's role in American government, however, the term *judicial review* refers to the power of the judiciary to decide whether the actions of the other two branches of government violate the U.S. Constitution.
3. 5 U.S. (1 Cranch) 137, 2 L.Ed. 60 (1803).

on the operation of each. . . . [I]f both [a] law and the Constitution apply to a particular case, . . . the Court must determine which of these conflicting rules governs the case. This is of the very essence of judicial duty." Since the *Marbury v. Madison* decision, the power of judicial review has remained unchallenged. Today, this power is exercised by both federal and state courts.

2–2 Basic Judicial Requirements

Before a lawsuit can be brought before a court, certain requirements must be met. These requirements relate to jurisdiction, venue, and standing to sue. We examine each of these important concepts here.

2–2a Jurisdiction

In Latin, *juris* means "law," and *diction* means "to speak." Thus, "the power to speak the law" is the literal meaning of the term **jurisdiction.** Before any court can hear a case, it must have jurisdiction over the person (or company) against whom the suit is brought (the defendant) or over the property involved in the suit. The court must also have jurisdiction over the subject matter of the dispute.

Jurisdiction over Persons or Property Generally, a particular court can exercise ***in personam*** **jurisdiction** (personal jurisdiction) over any person or business that resides in a certain geographic area. A state trial court, for instance, normally has jurisdictional authority over residents (including businesses) of a particular area of the state, such as a county or district. A state's highest court (often called the state supreme court[4]) has jurisdictional authority over all residents within the state.

A court can also exercise jurisdiction over property that is located within its boundaries. This kind of jurisdiction is known as ***in rem*** **jurisdiction**, or "jurisdiction over the thing." ■ **EXAMPLE 2.1** A dispute arises over the ownership of a boat in dry dock in Fort Lauderdale, Florida. The boat is owned by an Ohio resident, over whom a Florida court normally cannot exercise personal jurisdiction. The other party to the dispute is a resident of Nebraska. In this situation, a lawsuit concerning the boat could be brought in a Florida state court on the basis of the court's *in rem* jurisdiction. ■

Long Arm Statutes and Minimum Contacts. Under the authority of a state **long arm statute,** a court can exercise personal jurisdiction over certain out-of-state defendants based on activities that took place within the state. Before a court can exercise jurisdiction, though, it must be demonstrated that the defendant had sufficient contacts, or *minimum contacts*, with the state to justify the jurisdiction.[5]

Generally, the minimum-contacts requirement means that the defendant must have sufficient connection to the state for the judge to conclude that it is fair for the state to exercise power over the defendant. For instance, if an out-of-state defendant caused an automobile accident within the state or breached a contract formed there, a court will usually find that minimum contacts exist to exercise jurisdiction over that defendant. Similarly, a state may exercise personal jurisdiction over a nonresident defendant that is sued for selling defective goods within the state.

■ **CASE IN POINT 2.2** An Xbox game system caught fire in Bonnie Broquet's home in Texas and caused substantial personal injuries. Broquet filed a lawsuit in a Texas court against Ji-Haw Industrial Company, a nonresident company that made the Xbox components. Broquet alleged that Ji-Haw's components were defective and had caused the fire. Ji-Haw argued that the Texas court lacked jurisdiction over it, but a state appellate court held that the Texas long arm statute authorized the exercise of jurisdiction over the out-of-state defendant.[6] ■

Corporate Contacts. Because corporations are considered legal persons, courts use the same principles to determine whether it is fair to exercise jurisdiction over a corporation. A corporation normally is subject to personal jurisdiction in the state in which it is incorporated, has its principal office, and/or is doing business.

Courts apply the minimum-contacts test to determine if they can exercise jurisdiction over out-of-state corporations. The minimum-contacts requirement is usually met if the corporation advertises or sells its products within the state, or places its goods into the "stream of commerce" with the intent that the goods be sold in the state. ■ **EXAMPLE 2.3** A business is incorporated under the laws of Maine but has a branch office and manufacturing plant in Georgia. The corporation also advertises and sells its products in Georgia. These activities would likely constitute sufficient contacts with the state of

4. As will be discussed shortly, a state's highest court is often referred to as the state supreme court, but there are exceptions. For instance, in New York the supreme court is a trial court.

