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TEXT & EXERCISES



ROGER LEROY MILLER
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Business Law

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NINTH EDITION

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NINTH EDITION

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William Eric Hollowell

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Library of Congress Control Number: 2017945518

ISBN-13: 978-1-337-62465-7

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Printed in the United States of America

Print Number: 01

Print Year: 2017

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Preface to the Instructor

It is no exaggeration to say that today's legal world is changing at a pace never before experienced. In many instances, technology is both driving and facilitating this change. In the midst of this evolving environment, however, one thing remains certain: for students entering the business world, an awareness of the legal and regulatory environment of business is critical. Even for those students who do not pursue a business career, legal problems will arise. Thus, a solid background in business law is essential for everyone.

In *Business Law: Text and Exercises*, Ninth Edition, we present business law in a straightforward, practical manner. The essential aspects of every important topic are covered without overburdening the reader with numerous details and explanations of arcane exceptions.

What's New in the Ninth Edition

Instructors have come to rely on the coverage, accuracy, and applicability of *Business Law: Text and Exercises*. That is why in the Ninth Edition we continue to focus on engaging student interest and providing a basic understanding of business law. In every chapter, we have incorporated significant new details, timely examples, helpful exhibits, and recent cases.

New Chapter Content

To maintain the text's high-quality, up-to-date content, we have added several new topics and discussions to the Ninth Edition. These content additions include the following:

- A new chapter on **Mortgages** provides a basic explanation of mortgage loans and the laws and processes that surround them.
- The final chapter on International Law now presents a new section on the emerging area of **Space Law**.
- To reinforce student learning through visual aids, **fourteen new Exhibits** have been added to selected chapters.
- The chapter discussing employment law now includes **new sections on Worker Protections and Employee Privacy**.
- The coverage of corporations has been expanded to include **new sections on Sales of Securities, Corporate Ownership, Share Exchanges, and Takeover Attempts**.

All-New Pedagogy

The Ninth Edition complements its new content coverage with new pedagogical content. To provide students with a variety of study tools for retaining and reviewing chapter materials, we made the following additions and changes:

- A new section, titled ***Straight to the Point***, in every chapter features five to seven questions that focus on important points in the chapter content. These straightforward questions provide pedagogical variety while helping students retain important business law terms and topics.

- A new *Ethical Question* based on a recent court case in every chapter helps emphasize the importance of ethics in business.
- Every chapter presents all-new *Real Cases*, which are based on 2016 or 2017 cases (formerly titled *Real-World Case Examples*). Students can quickly read through the *Real Cases* to see how courts apply legal principles to everyday business scenarios.
- We have added more than forty new *Highlighting the Point* features. These features help students understand how business law can apply to common situations.
- We have added more than twenty new *Conflict Presented/Conflict Resolved* features (formerly titled *Facing/Answering a Legal Problem*). Each chapter opens with a brief legal *Conflict Presented* scenario and question. At the end of the chapter, the *Conflict Resolved* feature answers the *Conflict Presented* question.
- Examples are very helpful for students because they illustrate and clarify legal principles. We have added more than forty new *Numbered Examples* throughout the text.
- This edition includes forty-three new *Real Law* case problems (formerly called *Real-World Case Problems*). Most are based on 2016 cases.

Other Significant Revisions

Along with engaging new content and pedagogy, the Ninth Edition also boasts significant revisions and updates. To help students comprehend the more complex concepts of business law, we have removed legalese and reorganized content for better flow and understanding. To accomplish this editorial objective, we have revised some chapters.

- For smoother organization and more focused business law coverage, we have created four new chapters on **Business Torts, Business Crimes, Personal Property, and Bailments** by splitting chapters from the previous edition.
- In Unit 6, on Business Organizations, the coverage of **Corporations** has been expanded to three chapters to simplify coverage and introduce new topics and discussions.
- A complete revision of the chapter on **Bankruptcy Law** makes the content less confusing and easier to follow. The chapter now focuses on three common types of bankruptcy—Chapter 7, 11, and 13—and emphasizes the bankruptcy basics.
- Chapter 32, titled **Security Interests and Creditors' Remedies**, combines two chapters from the previous edition. The chapter has been condensed for a clear, layperson-oriented discussion of risk and credit in today's business world.

Additional Practical Learning Tools

To help students review chapter materials and prepare for testing, this text provides additional effective, practical features:

- *Learning Outcomes*—Every chapter starts with four to six *Learning Outcomes*. This edition includes thirty new *Learning Outcomes*. Each *Learning Outcome* is repeated in the margin at the point where it is discussed in the text. Additionally, each *Chapter Summary* includes that chapter's *Learning Outcomes* with a succinct review of the major points students need to remember.
- *Linking Business Law to Your Career*—Written in an easy-to-understand style, these features emphasize tips, pitfalls, and effective strategies for students

to remember once they are working and applying their knowledge of basic business law to real-life workplace scenarios. In selected chapters, these features often reflect new business developments and examples.

- **Work Sets**—At the end of every chapter, there is a tear-out sheet called a *Work Set*, which features true-false and multiple-choice questions, plus an *Answering More Legal Problems* fill-in-the-blank feature. This in-text study guide helps students review the material covered in the chapter.
- **Issue Spotters**—The *Issue Spotters* provide students with two hypothetical situations that end with questions related to the chapter topics. Students answer these questions by reviewing the topic material. They can then compare their answers with those provided in Appendix A at the end of this book.
- **Glossary**—For students' convenient reference, each boldfaced key term throughout the text is defined in the *Glossary*.

Supplements

Business Law: Text and Exercises, Ninth Edition, provides a comprehensive supplements package. The supplements were created with a single goal in mind: to make the tasks of teaching and learning more enjoyable and efficient. The following supplements are available for instructors.

MindTap Business Law for Business Law: Text & Exercises, Ninth Edition

MindTap™ is a fully online, highly personalized learning experience built upon authoritative Cengage Learning content. By combining readings, multimedia, activities, and assessments into a singular Learning Path, *MindTap* guides students through their course with ease and engagement. Instructors personalize the Learning Path by customizing Cengage Learning resources and adding their own content via apps that integrate into the *MindTap* framework seamlessly with Learning Management Systems.

Business law instructors have told us it is important to help students Prepare for class, Engage with the course concepts to reinforce learning, Apply these concepts in real-world scenarios, and use legal reasoning and critical thinking to Analyze business law content. Accordingly, the *Business Law MindTap* product provides a four-step Learning Path designed to meet these critical needs while also allowing instructors to measure skills and outcomes with ease.

- **Prepare**—Interactive worksheets are designed to prepare students for classroom discussion by ensuring that they have read and understood the reading.
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- **Apply**—Brief hypothetical case scenarios help students to practice spotting issues and applying the law in the context of short factual scenarios.
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Each and every item in the Learning Path is assignable and gradable. This gives instructors the knowledge of class standings and concepts that may be difficult. Additionally, students gain knowledge about where they stand—both individually and compared to the highest performers in class. *MindTap* also includes:

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Instructor's Companion Website

The *Instructor's Companion Website* for *Business Law: Text and Exercises*, Ninth Edition, contains the following supplements:

- ***Instructor's Manual.*** The *Instructor's Manual* contains all of the answers to the *Issue Spotters*, *Straight to the Point* questions, *Real Law* case problems, and *Ethical Questions*. In addition, it provides the answers to each chapter's *Work Set*.
- ***Test Bank.*** The comprehensive *Test Bank* contains multiple-choice, true-false, and short essay questions. More than 30 percent of the material in the *Test Bank* is either new or has been upgraded.
- ***PowerPoint Slides.***

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Acknowledgments

Business Law: Text and Exercises could never have been written without the extremely helpful criticisms, comments, and suggestions that we received from the following professors on the previous editions:

Helena Armour
Southwestern College of Business

David Blumberg
LaGuardia Community College–CUNY

Daniel Burnstein
Gibbs College

Jeffrey S. Chase
Clinton Community College

Jack R. Day
Sawyer College

Diamela delCastilla
University of Miami

Nancy K. Dempsey
Cape Cod Community College

Joseph L. DeTorres
Contra Costa College

Lucy Dorum
Clover Park Technical College

Greg Drummer
Stone Child College

John Elger
Georgia State University

Austin Emeagwai
Lemoyne Owen College

Linda Ferguson
Virginia Wesleyan College

Gary Grau
Northeast State Community College

Myrna Gusdorf
Linn-Benton Community College

Michael Harford
Morehead State University

James P. Hess
Ivy Technical State College

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Queens College

Karen S. Mozengo
Pitt Community College

Barb Portzen
Mid-State Technical College

Alan Questall
Richmond Community College

J. Kent Richards
Lake Superior College

Susan Rubisch-Gisler
Carlow University

Harold V. Rucker
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Steve Schneider
Lake Superior College

Mary T. Sessom
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Mira Costa College

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SUNY Rockland Community College

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Ron Weston
Contra Costa College

Roger D. Westrup
Heald Business College

Frederick D. White
Indian River Community College

Timothy G. Wiedman
Thomas Nelson Community College

Tom Wilson
Remington College

The staff at Cengage Learning went out of their way to make sure that the Ninth Edition of *Business Law: Text and Exercises* came out in accurate form. In particular, we wish to thank Bryan Gambrel and Vicky True-Baker for their countless new ideas, many of which have been incorporated into this new edition.

We also extend special thanks to Sarah Huber, our content developer, for her many useful suggestions and for her efforts in coordinating reviews and ensuring the timely and accurate publication of all supplemental materials.

Our senior content project manager, Martha Conway, made sure that we had a visually attractive edition. We will always be in her debt. We are also indebted to project managers Ann Borman and Alison Kuzmickas at SPi Global, our compositor. Their ability to generate the pages for this text quickly and accurately made it possible for us to meet our ambitious printing schedule.

The copyediting services of Beverly Peavler and the proofreading services of Jeanne Yost will not go unnoticed. We also thank Vickie Reiersen for her proofreading and project management assistance. Thank you to Leoni McVey for her detailed and thorough work on the Table of Cases and Index. Finally, our appreciation goes to Roxanna Lee and Suzanne Jasin for their special efforts on the project.

We know we are not perfect. If you find something you don't like or want us to change, write to us via e-mail, using the text's website. That is how we can make *Business Law: Text and Exercises* an even better book in the future.

R.L.M.
W.E.H.

DEDICATION

*To Clyde,
Whose mastery
of all things in publishing
continues to live on.
Thanks for everything.*

—R. L. M.

*Para mi esposa, Luisa,
y mi hijas, Sandra y Mariel,
con mucho amor.*

—W. E. H.



UNIT 1

The Law and Our Legal System

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Introduction to the Law

LEARNING OUTCOMES

The four Learning Outcomes below are designed to help improve your understanding of the chapter. After reading this chapter, you should be able to:

- 1 Define *law*.
- 2 List the major sources of law.
- 3 Identify the supreme law of the land.
- 4 Distinguish different legal systems.



Conflict Presented

Max owns photos and other art depicting the Beatles. Max does business through his website, thebeatlesartwork.com. Apple Corps, Ltd., owns trademarks—including “The Beatles”—that it uses to sell merchandise related to the group. Alleging trademark infringement, Apple Corps files a suit against Max.

Q Can Apple Corps obtain a court order to stop Max’s use of “The Beatles” and recover payment for its lost sales due to that use?

Persons entering the world of business today will find themselves subject to numerous laws and government regulations. An acquaintance with these laws and regulations is beneficial—if not essential—to anyone contemplating a successful career in business.

In this introductory chapter, we look at the nature of law in general. We also examine the history and sources—both domestic and international—of American law in particular.



1–1 What Is Law?

LEARNING OUTCOME 1

Define *law*.

law

Enforceable rules governing individuals and their society.

