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Chapter 1

Introduction to Law

LEARNING OBJECTIVES

After reading this chapter, you should be able to understand the nature and sources of law, and the concept of the rule of law and how it affects business and economic prosperity. At the conclusion of this chapter, you should be able to answer the following questions:

1. What is the law?
2. Where does our law come from?
3. What is a rule of law?
4. How is the law relevant to business?
5. How does the study of the legal environment of business create a foundation for future business courses?

You might be wondering what the law has to do with you. You try to follow the rules. You don't get into any trouble. You want to engage in honest dealings in business. Besides, you can always hire an attorney if you need legal help.

This may all be true. However, it is imperative for those in the business world to understand the legal environment in which they are operating. While you may have the best intentions and be truly diligent in your efforts to do business fairly, inevitably conflicts will arise in everyday business dealings. For example, what does it mean to do business "fairly"? Fair to whom? Fair to your shareholders? Fair to your employees? Fair to the consumers who will purchase your products? Through which ethical lens will you contemplate these issues? Trade-offs are a part of business. If you want to increase shareholder profits, you may need to reduce labor costs. One way to reduce labor costs is to use cheaper labor. If you pay your employees less, your employees will be less well off, but your shareholders may be happier.

Consider the credit crisis that came to the world's attention in October 2008 and nearly toppled the U.S. economy into depression. Hundreds of thousands of homes were foreclosed by banks ([Figure 1.1 "The Credit Crisis"](#)), leading to a vicious cycle of depressed housing prices, shattered consumer confidence, and business

retrenchment. You may be thinking that this has little to do with you or with the study of the legal environment of business. Think again. The credit crisis affected everyone. And the nature of the crisis implicated several legal environment issues.

In a nutshell, the U.S. financial system nearly collapsed under the weight of high default rates among mortgagees, the issuance of excessive subprime mortgages to unqualified debtors, collateralized debt obligations (CDOs) that were not being serviced and could not be sold, and a mortgage banking system with flawed incentive structures from the bottom to the top. The mortgage industry created incentives for those who worked in that industry to act in their own self-interest to make a profit, even at the expense of the long-term health of the institutions for which they were working.

Figure 1.1 *The Credit Crisis*



Source: Photo courtesy of Brendel, <http://en.wikipedia.org/wiki/File:Foreclosedhome.JPG>.

Considering this flawed incentive system, the results were not surprising to many economists, who know that people tend to act in their own self-interest, even at the expense of their institutions' goals. Mortgage brokers had very strong incentives to approve every mortgage applicant, regardless of creditworthiness or ability to service the mortgage. This was because the lenders were pressuring them for more mortgages, so that the lenders themselves could sell those mortgages for a profit. And this pressure for "more" was endemic at every level of the mortgage industry, from the would-be homeowner who wanted more house than he or she could afford to the investment bankers who wanted more CDOs on which they could profit. However, excessive risk was undertaken, and when mortgagees began defaulting on their mortgages, the market became flooded with houses that had been foreclosed. As supply of houses increased and demand for them fell, housing prices plummeted, which meant that not only were the investors not receiving income on their investments, but also homeowners were losing the value of their investments, since their house prices were plummeting. The end result was that many homeowners were "upside down" on their obligations, meaning that they owed more on their houses than what the houses were worth. This created an incentive for mortgagees to abandon their debt obligations. When the investors did not receive income on their investments, they also were not receiving the cash flow to cover their debts, and they could not service their obligations under their CDOs. Parties at every level began clamoring for protection from their creditors from the U.S. bankruptcy courts by filing petitions for bankruptcy.

Hyperlink: Credit Crisis

<http://vimeo.com/3261363>

This video explains the credit crisis and will help you begin thinking about the intersection between the legal environment of business and the role of government in regulating business.