5. The minimum-contacts standard was first established in *International Shoe Co. v. State of Washington*, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945).

6. *Ji-Haw Industrial Co. v. Broquet*, 2008 WL 441822 (Tex.App.—San Antonio 2008).

Georgia to allow a Georgia court to exercise jurisdiction over the corporation. ■

Some corporations do not sell or advertise their products in the general marketplace. Determining what constitutes minimum contacts in these situations can be more difficult. ■ **CASE IN POINT 2.4** Independence Plating Corporation is a New Jersey corporation that provides metal-coating services. Its only office and all of its personnel are located in New Jersey, and it does not advertise out of state. Independence had a long-standing business relationship with Southern Prestige Industries, Inc., a North Carolina company. Eventually, Southern Prestige filed suit in North Carolina against Independence for defective workmanship. Independence argued that North Carolina did not have jurisdiction over it, but the court held that Independence had sufficient minimum contacts with the state to justify jurisdiction. The two parties had exchanged thirty-two separate purchase orders in a period of less than twelve months.[7] ■

Jurisdiction over Subject Matter Subject-matter jurisdiction refers to the limitations on the types of cases a court can hear. Certain courts are empowered to hear certain kinds of disputes. In both the federal and the state court systems, there are courts of general (unlimited) jurisdiction and courts of limited jurisdiction.

A *court of general jurisdiction* can decide cases involving a broad array of issues. An example of a court of general jurisdiction is a state trial court or a federal district court.

In contrast, a *court of limited jurisdiction* can hear only specific types of cases. An example of a state court of limited jurisdiction is a probate court. **Probate courts** are state courts that handle only the disposition of a person's assets and obligations after that person's death, including issues relating to the custody and guardianship of children. An example of a federal court of limited subject-matter jurisdiction is a bankruptcy court. **Bankruptcy courts** handle only bankruptcy proceedings, which are governed by federal bankruptcy law.

A court's jurisdiction over subject matter is usually defined in the statute or constitution that created the court. In both the federal and the state court systems, a court's subject-matter jurisdiction can be limited by any of the following:

1. The subject of the lawsuit.
2. The sum in controversy.
3. Whether the case involves a felony (a serious type of crime) or a misdemeanor (a less serious type of crime).
4. Whether the proceeding is a trial or an appeal.

Original and Appellate Jurisdiction The distinction between courts of original jurisdiction and courts of appellate jurisdiction normally lies in whether the case is being heard for the first time. Courts having original jurisdiction are courts of the first instance, or trial courts. These are courts in which lawsuits begin, trials take place, and evidence is presented. In the federal court system, the *district courts* are trial courts. In the various state court systems, the trial courts are known by various names, as will be discussed shortly.

The key point here is that any court having original jurisdiction normally serves as a trial court. Courts having appellate jurisdiction act as reviewing, or appellate, courts. In general, cases can be brought before appellate courts only on appeal from an order or a judgment of a trial court or other lower courts.

Jurisdiction of the Federal Courts Because the federal government is a government of limited powers, the jurisdiction of the federal courts is limited. Federal courts have subject-matter jurisdiction in two situations: when a federal question is involved and when there is diversity of citizenship.

Federal Questions. Article III of the U.S. Constitution establishes the boundaries of federal judicial power. Section 2 of Article III states that "the judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority."

In effect, this clause means that whenever a plaintiff's cause of action is based, at least in part, on the U.S. Constitution, a treaty, or a federal law, a **federal question** arises. Any lawsuit involving a federal question, such as a person's rights under the U.S. Constitution, can originate in a federal court. Note that in a case based on a federal question, a federal court will apply federal law.

Diversity of Citizenship. Federal district courts can also exercise original jurisdiction over cases involving **diversity of citizenship.** The most common type of diversity jurisdiction[8] requires *both* of the following:

7. *Southern Prestige Industries, Inc. v. Independence Plating Corp.*, 690 S.E.2d 768 (N.C. 2010).

8. Diversity jurisdiction also exists in cases between (1) a foreign country and citizens of a state or of different states and (2) citizens of a state and citizens or subjects of a foreign country. Cases based on these types of diversity jurisdiction occur infrequently.