The British jurist William Blackstone (1723–1780) described law as “a rule of civil conduct, . . . commanding what is right, and prohibiting what is wrong.” There are many sets of rules that declare what is right and what is wrong. These may come from religion, philosophy, and other scholarly sources, or arise from peer pressure, customs, and other social conventions.

Only rules enacted by the government apply with equal force to all of the individuals in a society, however. Of course, these rules are effective only if they are enforced with penalties when they are broken. Thus, the **law** consists of enforceable rules governing relationships among individuals and between individuals and their society.



1–2 Business Activities and the Legal Environment

To make good business decisions, knowledge of the laws and regulations governing business is essential. Businesspersons must also develop critical thinking and reasoning skills to evaluate how the law might apply in a given situation and determine the best course of action. Businesspersons are also pressured to make ethical decisions. Thus, the study of business law involves an ethical dimension.

1–2a Many Different Laws May Affect a Single Business Transaction

As you will see, each chapter in this textbook covers a specific area of the law and shows how the legal rules in that area affect business activities. It is important to remember, however, that many different laws may apply to just one transaction.

Businesspersons should be aware of this and understand enough about the law to know when to hire an expert for advice. See the *Linking Business Law to Your Career* feature at the end of this chapter for more on this topic.

If a dispute cannot be resolved amicably, then a **lawsuit** may become necessary. At that point, it is also important to know about the laws and the rules concerning courts and court procedures.

lawsuit

A judicial proceeding for the resolution of a dispute.

Highlighting the Point

Mark Zuckerberg starts Facebook when he is a student at Harvard University. Later, others who attended Harvard at the same time assert that Zuckerberg stole their idea for a social networking website. Meanwhile, Facebook users contend that the company tracks their website visits and scans their messages to mine data to sell to advertisers.

What are some legal issues Zuckerberg and his company could face? The fellow students may have a claim against Zuckerberg in areas of the law that concern intellectual property, contracts, and partnerships. Facebook could also face a **class action lawsuit** for violating its users' privacy. Such an action could be brought under tort law, contract law, or constitutional law. Lastly, Facebook could be subject to action for claims by certain federal regulators, which would be based in administrative law.



class action lawsuit

A lawsuit in which a number of persons join together.

1–2b The Role of the Law in a Small Business

Some of you may end up working in, or owning and operating, a small business. The small-business owner is the most general of managers. When you seek additional financing, you become a finance manager. As you go over the books, you become an accountant. When you direct an advertising campaign, you are the marketing manager.

When you have employees and determine salaries and benefits, you become a human resources manager. Each of these roles has a link to the law. Exhibit 1.1 shows some of the legal issues that can arise in managing a small—or large—business.



1–3 Sources of American Law

To understand the law, you need to have some understanding of its origins. One major source is the *common law* tradition that originated in medieval England. Another is *constitutional law*, which includes the U.S. Constitution and the constitutions of the states. *Statutes*—the laws enacted by Congress and the state legislatures—comprise an additional source of American law. Finally, yet another source of American law is *administrative law*, which consists of the regulations created by administrative agencies.

LEARNING OUTCOME 2

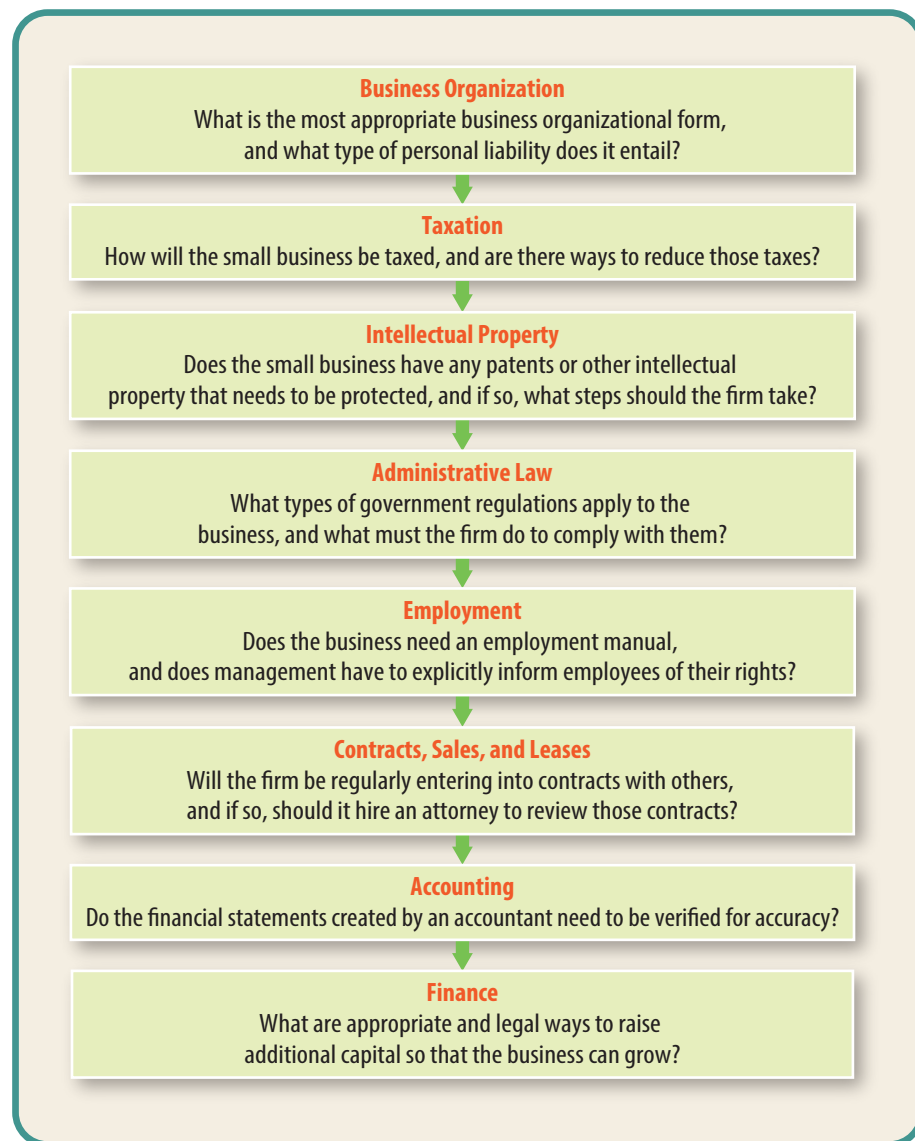
List the major sources of law.

1–3a The Common Law

In medieval England, the courts established a uniform set of rules from the customs and traditions that had been in force in various regions of the nation. These rules—and the principles behind them—were applied to resolve similar disputes in a consistent way. Each application served as a guide for future decisions—a legal **precedent**.

precedent

A court decision that guides subsequent decisions.

Exhibit 1.1 Linking Business Law to the Management of a Small Business**common law**

A body of law developed from court decisions.

case law

Rules of law announced in court decisions.

Over several centuries, these decisions developed into a body of **common law**. The English colonists brought this law to America and set up legal systems based on the common-law method of deciding disputes. When the United States was formed, these legal systems were the model for the new nation's courts.

Today, the common law is still a significant source of legal authority. This body of law—sometimes referred to as **case law**—includes court interpretations of constitutional provisions, statutes enacted by legislatures, and regulations issued by administrative agencies.

Real Case

Rosa Parks refused to give up her seat on a bus to a white man in violation of a law in Montgomery, Alabama. This event sparked the modern Civil Rights Movement. Her role 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 Parks's name and likeness. The Institute

filed a lawsuit against Target, alleging a violation of Michigan's common law. The court dismissed the suit. The Institute appealed.

Did Michigan's common law protect Target's sales of merchandise that depicted or discussed Rosa Parks and the modern Civil Rights Movement? Yes. In *Rosa and Raymond Parks Institute for Self-Development v. Target Corp.*, the U.S. Court of Appeals for the Eleventh Circuit affirmed the dismissal. Michigan's common law prohibits the use of a person's name or likeness without his or her consent. But the state's common law also includes a "privilege to communicate on matters of public interest. . . . Rosa Parks is a figure of great historical significance and the Civil Rights Movement a matter of . . . the highest public interest." Target's sales fell within this privilege.

—812 F.3d 824 (11th Cir.)

The Doctrine of Precedent—*Stare Decisis* The practice of deciding new cases with reference to previous decisions, or precedents, forms a doctrine called **stare decisis** (pronounced *ster-ay dih-si-ses*), which means "to stand on decided cases." According to this doctrine, a judge is obligated to follow the precedents established within her or his **jurisdiction**.

This practice is a cornerstone of the U.S. judicial system. The doctrine helps courts to be more efficient, and makes the law more stable and predictable. Someone bringing an **action** in a court can expect a result based on how the law has been applied in cases with similar facts.

Departures from Precedent A court may decide that a precedent is incorrect or that a change in society or technology has rendered it inapplicable. In that case, the court may rule contrary to the precedent.

Sometimes, there is no precedent, or there are conflicting precedents. In these situations, a court may base a decision on the principles announced in other court decisions. The court may also consider public policy, social values, or concepts and data from other fields of knowledge.

Equity A person brings a case to a court of law seeking a **remedy**, or relief from a wrong. Usually, that remedy is **damages**—the payment of money.

EXAMPLE 1.1 Elena is injured because of Rowan's wrongdoing. If Elena files a lawsuit and is successful, a court can order Rowan to compensate Elena for the harm by paying her a certain amount of money (damages). The compensation is Elena's remedy. ■

Money may not always be enough to make a situation right, however. Equity is a branch of the law that seeks to supply a fairer and more adequate remedy in such a case. For instance, a court might issue an **injunction** to order a party to do specifically what he or she promised. Or a contract might be cancelled and the contracting parties returned to the positions they held before the deal.

Two distinct systems of courts were created to grant the different types of remedies. A court of law could award only damages. A court of equity could provide other relief. Today, in most states, the courts of law and equity are merged. A court may now grant either a legal or an equitable remedy, or both, in the same action.

stare decisis

A doctrine under which judges must follow established precedents.

jurisdiction

The authority of a court to decide a specific dispute.

action

A court proceeding to enforce or protect a right, or redress or prevent a wrong.

remedy

The means to enforce a right or compensate for a wrong.

damages

Money sought as a remedy for a harm suffered.

injunction

A court order to do or not do a certain act.

1–3b Constitutional Law

The federal government and the states have separate constitutions that set forth the general organization, powers, and limits of their governments. The U.S. Constitution is the supreme law of the land. A law in violation of the Constitution, no matter what its source, will not be enforced.

Each state has its own constitution. Unless it conflicts with the U.S. Constitution, a state constitution is supreme within the state's borders.

LEARNING OUTCOME 3

Identify the supreme law of the land.

Highlighting the Point



The U.S. Constitution gives Congress the authority to regulate businesses involved in interstate commerce. Under this authority, Congress enacts a law prohibiting businesses from refusing to deal with the members of minority groups. Later, a state legislature enacts a law allowing businesses in the state to refuse to deal with members of the groups. Jill, a member of a minority group, brings an action against the state to stop the enforcement of the new state law.

Is the state law valid? No. The law violates the U.S. Constitution because it attempts to regulate an area over which the Constitution gives authority to the federal government. The law also violates the constitutional rights of the members of any minority group against which it discriminates. The court can order the state to stop its enforcement of the law.

statutory law

Laws enacted by a legislative body.

1–3c Statutory Law

Statutes enacted by Congress and the state legislative bodies make up another source of law, generally referred to as **statutory law**. Statutory law also includes the ordinances passed by cities and counties. None of these can violate the U.S. Constitution or the relevant state constitution.

Today, legislative bodies and regulatory agencies assume an ever-increasing share of lawmaking. Much of the work of modern courts consists of interpreting what the rulemakers meant when a law was passed and applying the law to a present set of facts.