After watching the video in [Note 1.2 "Hyperlink: Credit Crisis"](#), consider the intersection between law and economics. Former Federal Reserve Chairman Alan Greenspan had consistently maintained that private regulation (that is, self-regulation by private industry) was better at containing risk than government regulation. But when the 2008 credit crisis manifested, Greenspan retracted this belief, at least in part. He expressed that he was in “a state of shocked disbelief” concerning the financial institutions’ inability to self-regulate. Brian Knowlton and Michael M. Grynbaum, “Greenspan ‘Shocked’ That Free Markets Are Flawed,” *New York Times*, October 23, 2008, <http://www.nytimes.com/2008/10/23/business/worldbusiness/23iht-gspan.4.17206624.html> (accessed August 18, 2010). He always believed that the incentive of survival of the institution itself would force banks to self-regulate. However, this “shocked disbelief” underscored a fissure within the discipline of economics—namely, whether the same economic principles that apply to individuals also apply to organizations. While we know from our study of economics that individuals act in their own self-interest, the 2008 credit crisis perhaps illustrated that people continue to act in their own self-interest, even when working within a firm. The firm itself is only a collection of individual people, and so the firm itself does not act in any type of organizational self-interest.

You might be wondering why we are discussing economics. This is because economic principles are intertwined with economic prosperity, and economic prosperity is intertwined with business, as the preceding example illustrates. To understand what happened in the credit crisis and, more importantly, how to prevent something like this from happening in the future, we have to understand economic principles that impel behavior. Additionally, we have to understand how our laws can embody the knowledge that we have from economics to prevent situations like this from happening in the future. Specifically, while a basic principle of economics is that individuals act in their own self-interest, they do so within the rules of the game. That is, they do so within the parameters of the law. Additionally, sometimes individuals weigh the penalties of violating the law against

the chances of getting caught to determine how they should behave. In both instances, the law is a restraint on behavior.

Reflect on the credit crisis and how our laws could have entirely averted or seriously mitigated the fallout that resulted from it. For example, if the laws regulated the incentive structures that exist within private industry, the individual incentive to make a profit would not have been allowed to overtake the financial institutions' need to self-preserve by limiting risk. Likewise, if our banking regulations limited the types of services that banks could offer, perhaps the exotic financial instruments that were created as a precursor to the credit crisis would not have been permitted in the first place. If the size of our financial institutions had been limited by law, the dangerous fallacy that the financial institutions were too large to fail could not have been perpetuated. If compensation packages were legally restricted by limitations on size or severed from linkages to performance, then individual incentives to maximize profit could have been restrained. Additionally, this situation raises several ethics questions. For example, was it ethical to loan money to people who were not able to service those debts?

As you think about these questions and the many other questions that will arise during your study of the legal environment of business, try to set aside any fixed ideas that you have already formulated about law and the legal system. Many students who are new to the study of law find themselves sharply swayed by a particular type of fiction that has grown around the legal system. Specifically, many students find that they harbor a sense of repugnance to law, because they have heard that it is filled with frivolous lawsuits brought by a litigious public waiting to pounce at the smallest slight, along with money-grubbing attorneys waiting to cash in. We ask that you set aside those and any other preconceived notions that you may harbor about the law and the legal system. The law is a dynamic, sophisticated field. Frivolous lawsuits are not permitted to advance in our legal system, and most attorneys are committed to justice and fairness. They work hard to protect their clients' legal interests and simply do not have the desire or the time to pursue frivolous claims. Indeed, there is no incentive for them to pursue such claims, because our legal system does not reward such behavior.

Most people want to conduct themselves and their business dealings within the parameters of the law. Even if we are very cynical, barring any other compunction to behave well, we can see that it makes the most economic sense to do so. Following the rules of the game saves us money, time, and aggravation, and it preserves our individual and professional reputations. So if most people recognize that they have an incentive not to run afoul of the law, why are there so many legal disputes? There are many reasons for this, such as the fact that many of our laws are ambiguous, and reasonable people may disagree about what is "right." Additionally, legal injuries happen even under the best of conditions, and the

aggrieved parties need a method to press their claims to be compensated for their damages.