1. The plaintiff and defendant must be residents of different states.
2. The dollar amount in controversy must exceed $75,000.

For purposes of diversity jurisdiction, a corporation is a citizen of both the state in which it is incorporated and the state in which its principal place of business is located.

A case involving diversity of citizenship can be filed in the appropriate federal district court. (If the case starts in a state court, it can sometimes be transferred, or "removed," to a federal court.) A large percentage of the cases filed in federal courts each year are based on diversity of citizenship. As noted before, a federal court will apply federal law in cases involving federal questions. In a case based on diversity of citizenship, in contrast, a federal court will apply the relevant state law (which is often the law of the state in which the court sits).

The following case focused on whether diversity jurisdiction existed. A boat owner was severely burned when his boat exploded after being overfilled with fuel at a marina in the U.S. Virgin Islands. The owner filed a suit in a federal district court against the marina and sought a jury trial. The defendant argued that a plaintiff in an admiralty, or maritime, case (a case based on something that happened at sea) does not have a right to a jury trial unless the court has diversity jurisdiction. The defendant claimed that because both parties were citizens of the Virgin Islands, the court had no such jurisdiction.

Case Analysis 2.1

Mala v. Crown Bay Marina, Inc.

United States Court of Appeals, Third Circuit, 704 F.3d 239 (2013).

In the Language of the Court

SMITH, Circuit Judge.

* * * *

Kelley Mala is a citizen of the United States Virgin Islands. * * * He went for a cruise in his powerboat near St. Thomas, Virgin Islands. When his boat ran low on gas, he entered Crown Bay Marina to refuel. Mala tied the boat to one of Crown Bay's eight fueling stations and began filling his tank with an automatic gas pump. Before walking to the cash register to buy oil, Mala asked a Crown Bay attendant to watch his boat.

By the time Mala returned, the boat's tank was overflowing and fuel was spilling into the boat and into the water. The attendant manually shut off the pump and acknowledged that the pump had been malfunctioning in recent days. Mala began cleaning up the fuel, and at some point, the attendant provided soap and water. Mala eventually departed the marina, but as he did so, the engine caught fire and exploded. Mala was thrown into the water and was severely burned. His boat was unsalvageable.

* * * Mala sued Crown Bay in the District Court of the Virgin Islands. Mala's * * * complaint asserted * * * that Crown Bay negligently maintained its gas pump. [Negligence is the failure to exercise the standard of care that a reasonable person would exercise in similar circumstances. Negligence can form the basis for a legal claim.] The complaint also alleged that the District Court had admiralty and diversity jurisdiction over the case, and it requested a jury trial.

* * * *

* * * Crown Bay filed a motion to strike Mala's jury demand. Crown Bay argued that plaintiffs generally do not have a jury-trial right in admiralty cases—only when the court also has diversity jurisdiction. And Crown Bay asserted that the parties were not diverse in this case * * * . In response to this motion, the District Court ruled that both Mala and Crown Bay were citizens of the Virgin Islands. The court therefore struck Mala's jury demand, but nevertheless opted to empanel an advisory jury. [The court could accept or reject the advisory jury's verdict.]

* * * At the end of the trial, the advisory jury returned a verdict of $460,000 for Mala—$400,000 for pain and suffering and $60,000 in compensatory damages. It concluded that Mala was 25 percent at fault and that Crown Bay was 75 percent at fault. The District Court ultimately rejected the verdict and entered judgment for Crown Bay.

* * * *

This appeal followed.

* * * *

Mala * * * argues that the District Court improperly refused to conduct a jury trial. This claim ultimately depends on whether the District Court had diversity jurisdiction.

The Seventh Amendment [to the U.S. Constitution] creates a right to civil jury trials in federal court: "In Suits at common law * * * the right of trial by jury shall be preserved." Admiralty suits are not "Suits at common law," which means that when a district court has only admiralty jurisdiction the plaintiff does not have a jury-trial right. But [a federal statute] allows plaintiffs to pursue state claims in admiralty cases as long as the district court also has diversity jurisdiction. In such cases [the statute] preserves whatever jury-trial right exists with respect to the underlying state claims.

Case 2.1 Continues