Uniform Laws State laws differ from state to state. During the 1800s, the differences among state laws made trade and commerce among the states difficult. To counter these problems, a group of legal scholars and lawyers formed the National Conference of Commissioners on Uniform State Laws (NCCUSL). This organization began to draft uniform laws for the states to adopt.

Each state has the option of adopting or rejecting a uniform law. A state legislature may choose to adopt only part of a uniform law or to rewrite the sections that are adopted. Hence, even though many states may adopt a uniform law, the law may not be “uniform” across all these states. Once adopted by a state, a uniform act becomes a part of the statutory law of that state.

The Uniform Commercial Code (UCC) In 1932, the Uniform Commercial Code (UCC) was created through the joint efforts of the NCCUSL and the American Law Institute. The UCC has been adopted in forty-nine states, the District of Columbia, and the Virgin Islands. Louisiana has adopted Articles 1, 3, 4, 5, 7, 8, and 9. The UCC facilitates commerce among the states by providing a uniform, yet flexible, set of rules governing commercial transactions.

1–3d Administrative Law

administrative law

The rules, orders, and decisions created by administrative agencies.

Administrative law consists of the rules, orders, and decisions of administrative agencies. An administrative agency is a federal, state, or local government body established to perform a specific function. Congress or a state legislature charges these departments, commissions, and boards with carrying out the terms of particular laws.

Rules issued by administrative agencies affect almost every aspect of a business's operations. Regulations govern a business's capital structure and financing, hiring and firing procedures, relations with employees and unions, and making and selling of products.



1–4 Civil Law versus Criminal Law

The huge body of the law is broken down into several classifications. One important classification divides law into *civil law* and *criminal law*.

Civil law spells out the rights and duties that exist between persons and between citizens and their governments. In a civil case, one party tries to make the other party comply with a duty or pay for the damage caused by a failure to do so. Contract law is part of civil law.

EXAMPLE 1.2 If Craig fails to perform a contract with Mary, she may bring a lawsuit against Craig. The purpose of the lawsuit will be either to compel Craig to perform as promised or, more commonly, to obtain monetary damages for Craig's failure to perform. ■

Criminal law has to do with a wrong committed against the public as a whole. Criminal acts are prohibited by local, state, or federal government statutes. In a criminal case, the government seeks to impose a penalty (a monetary penalty and/or imprisonment) on an allegedly guilty person.

civil law

Law that defines and enforces all private and public rights, as opposed to criminal matters.

criminal law

Law that defines crimes and subjects criminals to punishment.



1–5 National Law around the World

The common law system practiced in the United States is one of the major legal systems of the world. Other countries that were once colonies of Great Britain—such as Australia, Canada, and India—generally also use common law systems.

Many nations employ a **civil law system**, however. The basis of the system is *codified law*—a set of legal principles enacted into law by a legislature. The primary source of law is a statutory code. Precedents do not bind courts, although previous decisions may serve as guidance for judges. Most European nations, along with many countries that were once their colonies, use civil law systems. In the United States, Louisiana has a civil law system, due to the state's historical ties to France.

LEARNING OUTCOME 4

Distinguish different legal systems.

civil law system

A legal system based on a statutory code.



1–6 International Law

International law can be defined as a body of written and unwritten laws observed by independent nations in their relations with other nations. It governs the acts of individuals as well as governments. International customs and treaties are generally considered to be two of the most important sources of international law.

The key difference between international law and national law (the law of a particular nation) is that national law can be enforced by government authorities. No such authority exists to enforce international law. The only methods to obtain compliance are persuasive tactics, such as sanctions, by other countries or international organizations.

International law must accommodate two conflicting goals of individual nations. Every nation desires to benefit economically from its dealings with individuals and other nations. At the same time, each nation is motivated

international law

The law that governs relations among nations.

by a need to be the final authority over its own affairs. International law attempts to balance these national desires and needs. And individual nations agree to be governed by international law in some respects to benefit from international trade.



Conflict Resolved

In the *Conflict Presented* feature at the beginning of this chapter, Max sells art depicting the Beatles through a website, thebeatlesartwork.com. Apple Corps, Ltd., owns the trademark “The Beatles,” which Apple Corps uses to sell its own products related to the group. Alleging trademark infringement, Apple Corps files a lawsuit against Max.

A Can Apple Corps get a court order to stop Max’s use of “The Beatles” and recover payment for lost sales due to that use? Yes. A court can grant both types of remedies in a single case. Max infringed the “The Beatles” trademark. The court can issue an injunction to stop him from using “The Beatles” in his business and domain names. Apple Corps also provides evidence that shows a big decrease in the company’s revenue during Max’s infringing use. The court can order Max to pay Apple Corps for its lost sales.

Linking Business Law to Your Career



CONSULTING AN EXPERT FOR ADVICE

Whether you own a business or work for one, you will face many issues that touch on subjects about which you know little. Not every manager is aware of all the information needed to manage a business. It is therefore necessary for you to know when to ask for advice from experts.

With respect to the law, you may know enough about the law to prevent a potential legal dispute simply by taking the appropriate action. In other circumstances, however, the best alternative will be to seek outside counsel.

Why Consult a Legal Expert?

It is not possible to keep up with the variety of statutes, rules, and

regulations that affect the conduct of business in the United States. This problem only gets worse with laws that concern doing business on a global scale. It is possible to break a law without knowing that a law has been broken.

The general standard for compliance with the law is “good faith,” but at any time, an issue may arise that can only be resolved with special expertise. When your business’s reputation and profits are on the line, there is no substitute for the right advice.

How Can You Find an Attorney?

To choose an attorney for an issue that affects your employer’s business, first

ask for your employer’s recommendations. There may be an advocate who works for your organization or with whom your employer consults on a regular basis.

To find an attorney for a question that concerns your own business, obtain the recommendations of your friends, relatives, or business associates. Ask for endorsements from those who have had long-standing relationships with their attorneys.

Other sources of referrals include your local or state bar association and online directories.



CHAPTER SUMMARY—INTRODUCTION TO THE LAW

LEARNING OUTCOME 1: Define *law*.

Law consists of enforceable rules governing relationships among individuals and between individuals and their society.

LEARNING OUTCOME 2: List the major sources of law.

The common law consists of past judicial decisions. According to the doctrine of *stare decisis*, these decisions are applied to resolve current disputes.

Constitutional law is the law expressed in the U.S. Constitution and the various state constitutions. Statutory law consists of laws or ordinances created by federal, state, or local legislatures and governing bodies.

LEARNING OUTCOME 3: Identify the supreme law of the land.

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 violate the U.S. Constitution or a federal law. No federal, state, or local statute or ordinance can violate the U.S. Constitution or the relevant state constitution.

LEARNING OUTCOME 4: Distinguish different legal systems.

The common law system involves the practice of deciding new cases with reference to previous decisions, or precedents. A judge is obligated to follow the precedents established within her or his jurisdiction.

The civil law system is a legal system in which the primary source of law is a statutory code—a set of legal principles enacted into law by a legislature or governing body. Precedents are not binding in a civil law system.



ISSUE SPOTTERS

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

- Under what circumstances might a judge rely on case law to determine the intent and purpose of a statute? (See *Sources of American Law*.)
- The First Amendment of the U.S. Constitution protects the free exercise of religion. A state legislature enacts a law that outlaws all religions that do not derive from the Judeo-Christian tradition. Is this state law valid? Why or why not? (See *Sources of American Law*.)



STRAIGHT TO THE POINT

- Why is knowledge of business law essential for any businessperson? (See *Business Activities and the Legal Environment*.)
- What is the common law? (See *Sources of American Law*.)
- When and why does a court apply the decision of another court to determine the result in a case? (See *Sources of American Law*.)
- What are some of the remedies that a party can obtain from a court to make a wrong situation right? (See *Sources of American Law*.)
- Which aspects of a business's operation do the rules, orders, and decisions of administrative agencies affect? (See *Sources of American Law*.)



REAL LAW

1-1. Stare Decisis. A patent is an exclusive right granted to the creator of an invention. Under U.S. law, a patent owner possesses that right for twenty years. The owner can allow another party to make and market a product based on the invention in exchange for a payment of royalties on the sales. According to the United States Supreme Court in a case known as the *Brulotte* decision, a contract to pay royalties after a patent has expired is unenforceable. Stephen Kimble owned the patent to a toy glove that could shoot foam intended to look like the web of Marvel Comics' Spider-Man. Kimble agreed to allow Marvel Entertainment, LLC, to sell its version of the toy. Marvel agreed to pay Kimble a royalty of 3 percent on the sales. Their contract did not specify an end date. After the patent expired, Marvel sued to stop the payments. What is the doctrine of *stare decisis*? What are the arguments for and against applying it in this case? Discuss. [*Kimble v. Marvel Entertainment, LLC*, 135 S.Ct. 2401, 192 L.Ed.2d 463 (2015)] (See *Sources of American Law*.)

1-2. Role of Law. Otto May, Jr., a pipefitter for Chrysler Group, LLC, was the target of racist, homophobic, and

anti-Semitic remarks. He received death threats, his bike and car tires were punctured, and someone poured sugar into the gas tank of his car. A dead bird was placed at his workstation wrapped in toilet paper to look like a member of the Ku Klux Klan. Chrysler documented and investigated the incidents. Records were checked to determine who was in the building when the incidents occurred, the graffiti handwriting was examined, and employees were reminded that harassment was not acceptable. What role might the law play in these circumstances? Discuss. [*May v. Chrysler Group, LLC*, 716 F.3d 963 (7th Cir. 2013)] (See *Business Activities and the Legal Environment*.)

1-3. Constitutional Law. Under a Massachusetts statute, large wineries could sell their products through wholesalers or to consumers directly, but not both. Small wineries could use both methods. Family Winemakers of California filed a suit against the state, arguing that this restriction gave small wineries a competitive advantage in violation of the U.S. Constitution. Which source of law takes priority, and why? [*Family Winemakers of California v. Jenkins*, 592 F.3d 1 (1st Cir. 2010)] (See *Sources of American Law*.)



ETHICAL QUESTIONS

1-4. Anticipation of Legal Problems. Should legal problems be anticipated? Why and why not? (See *Business Activities and the Legal Environment*.)

1-5. The Doctrine of Precedent. Sandra White operated a travel agency. To obtain lower airline fares for her nonmilitary clients, she booked military-rate travel by forwarding fake military identification cards to the airlines. The U.S. government charged White with identity theft, which requires the "use" of another's identification. As background, the court in the *White* case had two cases that represented precedents.

In the first case, David Miller obtained a loan to buy land by representing that certain investors had approved the loan when, in fact, they had not. Miller's conviction for identity

theft was overturned because he had merely *said* that the investors had done something when they had not. According to the court, this was not the "use" of another's identification.

In the second case, Kathy Medlock, an ambulance service operator, had transported patients for whom there was no medical necessity to do so. To obtain payment, Medlock had forged a physician's signature. The court concluded that this was "use" of another person's identity. Which precedent—the *Miller* case or the *Medlock* case—is similar to White's situation, and why? How would you describe the parties' ethics in all of these cases? Discuss. [*United States of America v. Sandra Maxine White*, 846 F.3d 170 (6th Cir. 2017)] (See *Sources of American Law*.)

Chapter 1—Work Set



TRUE-FALSE QUESTIONS

- _____ 1. Law consists of enforceable rules governing relationships among individuals and between individuals and their society.
- _____ 2. *Stare decisis* refers to the practice of deciding new cases with reference to previous decisions.
- _____ 3. The doctrine of *stare decisis* illustrates how unpredictable the law can be.
- _____ 4. *Common law* is a term that normally refers to the body of law consisting of rules of law announced in court decisions.
- _____ 5. Statutes are a primary source of law.
- _____ 6. Administrative rules and regulations have virtually no effect on the operation of a business.
- _____ 7. Each state's constitution is supreme within that state's borders even if it conflicts with the U.S. Constitution.
- _____ 8. The Uniform Commercial Code was enacted by Congress for adoption by the states.
- _____ 9. In most states, the same courts can grant both legal and equitable remedies.