A common theme in the study of the legal environment is responsibility. Much of our legal wrangling seeks to answer the questions, “Who is responsible, and what should be done about this injury?” Additionally, and perhaps more importantly for business, is the concern of how to limit liability exposure in the first place. A solid understanding of the legal environment of business should help limit the risk of liability and thus avoid legal disputes. Moreover, it should help you recognize when you need to contact your attorney for assistance in defining the contours of the law, which are the rules of the game. The law provides continuity and a reasonable expectation of how things will be, based on how they have been in the past. It provides predictability and stability.

This book does not teach you how to practice law or to conduct legal research. That is the work of attorneys. Legal research is a sophisticated method of research that seeks to determine the current state of the law regarding narrowly defined legal issues. Legal research helps guide our behavior to help us comply with the rules of the game. When you need an answer regarding a specific legal issue, you will contact your attorney, who will research the issue, inform you of the results of that research, and advise you of the decisions you must make with respect to that issue.

The goals of this book are practical. Try to conceptualize your study of the legal environment of business as a map by which you must navigate your business dealings. We want to teach you how to read this map so that you are able to understand the law and how it affects your business and your life. Besides limiting legal liability proactively, an understanding of the law can also help you avoid serious missteps. After all, ignorance of the law is no defense for violating the law.

This chapter provides an overview of the legal system. We begin with a discussion of what the law is, and then we turn our attention to the sources of law, the rule of law, the reasons why rule of law is important to business, and how law affects business disciplines such as management, marketing, finance, and accounting. The chapter concludes with a discussion of the link between rule of law and economic prosperity.

Key Takeaways

Law is a dynamic and ever-changing field that affects everyone, both in their individual capacities as people and in their business interactions. Studying the legal environment of business helps us understand how to reduce liability risks, identify legal problems that require an attorney's assistance, and identify the links between business and the law.

1.1 What Is Law?

LEARNING OBJECTIVES

1. Understand the meaning of jurisprudence and how its study can lead to greater understanding of our laws and legal system.
2. Distinguish among law as power, legal positivism, legal realism, and natural law.
3. Examine strengths and criticisms of several theories of jurisprudence.
4. Explore examples of several theories of jurisprudence.

If you were asked to define “the law,” what would you say? Is “you should eat five fruits and vegetables a day” a law? What distinguishes law from mere suggestions or good advice? The key difference is obviously enforcement and consequence. If you don’t eat five fruits and vegetables a day, you are not going to be imprisoned or fined. If you steal or embezzle, however, you may be prosecuted and face stiff financial penalties and imprisonment. *Law*, therefore, is a set of rules that are enforced by a government authority.

Now consider the nature of law. Would you say that the law includes only the actual words that are written, or does it also include reading between the lines to discern the spirit of the law? Would you follow a law that you disagreed with, or would you ignore such a law? Do you believe that what the law actually is matters as much as who enforces it? Do you think that morality is a part of legality, or do you think that morality is wholly separate from the law?

Based on the particular system of jurisprudence to which one ascribes, these questions will generate different answers. Not only will the answers to these questions differ, but the potential outcomes of legal disputes can also vary widely, depending on one’s conception of what the law is. These differences highlight fundamental disagreements over the *nature* of law.

Jurisprudence¹ is the philosophy of law. The nature of law has been debated for centuries, giving rise to a general coalescence of ideas to create particular schools of thought. Several different theories of jurisprudence are explored in the paragraphs that follow.

1. The philosophy of law.

At a most basic interpretation, some believe that law is simply power. That is, the law is followed because the sovereign issues orders that are backed by threats. Consider tyrannical rulers who create arbitrary laws or bad laws. If the sovereign has the power to enforce those “laws,” then regardless of the “badness” of the law, it is still law. The Nazis executed six million Jews pursuant to German law during World War II. Saddam Hussein routinely tortured and executed political opponents and minority Sunni Muslims in Iraq under Iraqi law. The military in Myanmar (known euphemistically as the State Peace and Development Council) imprisoned the democratically elected and Nobel Peace Prize–winning prime minister of the country, Aung San Suu Kyi (Figure 1.2 "Aung San Suu Kyi"), under **color of authority**². (Actions taken under the law are said to be under the color of authority.) Those who ascribe to the idea that law is power often argue that coercion is an essential and necessary feature of law.