MULTIPLE-CHOICE QUESTIONS

- _____ 1. The doctrine of *stare decisis* performs many useful functions, including
 - a. efficiency.
 - b. uniformity.
 - c. stability.
 - d. all of the above.
- _____ 2. In addition to case law, when making decisions, courts sometimes consider other sources of law, including
 - a. the U.S. Constitution.
 - b. state constitutions.
 - c. administrative agency rules and regulations.
 - d. all of the above.
- _____ 3. Which of the following is a CORRECT statement about the distinction between law and equity?
 - a. Equity involves remedies different from those available at law.
 - b. Most states maintain separate courts of law and equity.
 - c. Damages may be awarded only in actions in equity.
 - d. None of the above.
- _____ 4. Under the doctrine of *stare decisis*, a judge compares the facts in a case with facts in
 - a. another case.
 - b. a hypothetical case.
 - c. the arguments of the parties involved in the case.
 - d. none of the above.
- _____ 5. To learn about the coverage of a statute and how the statute is applied, a person must
 - a. only read the statute.
 - b. only see how courts in his or her jurisdiction have interpreted the statute.
 - c. read the statute and see how courts in his or her jurisdiction have interpreted it.
 - d. none of the above.

- _____ 6. Our common law system involves the application of legal principles applied in earlier cases
- with different facts.
 - with similar facts.
 - whether or not the facts are similar.
 - none of the above.
- _____ 7. The statutory law of the United States includes
- the statutes enacted by Congress and state legislatures.
 - the rules, orders, and decisions of administrative agencies.
 - both the statutes enacted by Congress and state legislatures and the rules, orders, and decisions of administrative agencies.
 - none of the above.
- _____ 8. The U.S. Constitution takes precedence over
- a provision in a state constitution or statute only.
 - a state supreme court decision only.
 - a state constitution, statute, or court decision.
 - none of the above.
- _____ 9. Civil law concerns
- duties that exist between persons or between citizens and governments.
 - wrongs committed against the public as a whole.
 - both a and b.
 - none of the above.
- _____ 10. In a civil law system, the primary source of law is
- case law.
 - the decisions of administrative agencies.
 - a statutory code.
 - none of the above.



ANSWERING MORE LEGAL PROBLEMS

1. Dark Brew and Sparkling Ale are competitors in the microbrewing industry. To market their competing wares, they use Facebook, Twitter, and other social media. A dispute arises between these parties over the statements each makes about the other through these sites. Dark Brew files a suit against Sparkling Ale. The parties argue their respective sides of the dispute, each citing earlier cases that appear to favor their contentions. Each party asks the court to consider the principles of law established in these cases to make a decision in this case.

What is the term for these former decisions? Which decisions, if any, is the court obligated to follow? The earlier cases are known as _____. Later cases that involve similar principles or facts are decided with reference to those _____. Courts are obligated to follow the _____ established within their _____. The doctrine attempts

to harmonize the results in cases with _____. In other words, the objective is to decide similar cases in a similar way.

2. In Dark Brew and Sparkling Ale's case, the court follows a doctrine that requires it to review the rules of law established by other courts.

What is the term for the doctrine under which a court reviews the principles suggested by the decisions of other courts in earlier cases? What are the advantages of this practice? The practice of deciding new cases by referring to earlier court decisions is known as the doctrine of _____. This practice is a _____ of the U.S. judicial system. The reasoning in the other courts' opinions can serve as a guide, allowing a court reviewing the cases to be more _____. When the law on a subject is well settled, the application of this doctrine makes the law more _____.

2 Ethics in Business



Conflict Presented

BMI Food Company makes Chuck Wagon, a plastic-wrapped meal, for children. Chuck Wagon meals consist of food such as bologna, chips, candy, and soda. These combinations provide an unhealthful mix of fat, sugar, and salt. BMI sells Chuck Wagon by sponsoring television shows directed at children.

Q Is BMI's making and marketing of Chuck Wagon unethical?

LEARNING OUTCOMES

The four Learning Outcomes below are designed to help improve your understanding of the chapter. After reading this chapter, you should be able to:

- 1 Discuss how businesses can discourage unethical behavior.
- 2 Explain the relationship between law and ethics.
- 3 Compare duty-based ethics and utilitarian ethics.
- 4 Identify some ethical problems in the global context.

One of the most complex issues that businesspersons and corporations face is ethics. Ethics is not as well defined as the law, and yet it can have a tremendous impact on a firm's finances and reputation. Consider what happened to Wells Fargo Bank when it imposed sales quotas on employees requiring them to unrealistically open at least ten new accounts a day. Bank managers companywide berated and threatened employees, who were told to do whatever it took to reach these quotas. As a result, many employees resorted to opening more than 2 million "new" accounts by transferring funds from customers' existing accounts *without their consent*. These unauthorized accounts incurred an estimated \$2.5 million in bank fees.

Once this systematic unethical practice was uncovered in 2016, Wells Fargo fired thousands of employees and paid \$185 million in fines. Despite this fall-out, the scandal will continue to affect Wells Fargo's reputation and its bottom line for years to come.

Wells Fargo's conduct has raised several legal questions, but it clearly also raises questions about ethics in business. Business ethics cannot be taken lightly. This chapter examines its definitions, its philosophical bases, and its application to today's global business situations.



2-1 The Importance of Business Ethics

Ethics can be defined as the study of what constitutes right or wrong behavior. It is the branch of philosophy that focuses on morality and the way in which moral principles are derived or the way in which a given set of moral principles applies to conduct in daily life.

Ethics has to do with questions relating to the fairness, justness, rightness, or wrongness of an action. What is fair? What is just? What is the right thing to do in this situation? These are essentially ethical questions.

ethics

A set of moral principles and values applied to social behavior.

business ethics

A consensus of what constitutes right or wrong behavior in the world of business.

2–1a What Is Business Ethics?

Business ethics focuses on what constitutes right or wrong behavior in the business world. It has to do with how moral and ethical principles are applied by businesspersons to situations that arise in their daily activities in the workplace. Business ethics is not a separate *kind* of ethics. The ethical standards that guide our behavior as students apply equally well to our activities as businesspersons.

2–1b Why Is Business Ethics Important?

Making ethical business decisions is vitally important to the long-run viability of a corporation. A thorough knowledge of business ethics is also important to the well-being of the company's management and employees. Certainly, corporate decisions and activities can also significantly affect such groups as suppliers, the community, and society as a whole.



2–2 Setting the Right Ethical Tone

LEARNING OUTCOME 1

Discuss how businesses can discourage unethical behavior.

Many unethical business decisions are made simply because they *can* be made. In other words, the decision makers have the opportunity to make such decisions and are not too concerned about being seriously sanctioned for their unethical actions. Perhaps one of the most difficult challenges for business leaders today is to create the right “ethical tone” in their workplaces.

2–2a The Importance of Ethical Leadership

Talking about ethical business decision making means nothing if management does not set standards. Moreover, managers must apply those standards to themselves and to the employees of the company.

One of the most important factors in creating and maintaining an ethical workplace is the attitude of top management. Managers who are not totally committed to maintaining an ethical workplace will rarely succeed in creating one. Employees take their cues from management. If a firm's managers do not violate obvious ethical norms in their business dealings, employees will be likely to follow that example.

In contrast, if managers act unethically, employees will see no reason not to do so themselves. **EXAMPLE 2.1** Janice works at Granite Software. If Janice observes her manager cheating on his expense account, Janice quickly understands that such behavior is acceptable. ■

2–2b Ethical Codes of Conduct

One of the most effective ways of setting the tone of ethical behavior within an organization is to create an ethical code of conduct. A well-written code of ethics explicitly states a company's ethical priorities. Its provisions must be clearly communicated to employees.

Most large companies and organizations have implemented ethics training programs, seminars, and face-to-face meetings to communicate the importance of ethical conduct to employees. Managers find that applying clear codes of ethics can deter unethical behavior in the workplace, as well as other settings, including university campuses.

Real Case

Case Western Reserve University requires its students to meet a standard of professionalism, which includes “ethical behavior.” A Committee on Students determines whether a student meets this requirement. Amir Al-Dabagh was a good student academically, but there had been several complaints about his behavior. The complaints included his sexually harassing fellow students, asking instructors not to mark him late, and being convicted of driving while intoxicated. The committee refused to certify Al-Dabagh for graduation and dismissed him from the university. Al-Dabagh filed a lawsuit in a federal district court against Case Western, alleging a breach of good faith and fair dealing. The court ordered the school to issue a diploma. Case Western appealed.

Should the court defer to the university’s determination that its student lacked the professionalism required to graduate? Yes. In *Al-Dabagh v. Case Western Reserve University*, the U.S. Court of Appeals for the Sixth Circuit reversed the lower court’s order. The committee’s finding that Al-Dabagh lacked professionalism and its refusal to approve him for graduation were academic judgments. The appellate court would overturn such a decision only if Case Western had substantially departed from accepted academic norms. This did not occur and Case Western did not deal unfairly with Al-Dabagh.

—777 F.3d 355 (6th Cir. Ohio)



2–2c Corporate Compliance Programs

In large corporations, ethical codes of conduct are usually just one part of a comprehensive corporate compliance program. Other components of such a program include a corporation’s ethics committee, ethical training programs, and internal audits to monitor compliance with applicable laws and the company’s standards of ethical conduct.

To be effective, especially in large corporations, a compliance program must be integrated throughout the firm. Ethical policies and programs need to be coordinated and monitored by a committee that is separate from other corporate departments. Otherwise, unethical behavior in one department could easily escape the attention of those in control of the business.

2–2d Conflicts and Trade-offs

Firms have implied ethical (and legal) duties to a number of groups, including shareholders and employees. Because these duties may conflict, management is constantly faced with ethical trade-offs.

Highlighting the Point

Mooseback Outfitters, Inc., a national retailer of outdoor gear and apparel, decides to reduce costs by downsizing and restructuring its business model. While this decision may benefit the company’s stockholders, it will have a direct impact on those employees who are laid off. Mooseback’s president suggests laying off the most senior employees, while other managers recommend making the cuts in jobs with younger employees. It is not illegal to fire senior employees, but ethical issues arise when making such decisions.



(Continues)

Which group of employees should Mooseback management downsize first? The answer depends on how management weighs the trade-offs involved. If the company lays off the most senior employees, it can cut costs more quickly because they earn higher salaries. The trade-off in keeping these employees is their loyalty and experience, which could help the company adjust to the downsizing more easily. A negative trade-off is that Mooseback would have to lay off twice as many of the younger employees to make up the dollar difference in salaries because they do not earn as much. By downsizing the younger employees, Mooseback also loses most of its expertise in new product technology and online sales strategies.



2–3 The Sarbanes-Oxley Act

Congress enacted the Sarbanes-Oxley Act to help reduce corporate fraud and unethical management decisions. Among other things, the act calls for a greater degree of government oversight of public accounting practices.

2–3a The Public Company Accounting Oversight Board

To this end, the act created the Public Company Accounting Oversight Board. Generally, the duties of the board are as follows:

1. To oversee the audit of companies, or issuers, whose securities are sold to public investors in order to protect the interests of investors and the public.
2. To register public accounting firms that prepare audit reports for issuers.

The board also establishes standards relating to the preparation of audit reports for issuers.

2–3b Enforcement and Penalties

To enforce compliance, the board can inspect registered public accounting firms, investigate firms that violate the act, and discipline those firms by imposing sanctions. Sanctions range from temporary or permanent suspension to civil penalties that can be as high as \$15 million for intentional violations.

The Sarbanes-Oxley Act prohibits destroying or falsifying records with the intent to obstruct or influence a federal investigation or in relation to bankruptcy proceedings. Violation of this provision can result in a fine, imprisonment for up to twenty years, or both.



2–4 Business Ethics and the Law

moral minimum

The minimum degree of ethical behavior expected of a firm.

Today, legal compliance is regarded as a **moral minimum**—the minimum acceptable standard for ethical business behavior. Simply obeying the law does not fulfill all business ethics obligations, however. In the interests of preserving personal freedom, as well as for practical reasons, the law does not—and cannot—codify all ethical requirements. No law says, for instance, that it is illegal to tell a lie, but it may be unethical to do so.

In contrast, it may seem that answering a question concerning the legality of a given action should be simple. Either something is legal or it is not. In fact, one of the major challenges businesspersons face is that the legality of a particular action is not always clear. In part, this is because there are so many laws regulating business that it is possible to violate one of them without realizing it.

LEARNING OUTCOME 2

Explain the relationship between law and ethics.

2–4a Laws Regulating Business

Today's business firms are subject to extensive government regulation. Nearly every action a firm undertakes—from going into business, to hiring and firing personnel, to selling products in the marketplace—is subject to statutory law as well as regulations issued by administrative agencies.

Determining whether a planned action is legal thus requires that decision makers keep abreast of the law. Ignorance of the law will not excuse a business owner or manager from liability for violating a statute or regulation. Normally, large business firms have attorneys on their staffs to assist them in making key decisions. Small firms must also seek legal advice before making important business decisions because the consequences of just one violation may be costly.

2–4b “Gray Areas” in the Law

In many situations, business firms can predict with a fair amount of certainty whether a given action would be legal. In some situations, though, the legality of a particular action may be less clear. These “gray areas” in the law make it difficult to predict with certainty how a court may apply a given law to a particular action.

Uncertainties concerning how particular laws may apply to specific factual situations have been compounded in the cyber age. The widespread use of the Internet has given rise to legal and ethical questions in circumstances that never existed before.

In short, business decision makers need to proceed with caution and evaluate an action and its consequences from an ethical perspective. Generally, if a company can demonstrate that it acted in good faith and responsibly in the circumstances, it has a better chance of successfully defending its action.

Highlighting the Point

Airway Airlines makes an online forum available to its pilots so that they can exchange ideas and information. Some Airway pilots publish on the forum a series of harassing, gender-based, false messages about Beth Jones, one of Airway's female pilots.

Could Airway be liable to Jones for any harm caused by these messages? Yes. An online forum can be considered similar to a company bulletin board, which is part of a workplace. If Airway knows about the messages and does nothing to stop them, the airline can be perceived as sending Jones the statement that the harassment is acceptable. If the airline does not know about the postings or if it does attempt to stop them, however, it can argue that it is acting in good faith.



2–5 Approaches to Ethical Reasoning

Each individual, when faced with an ethical dilemma, engages in ethical reasoning. In this process, the individual links his or her moral convictions or ethical standards to the particular situation at hand. Businesspersons do likewise when making decisions with ethical implications.

Ethical reasoning relating to business traditionally has been characterized by two fundamental approaches. One approach defines ethical behavior in terms of duty, which also implies certain rights. The other approach determines what is ethical in terms of the consequences, or outcomes, of any given action.

LEARNING OUTCOME 3

Compare duty-based ethics and utilitarian ethics.

2–5a Duty-Based Ethics

Duty-based ethical standards often are derived from revealed truths, such as religious precepts. They can also be derived through philosophical reasoning.

Religion In the Judeo-Christian tradition, which is the dominant religious tradition in the United States, the Ten Commandments of the Old Testament establish fundamental rules for moral action. Other religions have their own sources of revealed truth. Religious rules generally are absolute with respect to the behavior of their adherents.

For instance, the commandment “Thou shalt not steal” is an absolute mandate for a person who believes that the Ten Commandments reflect revealed truth. Even a benevolent motive for stealing (such as Robin Hood’s) cannot justify the act, because the act itself is inherently immoral and thus wrong.

Ethical standards based on religious teachings also involve an element of *compassion*. **EXAMPLE 2.2** It might be profitable for Sun Valley Farms to lay off Lee, who is a less productive employee. Lee would find it difficult to get employment elsewhere and his family would suffer as a result, however. This potential suffering would be given substantial weight by decision makers whose ethical standards were based on religion. ■ Compassionate treatment of others is also mandated by the Golden Rule—Do unto others as you would have done unto you—which has been adopted by most religions.

Philosophy Duty-based ethical standards may also be derived solely from philosophical reasoning. The German philosopher Immanuel Kant (1724–1804), for instance, identified principles for moral behavior based on what he believed to be the fundamental nature of human beings.

Kant held that it is rational to assume that human beings are qualitatively different from other physical objects in our world. Persons are endowed with moral integrity and the capacity to reason and conduct their affairs rationally. Therefore, their thoughts and actions should be respected. When human beings are treated merely as a means to an end, they are being regarded as the equivalent of objects and are being denied their basic humanity.

Kant believed that individuals should evaluate their actions in light of the consequences that would follow if *everyone* in society acted in the same way. This **categorical imperative** can be applied to any action. **EXAMPLE 2.3** Julie is deciding whether to cheat on an examination. If she adopts Kant’s categorical imperative, she will decide not to cheat, because if everyone cheated, the examination would be meaningless. ■

categorical imperative

An evaluation based on the effect if everyone acted in the same way.

The Principle of Rights Another view of duty-based ethics focuses on basic rights. The principle that human beings have fundamental rights, such as the rights to life, freedom, and the pursuit of happiness, is embedded in Western culture.

Those who adhere to this **principle of rights** believe that a key factor in determining whether a business decision is ethical is how that decision affects the rights of others. These others include the firm’s owners, its employees, its customers, its suppliers, the community in which it does business, and society as a whole.

In general, rights theorists believe that the right with the highest value in a particular circumstance takes precedence. **EXAMPLE 2.4** Murray Chemical has to decide whether to keep its Utah plant open—thereby saving the jobs of one hundred workers—or shut it down. Closing the plant will avoid contaminating a nearby river with pollutants that could endanger the health of tens of thousands of people. A rights theorist could easily choose which group to favor because the value of the right to health and well-being is obviously stronger than the basic right to work. ■

principle of rights

The principle that human beings have certain fundamental rights.

2–5b Outcome-Based Ethics: Utilitarianism

Utilitarianism is a philosophical theory developed by Jeremy Bentham (1748–1832) and modified by John Stuart Mill (1806–1873)—both British philosophers. In contrast to duty-based ethics, utilitarianism is outcome oriented. It focuses on the consequences of an action, not on the nature of the action itself or on a set of moral values or religious beliefs.

Those who apply utilitarian ethics believe that an action is morally correct when it produces the greatest amount of good for the greatest number. When an action affects the majority adversely, it is morally wrong. Applying the utilitarian theory requires three steps:

1. A determination of which individuals will be affected by the action in question.
2. A **cost-benefit analysis**—an assessment of the negative and positive effects of alternative actions on these individuals.
3. A choice among alternative actions that will produce the greatest positive benefits for the greatest number of individuals.

utilitarianism

An evaluation of an action based on its “good” consequences.

cost-benefit analysis

Weighing the costs of a given action against the benefits.

Highlighting the Point

International Foods Corporation (IFC) markets baby formula in developing countries. IFC learns that mothers in those countries often mix the formula with impure water, to make the formula go further. As a result, babies are suffering from malnutrition, diarrhea, and in some instances, even death.

Is IFC in violation of the law? No. **What is IFC’s ethical responsibility in this situation?**

If IFC’s decision makers feel that they have an absolute duty not to harm others, then their response will be to withdraw the product from those markets.

If they approach the problem from a utilitarian perspective, they will engage in a cost-benefit analysis. The cost of the action (the suffering and death of babies) will be weighed against its benefit (the availability of the formula to mothers).

Having the formula available frees mothers from the task of breastfeeding and thus allows them to work to help raise their incomes and standards of living. The question in a utilitarian analysis focuses on whether the benefit outweighs the cost.



2–5c Corporate Social Responsibility

Groups concerned with employee safety, consumer protection, environmental preservation, and other causes often pressure corporations to behave responsibly with respect to these causes. That corporations have such an obligation is the concept of **corporate social responsibility**. (See this chapter’s *Linking Business Law to Your Career* feature for more details on this topic.)

The Stakeholder Approach One view of corporate social responsibility stresses that corporations have a duty not just to shareholders but also to other groups affected by corporate decisions called stakeholders. These groups include employees, customers, creditors, suppliers, and the community. Sometimes, one of these groups may have a greater stake in a company decision than shareholders do.

EXAMPLE 2.5 To reduce labor costs without laying off its employees, Ellis, Inc., implements four-day workweeks, unpaid vacations and voluntary wage freezes, and flexible work schedules. These options can be in the best interests of many of Ellis’s stakeholders, including its employees and the community in which it does business. ■

corporate social responsibility

The idea that corporations should act ethically and be accountable for their actions.

Corporate Citizenship Another theory of social responsibility argues that corporations should promote goals that society deems worthwhile and take steps toward solving

social problems. The idea is that business controls so much of a country's wealth and power that it should use that wealth and power in socially beneficial ways.

EXAMPLE 2.6 The Hitachi Group releases an Annual Corporate Social Responsibility Report that outlines its environmental strategy (including its attempts to reduce carbon dioxide emissions). The report also discusses its commitment to human rights awareness. ■

A Way of Doing Business Corporate social responsibility attains its maximum effectiveness if it is treated as a way of doing business rather than as a special program. The most successful activities are relevant and significant to the corporation's stakeholders.

EXAMPLE 2.7 Derek Industries is one of the world's largest diversified metals and mining companies. As a part of its business decision making, it invested more than \$150 million in social projects involving health care, infrastructure, and education around the world. At the same time, it invested more than \$300 million in environmental projects, including the rehabilitation of native species in the Amazon River Valley. ■



2-6 Business Ethics and Social Media

Today, social media affect many areas of daily life, including the business world. As a result, businesses now face unique ethical issues with respect to all social media platforms. In particular, social media raise ethical questions in business hiring decisions.

To gain better insight into a job candidate, managers ask for professional references from former employers, as well as character references from others who know the candidate. Employers are likely to also conduct Internet searches to discover more about job candidates. Often, an online search can lead managers to several links regarding a candidate. With relative ease, managers can often view the prospective candidate's postings, photos, videos, blogs, and tweets.

In addition, some employers may decide that a candidate with no social media presence is behind the times and is not a good employee choice. Some would consider this type of employer behavior to be unethical as well.

Highlighting the Point



Penny applies for a sales clerk position at Fair City Market, a convenience store in rural Wyoming. Craig, Fair City's owner, interviews Penny and is seriously considering her for the position. After the interview, Craig does an online search on Penny. The search results reveal that Penny is politically active in an effort to ban off-road vehicles in local wilderness areas. Craig is an off-road enthusiast.

Should Craig consider Penny's activism when deciding to hire her? No. Many people believe that judging a job candidate based on what she or he does outside of the workplace is unethical. Penny's personal opinions and activities should not factor into Craig's hiring decision.



2-7 Business Ethics on a Global Level

Frequent conflicts in ethics arise between foreign and U.S. businesspersons. In certain countries, the consumption of alcohol and specific foods is forbidden for religious reasons. Under such circumstances, it would be thoughtless and imprudent for a visiting U.S. businessperson to invite a local business contact out for a drink.

The role played by women in other countries also may present some difficult ethical problems for firms doing business internationally. Equal employment opportunity is a fundamental public policy in the United States, and Title VII of the Civil Rights Act of 1964 prohibits discrimination against women in the employment context. Some other countries, however, offer little protection for women against gender discrimination in the workplace, including sexual harassment.

LEARNING OUTCOME 4

Identify some ethical problems in the global context.

2–7a Monitoring the Practices of Foreign Suppliers

Many U.S. businesses contract with companies in developing nations to produce goods, because the wage rates are significantly lower than in the United States. Yet what if a foreign company exploits its workers—by hiring women and children at below-minimum-wage? What if the company’s workplace is full of health hazards? What if the company’s supervisors routinely engage in workplace conduct that is offensive to women?

Given today’s global communications network, few companies can assume that their actions in other nations will go unnoticed by “corporate watch” groups that publicize unethical corporate behavior. As a result, U.S. businesses take steps to avoid such adverse publicity. They may refuse to deal with certain suppliers or arrange to monitor their suppliers’ workplaces to make sure that the workers are not being mistreated.

2–7b The Foreign Corrupt Practices Act

Another ethical problem in international business dealings has to do with the legitimacy of certain side payments to government officials. In the United States, most contracts are formed within the private sector. In many foreign countries, however, decisions on major construction and manufacturing contracts are made by government officials who control local trade and industry.

Side payments (bribes) to government officials in exchange for favorable business contracts are not unusual in such countries, nor are they considered unethical. U.S. companies, however, are prohibited from making such payments to foreign officials by the Foreign Corrupt Practices Act (FCPA).

Bribery of Foreign Officials The first part of the FCPA applies to all U.S. companies and their directors, officers, shareholders, employees, and agents. This part prohibits payments intended to get a foreign official to act in his or her official capacity to provide business opportunities.

The FCPA does not prohibit payments made to minor officials whose duties are ministerial. (A ministerial action is a routine activity, such as the processing of paperwork with little or no discretion involved in the action.) These payments are often referred to as “grease,” or facilitating payments. They are meant to speed up administrative services that might otherwise be performed at a slow pace. The act also does not prohibit payments to private foreign parties unless the U.S. firm knows that the payments will be passed on in violation of the FCPA.

Highlighting the Point

Joan Anderson, who is a representative for American Exports, Inc., makes a payment on American’s behalf to a minor official in Nigeria to speed up an import licensing process.

Has either Anderson or her firm violated the Foreign Corrupt Practices Act? No, if the payment does not violate Nigerian law. Generally, the Foreign Corrupt Practices Act permits “grease” payments to foreign officials if such payments are lawful within the foreign country.



Accounting Requirements The second part of the FCPA is directed toward accountants, because in the past bribes were often concealed in corporate financial records. All companies must keep detailed records that “accurately and fairly” reflect their financial activities.

In addition, their accounting systems must provide “reasonable assurance” that all transactions entered into by the companies are accounted for and legal. These requirements assist in detecting illegal bribes. The FCPA prohibits any person from making false statements to accountants or false entries in any record or account.



Conflict Resolved

In the *Conflict Presented* feature at the beginning of this chapter, BMI Food Company makes Chuck Wagon, a plastic-wrapped meal, for children. Chuck Wagon meals consist of foods that provide an unhealthful mix of fat, sugar, and salt. BMI sells Chuck Wagon through advertising directed at children.

A **Is BMI’s making and marketing of Chuck Wagon unethical?** Yes. Consumers generally prefer the taste of fat, sugar, and salt. Consequently, many food products are processed to contain a tasty, but unhealthful mix of these three. Adults can decide for themselves what to eat. But children may be especially susceptible to advertising. BMI has an ethical obligation to its targeted audience—children—to make and market its products responsibly.

Linking Business Law to Your Career



MANAGING A COMPANY’S REPUTATION

Accounting is typically associated with developing balance sheets and profit-and-loss statements, but it can also provide information that helps managers do their jobs. The provision of accounting information for a company’s internal use, called *managerial accounting*, helps in planning and decision making.

Managerial accountants also use their skills to manage corporate reputations. More than 2,500 multinational companies now release large quantities of accounting information to the public.

Internal Reports Designed for External Scrutiny

Some large companies refer to the managerial accounting information that they

release to the public as corporate sustainability reports. Dow Chemical Company, for example, issues a sustainability report annually.

Other corporations call their published documents social responsibility reports. Symantec Corporation issues corporate responsibility reports to demonstrate its focus on environmental, social, and governance issues.

Why Use Managerial Accounting to Manage Reputations?

We live in an age of information. Such sources as cable and online news networks, social media, and smartphones guarantee that any news, positive or negative, will be known throughout

the world almost immediately after it happens.

Consequently, corporations want to manage their reputations by preparing and releasing company news themselves. In a world in which corporations are often blamed for anything bad that happens, managerial accounting information can be a useful counterweight.

To this end, some corporations have combined their social responsibility reports with their traditional financial accounting information. When a corporation’s reputation is on the line, its future is at stake.



CHAPTER SUMMARY—ETHICS IN BUSINESS

LEARNING OUTCOME 1: Discuss how businesses can discourage unethical behavior.

Managers must set and apply ethical standards to which they are committed. Employees will likely follow their example. Components of a comprehensive corporate compliance program include an ethical code of conduct, an ethics committee, training programs, and internal audits to monitor compliance. These components should be integrated throughout the firm. In making ethical trade-offs, a firm's management must consider which of the firm's constituent groups has a greater stake in the decision to be made.

LEARNING OUTCOME 2: Explain the relationship between law and ethics.

The minimum acceptable standard for ethical business behavior is compliance with the law. The law has its limits, though, and some actions may be legal, yet not ethical.

LEARNING OUTCOME 3: Compare duty-based ethics and utilitarian ethics.

Duty-based ethical standards are based on religious precepts or derived through philosophical reasoning. Duty-based standards imply that human beings have basic rights. A key factor in determining whether a business decision is ethical is how it affects these rights.

Utilitarian ethics are outcome oriented, focusing on the consequences of an action. Under this standard, an action is "right" when it produces the greatest amount of good for the greatest number of people.

LEARNING OUTCOME 4: Identify some ethical problems in the global context.

Ethical conflicts between foreign and U.S. businesses may arise because of inherent differences between nations. Notable differences relate to workplace conditions and the practice of giving side payments to foreign officials to secure favorable contracts.



ISSUE SPOTTERS

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

1. Mac Tools, Inc., markets a product that under some circumstances is capable of seriously injuring consumers. Does Mac have an ethical duty to remove this product from the market, even if the injuries result only from misuse? (See *Approaches to Ethical Reasoning*.)
2. Acme Corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees. Does this raise an ethical conflict among Acme's employees? Between Acme and its employees? Between Acme and its shareholders? (See *Approaches to Ethical Reasoning*.)



STRAIGHT TO THE POINT

1. Why is the study of business ethics important? (See *The Importance of Business Ethics*.)
2. How can businesspersons encourage ethical conduct in their workplaces? (See *Setting the Right Ethical Tone*.)
3. How does the Sarbanes-Oxley Act help to prevent unethical management decisions? (See *The Sarbanes-Oxley Act*.)
4. How should business decision makers proceed when the legality of a particular action is not clear? (See *Business Ethics and the Law*.)
5. What are the two fundamental approaches by which ethical business reasoning has traditionally been characterized? (See *Approaches to Ethical Reasoning*.)
6. What is the concept of corporate social responsibility? (See *Approaches to Ethical Reasoning*.)
7. How might social media raise ethical questions with respect to business hiring decisions? (See *Business Ethics and Social Media*.)



REAL LAW

2-1. Business Ethics. Priscilla Dickman worked as a medical technologist at the University of Connecticut Health Center. Dickman's supervisor received complaints she was getting personal phone calls and was frequently absent from her work area. Based on e-mails and other documents found on her work computer, the state investigated her for violations of state law. She was convicted of conducting "personal business for financial gain on state time utilizing state resources." Separate investigations resulted in convictions for forgery and the filing of an unrelated fraudulent insurance claim. Dickman "retired" from her job and filed a claim with the state of Connecticut against the health center, alleging that her former employer had initiated the investigations to harass her and force her to quit. For lack of "credible evidence or legal support," Dickman's claim was dismissed. Were any of Dickman's actions unethical? If so, identify the actions, and explain why they were unethical. [*Dickman v. University of Connecticut Health Center*, 162 Conn.App. 441, 132 A.3d 739 (2016)] (See *The Importance of Business Ethics*.)

2-2. Business Ethics. Stephen Glass made himself infamous as a dishonest journalist by fabricating material for more than forty articles for *The New Republic* and

other publications. At the time, he was a law student at Georgetown University. Once suspicions were aroused, Glass tried to avoid detection. Later, Glass applied for admission to the California bar. The California Supreme Court denied his application, citing "numerous instances of dishonesty" during his "rehabilitation" following the exposure of his misdeeds. How do these circumstances underscore the importance of ethics? [*In re Glass*, 58 Cal.4th 500, 316 P.3d 1199 (2014)] (See *The Importance of Business Ethics*.)

2-3. Business Ethics. Mark Ramun worked as a manager for Allied Erecting and Dismantling Co., where he had a tense relationship with John Ramun, Allied's president and Mark's father. After more than ten years, Mark left Allied, taking 15,000 pages of Allied's documents (trade secrets) with him. Later, he joined Allied's competitor, Genesis Equipment & Manufacturing, Inc. Genesis soon developed a piece of equipment that incorporated design elements of Allied equipment. Who violated business ethics in these circumstances, and how? [*Allied Erecting and Dismantling Co. v. Genesis Equipment & Manufacturing, Inc.*, 2013 WL 85907 (6th Cir. 2013)] (See *The Importance of Business Ethics*.)



ETHICAL QUESTIONS

2-4. Ethical Workplace. What factors help to create an ethical workplace? (See *Setting the Right Ethical Tone*.)

2-5. Ethical Leadership. Mark Clapp and Albert DiBrito worked for the Public Safety Department (PSD) in St. Joseph, Michigan. Clapp was the director, and DiBrito was the deputy director. One day, Clapp told Tom Vaught, a PSD employee, that the previous city manager had only hired DiBrito because DiBrito had been investigating the city manager for possible wrongdoing. Clapp said that DiBrito

had dropped his investigation in exchange for the deputy director position. Richard Lewis, the current city manager, concluded that Clapp's remarks were "inappropriate statements for a commanding officer to make." In the meantime, though, DiBrito made his own "inappropriate statements" about Clapp to other PSD employees. How do a manager's attitudes and actions affect a workplace? What steps do you think Lewis could take to prevent future conflicts? Discuss. [*DiBrito v. City of St. Joseph*, 2017 WL 129033 (6th Cir. 2017)] (See *Setting the Right Ethical Tone*.)

Chapter 2—Work Set



TRUE-FALSE QUESTIONS

- _____ 1. Ethics is the study of what constitutes right and wrong behaviors.
- _____ 2. A background in business ethics is as important as knowledge of specific laws.
- _____ 3. The *minimum* acceptable standard for ethical behavior is compliance with the law.
- _____ 4. According to utilitarianism, it does not matter how many people benefit from an act.
- _____ 5. The best course for accomplishing legal and ethical behaviors is to act responsibly and in good faith.
- _____ 6. The ethics of a particular act is always clear.
- _____ 7. To foster ethical behavior among employees, managers should apply ethical standards to which they are committed.
- _____ 8. If an act is legal, it is ethical.
- _____ 9. Bribery of public officials is strictly an ethical issue.



MULTIPLE-CHOICE QUESTIONS

- _____ 1. Beth is a marketing executive for Consumer Goods Company. Compared with Beth's personal actions, her business actions require the application of ethical standards that are
 - a. more complex.
 - b. simpler.
 - c. the same.
 - d. none of the above.
- _____ 2. Pat, an employee of Quality Products, Inc., takes a duty-based approach to ethics. Pat believes that regardless of the consequences, he must
 - a. avoid unethical behavior.
 - b. conform to society's standards.
 - c. place his employer's interests first.
 - d. produce the greatest good for the most people.
- _____ 3. Joy adopts religious ethical standards. These involve an element of
 - a. compassion.
 - b. cost-benefit analysis.
 - c. discretion.
 - d. utilitarianism.
- _____ 4. Eve, an employee of Fine Sales Company, takes an outcome-based approach to ethics. Eve believes that she must
 - a. avoid unethical behavior.
 - b. conform to society's standards.
 - c. place her employer's interests first.
 - d. produce the greatest good for the most people.
- _____ 5. In a debate, Ed's best criticism of utilitarianism is that it
 - a. encourages unethical behavior.
 - b. fosters conformance with society's standards.
 - c. mandates acting in an employer's best interests.
 - d. results in human costs many persons find unacceptable.

- _____ 6. Acme Services, Inc., represents to Best Production Company that certain services can be performed for a stated fee. This representation would be unethical if Acme knew at the time that
- Acme could not perform the services alone.
 - the actual charge would be substantially higher.
 - the actual charge would be substantially lower.
 - the fee was a competitive bid.
- _____ 7. Tina, the president of United Sales, Inc., tries to ensure that United's actions are legal and ethical. To achieve this result, the best course for Tina and United is to act in
- good faith.
 - ignorance of the law.
 - regard for the firm's shareholders only.
 - their own self-interest.
- _____ 8. Alan, an executive with Beta Corporation, follows the "principle of rights" theory. Under this theory, whether an action is ethical depends on how it affects
- the right determination under a cost-benefit analysis.
 - the right of Alan to maintain his dignity.
 - the right of Beta to make a profit.
 - the rights of others.
- _____ 9. Gamma, Inc., a U.S. corporation, makes a side payment to the minister of commerce of another country for a favorable business contract. In the United States, this payment would be considered
- illegal only.
 - unethical only.
 - illegal and unethical.
 - none of the above.



ANSWERING MORE LEGAL PROBLEMS

1. Carney & Deb, an accounting firm, performs a variety of tasks for its clients, including completing financial statements and tax returns. To accomplish these tasks, Carney & Deb collects personal and financial information from the clients.
2. Carney & Deb can store the personal and financial information of its clients on any electronic device, including an iPhone, a flash drive, and a laptop. When Carney & Deb upgrades its storage media, the information is transferred between devices.

Does Carney & Deb have an ethical obligation to its clients with respect to this information? Ethics is the study of what constitutes right and wrong _____, focusing on morality and the way in which _____ principles are derived or the way in which such principles apply to conduct in daily life. Sometimes, the issues that arise concern fairness, justice, and "the right thing to do." To answer the question of the firm's ethical obligation, you should note that the confidentiality of its clients' sensitive personal and business information is at stake. The accountants have a(n) _____ duty to ensure that reasonable security precautions are taken to preserve this confidentiality and protect this information.

What are the ethical concerns in this situation? **Discuss.** The _____ concerns in this situation relate to fairness, justice, "the right thing to do," personal honesty and integrity, and the duty to maintain the _____ of the clients' information. The accountants need to understand where they are putting the information, assess what the risks are of that location, and consider whether it is appropriate to put the _____ there. For example, putting sensitive information on an unencrypted flash drive would be a bad idea. When the storage media are upgraded, client confidentiality needs to be maintained. Any storage device should be sanitized, or wiped clean, of sensitive data before it is discarded.

3 | The Courts and Our Legal System



Conflict Presented

Rob slips and falls in Tia's Restaurant, and as a result, he hurts his back. Rob then files a claim with Tia's insurer, Secure Insurance Company, to recover damages for this injury. Rob contends that the injury prevents him from working or engaging in any strenuous activity. Secure denies the claim. Rob files a lawsuit against the insurer. As part of the discovery process before trial, Secure asks Rob to supply all of his Twitter and Facebook postings since the accident. Rob objects to this request.

Q Is Secure's request appropriate? Why or why not?

LEARNING OUTCOMES

The five Learning Outcomes below are designed to help improve your understanding of the chapter. After reading this chapter, you should be able to:

- 1 Outline a state court system.
- 2 Define federal court jurisdiction.
- 3 Discuss trial procedure.
- 4 Summarize the steps in a lawsuit.
- 5 Identify alternative methods for resolving disputes.

Every society needs to have an established method for resolving disputes. This is particularly true in the business world. Nearly every businessperson will face a lawsuit at some time in his or her career. For this reason, anyone involved in business needs to have an understanding of court systems in the United States, as well as of other methods of dispute resolution that can be pursued outside the courts.

American law has many sources. They include the cases that form the common law, the federal and state constitutions, and the statutes passed by Congress and the state legislatures. With respect to the common law, the role of the courts is to declare judicial precedents. Courts are also called upon to interpret the language of constitutions and statutes. In all cases, it is the duty of the courts to apply the law—whatever its source—to a given set of facts. Thus, the function of the courts is to interpret and apply the law.

Even though there are fifty-two court systems—one for each of the fifty states, one for the District of Columbia, plus a federal system—similarities abound. Keep in mind that the federal courts are not superior to the state courts. They are simply an independent system of courts.



3-1 Jurisdiction

Jurisdiction refers either to the geographical area within which a court has the right and power to decide cases or to the right and power of a court to decide matters concerning certain persons, property, or subject matter. Before any court can hear a case, it must have jurisdiction over the person against whom the lawsuit is brought or over the property involved in the lawsuit, as well as jurisdiction over the subject matter.

jurisdiction
Authority to decide a case.

3–1a Jurisdiction over Persons or Property

Generally, a court's power is limited to the territorial boundaries of the state in which it is located. Thus, a court can exercise personal jurisdiction (*in personam* jurisdiction) over residents of the state and anyone else within its boundaries. A court can also exercise jurisdiction over property (*in rem* jurisdiction) located within its boundaries.

long arm statute

A state statute that permits jurisdiction over nonresident defendants.

Under a state **long arm statute**, a court can exercise jurisdiction over out-of-state defendants based on activities that took place within the state. The defendant must have had enough of a connection with the state for the court to conclude that it is fair to exercise its power over the defendant.

Courts apply a *minimum-contacts* test to determine if they can exercise jurisdiction over out-of-state corporations. The test is usually met if a corporation advertises or sells its products within the state. The test can also be met if the corporation has an ongoing business relationship with a party within the state, as shown by frequent transactions.

EXAMPLE 3.1 Allison, a Texas resident, is injured when the PowerFlex exercise machine she is using collapses. Allison files a lawsuit against PowerFlex in a Texas court. PowerFlex, which is headquartered in Chicago, argues that the state court lacks jurisdiction over it. Because PowerFlex sells its exercise products at many retail outlets in Texas, however, there is enough minimum contact within the state for the case to proceed. ■

3–1b Jurisdiction in Cyberspace

The Internet's capacity to bypass boundaries undercuts the traditional basis for jurisdiction. Generally, if a defendant's only connection to a state is through dealings with citizens of the state over the Internet, a "sliding-scale" standard determines when the exercise of jurisdiction is proper.

Jurisdiction is proper when substantial business is done over the Internet. Some interactivity through a website may or may not establish an appropriate basis for jurisdiction. A website with no interactivity—such as passive advertising—does not provide any ground for jurisdiction.



3–2 The State Court System

LEARNING OUTCOME 1

Outline a state court system.

The typical state court system is made up of trial courts and appellate courts. Trial courts are courts in which trials are held and testimony is taken. Appellate courts are courts of appeal and review. Exhibit 3.1 shows how state court systems, as well as the federal court system, are structured.

Any person who is a party to a lawsuit typically has the opportunity to plead the case before a trial court and then, if he or she loses, before at least one level of appellate courts. If a federal statute or constitutional issue is involved in the decision of the state supreme court, that decision may be further appealed to the United States Supreme Court.

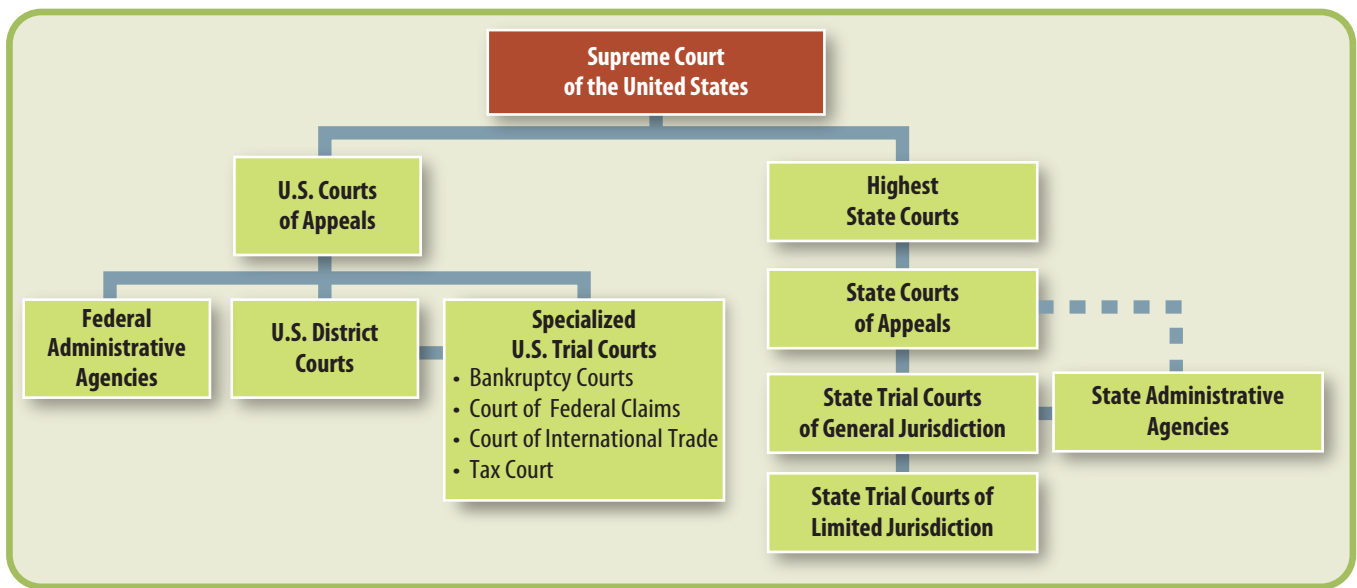
3–2a Trial Courts

The state trial courts have either *general* or *limited* jurisdiction. Trial courts that have general jurisdiction as to subject matter may be called county, district, superior, or circuit courts. The jurisdiction of these courts is often determined by the size of the county in which the court sits.

Courts with limited jurisdiction as to subject matter are often called special inferior trial courts or minor judiciary courts. **Small claims courts** are inferior trial courts that hear only civil cases involving claims of less than a certain

small claims court

A trial court for small claims, usually involving \$2,500 or less.

Exhibit 3.1 The State and Federal Court Systems

amount, usually \$2,500. Most small claims are less than \$1,000. Suits brought in small claims courts are generally conducted informally, and lawyers are not required.

Other courts of limited jurisdiction are domestic relations courts, local municipal courts, and probate courts. Domestic relations courts handle only divorce actions and child-custody cases. Local municipal courts mainly handle traffic cases, while probate courts handle the administration of wills and estate-settlement problems.

3–2b Appellate, or Reviewing, Courts

Every state has at least one appellate, or reviewing, court. About half of the states have intermediate appellate courts. The subject-matter jurisdiction of these courts is substantially limited to hearing appeals.

Appellate courts normally examine the record of a case on appeal and determine whether the trial court committed an error. They look at questions of law and procedure, but usually not at questions of fact. An appellate court will modify a trial court's finding of fact, however, when the finding is clearly erroneous—that is, when it is contrary to the evidence presented at trial—or when there is no evidence to support the finding.

The highest appellate court in a state is usually called the supreme court but may be called by some other name. For instance, in both New York and Maryland, the highest state court is called the court of appeals. The decisions of each state's highest court on all questions of state law are final. Only when issues of federal law are involved can a state's highest court be overruled by the United States Supreme Court.



3–3 The Federal Court System

The federal court system is similar in many ways to most state court systems. It is a three-level model consisting of trial courts, intermediate courts of appeals, and the United States Supreme Court (see Exhibit 3.1).

3–3a U.S. District Courts

At the federal level, the United States is divided into thirteen federal judicial “circuits,” and the circuits are subdivided into districts. A federal district court is the equivalent of a state trial court of general jurisdiction. There is at least one federal district court in every state. The number of judicial districts can vary over time, primarily owing to population changes and corresponding caseloads. The law now provides for ninety-four judicial districts.

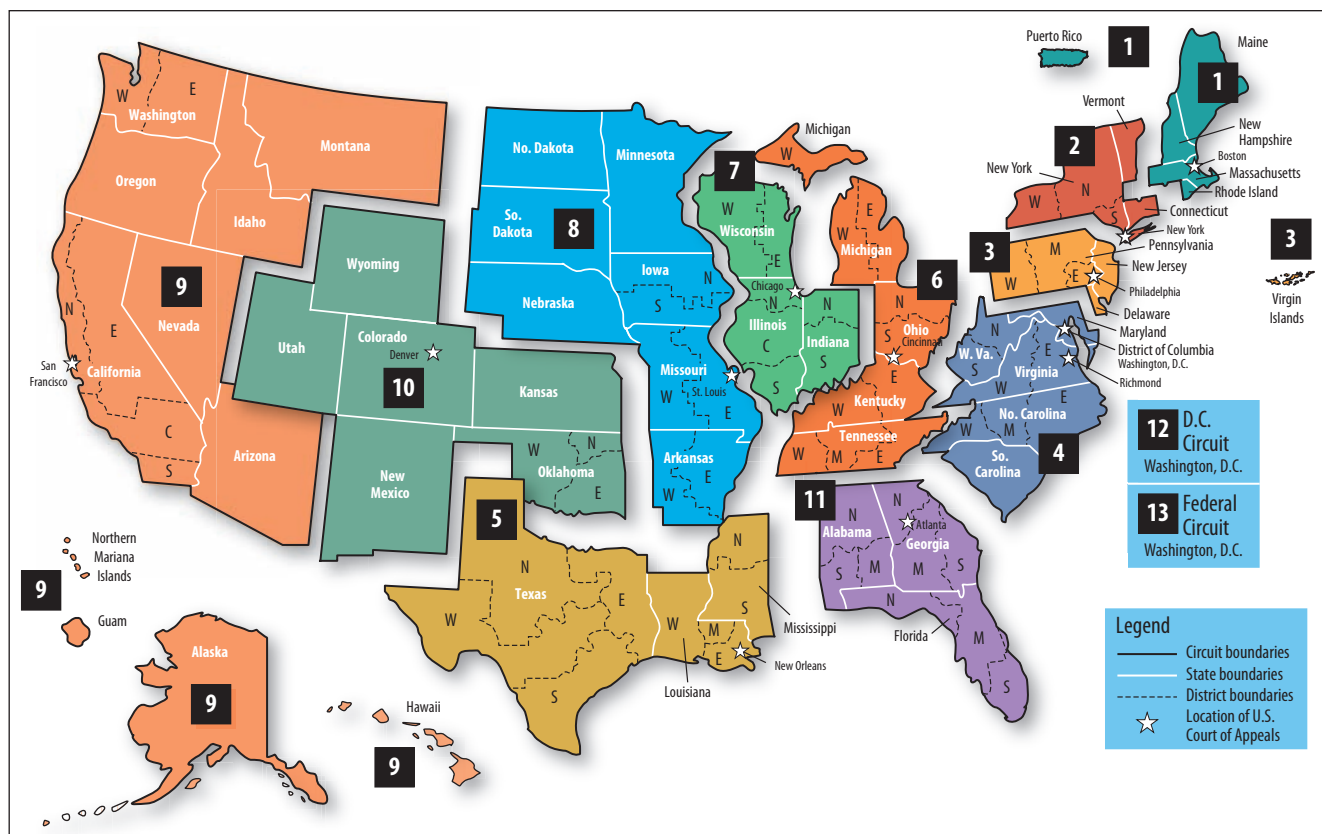
U.S. district courts have original jurisdiction in federal matters. In other words, federal cases originate in district courts. There are other trial courts with original—although special (or limited)—jurisdiction, such as the U.S. Tax Court, the U.S. Bankruptcy Court, and the U.S. Court of Federal Claims.

3–3b U.S. Courts of Appeals

The U.S. courts of appeals for twelve of the thirteen federal judicial circuits hear appeals from the federal district courts located within their respective circuits. The court of appeals for the thirteenth circuit, called the federal circuit, has national jurisdiction over certain types of cases, such as those concerning patent law.

The decisions of the circuit courts of appeals are final in most cases. Appeal to the United States Supreme Court is possible, however. Appeals from federal administrative agencies, such as the Federal Trade Commission, are also made to the U.S. circuit courts of appeals. See Exhibit 3.2 for the geographical boundaries of the U.S. courts of appeals and U.S. district courts.

Exhibit 3.2 Boundaries of the U.S. Courts of Appeals and U.S. District Courts



Source: Administrative Office of the United States Courts.

3–3c The United States Supreme Court

The highest level of the three-level model of the federal court system is the United States Supreme Court. All other courts in the federal system are considered “inferior.”

The United States Supreme Court has original, or trial court, jurisdiction in a small number of situations. In all other cases, its jurisdiction is appellate. The Court can review any case decided by any of the federal courts of appeals. It also has appellate authority over some cases decided in the state courts. Whether the Court will review a case is entirely within its discretion.

3–3d Federal Court Jurisdiction

The Constitution gives Congress the power to control the number and kind of inferior courts in the federal system. Except in those cases in which the Constitution gives the Supreme Court original jurisdiction, Congress can also regulate the jurisdiction of the Supreme Court.

Federal Questions In general, federal courts have jurisdiction over cases involving federal questions. A **federal question** is an issue of law based, at least in part, on the Constitution, a treaty, or a federal law.

Diversity of Citizenship Federal jurisdiction also extends to cases involving diversity of citizenship. **Diversity-of-citizenship** cases are those arising between (1) citizens of different states, (2) a foreign country and citizens of a state or of different states, or (3) citizens of a state and citizens or subjects of a foreign country. The amount in controversy in diversity cases must be more than \$75,000 before a federal court can take jurisdiction.

Exclusive versus Concurrent Jurisdiction Some cases can be heard in either federal or state courts. This is true of many cases involving federal questions, as well as diversity-of-citizenship cases. When both federal and state courts have the power to hear a case, **concurrent jurisdiction** exists. When cases can be tried only in federal courts or only in state courts, **exclusive jurisdiction** exists.

Federal courts have exclusive jurisdiction in cases involving federal crimes, bankruptcy, patents, and copyrights, as well as in suits against the United States and in some areas of admiralty law (law governing transportation on the seas). States also have exclusive jurisdiction over certain subject matters, such as divorce and adoption. The concepts of exclusive and concurrent jurisdiction are illustrated in Exhibit 3.3.

LEARNING OUTCOME 2

Define federal court jurisdiction.

federal question

An issue based on federal law.

diversity-of-citizenship

Situation in which parties to a lawsuit are citizens of different states or countries.

concurrent jurisdiction

When two different courts have the power to hear a case.

exclusive jurisdiction

When only one court has the power to hear a case.



3–4 The State Court Case Process

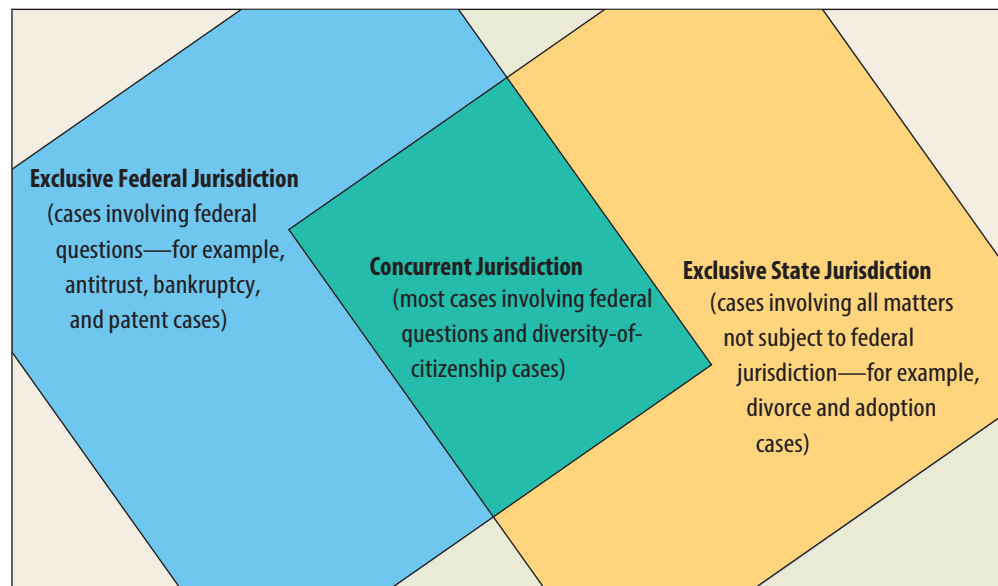
Procedural law establishes the rules and standards for determining disputes in courts. The rules vary from court to court. There is a set of federal rules of procedure, and there are various sets of rules for state courts. In addition, procedural rules differ in criminal and civil cases. To clarify some of these procedural rules, we next follow a civil case, in which one party files a lawsuit against another party.

3–4a Standing to Sue

Before a person can bring a lawsuit before a court, the party must have **standing to sue**. To have standing, a party must have a legally protected and tangible interest at stake in the litigation. Additionally, the party must have suffered a harm, or have been threatened by a harm, as a result of the action about which she or he has complained.

standing to sue

A stake in a controversy sufficient to entitle an individual to bring a lawsuit.

Exhibit 3.3 Exclusive and Concurrent Jurisdictions**3–4b The Pleadings****pleadings**

Statements of facts, charges, and defenses in a case.

The **pleadings** inform each party of the claims of the other and specify the issues (disputed questions) involved in the case. Pleadings remove the element of surprise from a case. They allow lawyers to gather the most persuasive evidence and to prepare better arguments, thus increasing the probability that a just and true result will be forthcoming from the trial. The pleadings include the complaint and summons (and a motion to dismiss or an answer.)

complaint

A pleading alleging wrongdoing on the part of the defendant.

Complaint A lawsuit begins when a lawyer files a **complaint** (sometimes called a petition or a declaration) with the clerk of the trial court with the appropriate jurisdiction. The party who files the complaint is known as the **plaintiff**. The party against whom a complaint is filed is the **defendant**.

plaintiff

A person who initiates a lawsuit.

The complaint contains the following:

defendant

A person against whom a lawsuit is brought.

1. A statement alleging the facts necessary for the court to take *jurisdiction*.
2. A short statement of the facts necessary to show that the plaintiff is *legally* entitled to a remedy. For instance, a statement of facts should be specific and detailed enough to clearly show the legal basis for the complaint. If important facts are missing or lacking, a court is within its rights to dismiss a complaint.
3. A statement of the *remedy* the plaintiff is seeking.

Highlighting the Point

Kevin Anderson, driving a Toyota Camry, is in an accident with Lisa Marconi, driving a Ford Focus. The accident occurs at the intersection of Wilshire Boulevard and Rodeo Drive in Beverly Hills, California. Marconi suffers personal injuries, incurring medical and hospital expenses as well as lost wages for four months. Anderson and Marconi are unable to agree on a settlement, and Marconi wants to sue Anderson.