Let’s explore whether the law is nothing more than power. If an armed person robs your store, you will very likely hand over whatever it is that he or she wants. The robber has exercised power over you but has not exercised the law. This is because, as you might point out, an armed robber is not the sovereign power. But compare this to a sovereign who exercises power over you. For instance, imagine a government that institutes compulsory military service (the draft) under threat of imprisonment for failing to comply. The sovereign would have the power to deprive us of our liberty if we did not follow the rules; such a law certainly has the force of power behind it.

Figure 1.2 Aung San Suu Kyi



Source: Photo courtesy of the U.S. Department of State, http://en.wikipedia.org/wiki/File:Burma_3_150.jpg.

Many have criticized the understanding of law as nothing more than power backed by threats. For example, some point out that if law is nothing more than power, then the subjects of the law are simply at the mercy of whoever is in power. If we look at the U.S. system of government, however, citizens generally do not feel that they are “at the mercy” of the government. This is because people also have power. People can elect their government officials, and they can vote “out” government officials who aren’t doing a good job. In this way, those in power are accountable to the people. Other criticisms include the more piercing observation that not all law requires the exercise or threat of overt power. For instance, many of our laws rely on economic incentives, rather than force of power, to encourage compliance. Though penalty provisions may exist for violating those laws, those penalties may not be driving compliance itself.

2. Refers to actions taken under the law.

A competing view is that of **legal positivism**³, whose proponents disagree that law is simply power. Legal positivists believe that the law is what the law says. The laws are written, human-made rules. The law is not drawn from any source higher than man. Legal positivists do not try to read between the lines. They may disagree with the law as it is written, but they will acquiesce to the sovereign power and follow the law as it is written. They reject any belief that they have an individual right to disobey a law that they happen to oppose, providing that the law is from a legitimate source. Positivists believe that law is wholly separate from any consideration of ethics. Moreover, they do not believe that people have intrinsic human rights other than those created by the law. This is very different from a natural rights perspective, which is discussed in the following paragraphs.

Positivists differ from the view that law is simply power, because they believe that valid law must be created pursuant to the existing rules that allow the sovereign to create law. Under this way of thinking, an arbitrary declaration of law by a sovereign who did not follow the rules for creating the law would not be viewed as valid law. Additionally, positivists would not consider any rule or “law” created by an illegitimate ruler as valid law. Consequently, a legal positivist would feel no need to obey an illegitimately created “law.”

Consider the example of the draft again. Some people have a strong moral objection to engaging in armed conflict with other human beings. However, a legal positivist would most certainly comply with a law that required compulsory conscription, though he or she might use other legal channels to try to change the law.

A common criticism of legal positivism is that it prohibits individuals from remaining true to their own consciences when their consciences conflict with the laws of the sovereign. However, for a positivist, the desirability of enacting a law that might be viewed as “good” or “bad” is not relevant for determining what the law is.

Some critics point out that legal positivism is too limited in its conception of law. For instance, at least some laws seem to reflect a moral stance. The prohibition against **insider trading**⁴ (using nonpublic information to buy or sell a stock to make money) might be said to encompass the idea of fairness, which is a moral consideration. Likewise, **due process**⁵ (fundamental fairness and decency in government actions) might be said to encompass the ideas of both fairness and a moral position against cruelty. Moreover, not all law is the result of a sovereign-issued, written rule. For example, **international customary law**⁶ has developed through customary practices. It is valid law, but it is not a set of rules handed down from a sovereign ruler.

3. A belief that the law is whatever the sovereign says it is. The law is written, human-made rules.
4. The use of nonpublic information to buy or sell a stock to make money.
5. Ensures fundamental fairness and decency in government actions; levels of due process vary according to the property or liberty interest at stake.
6. Law composed of long-standing international customs or practices that have the force of law.

A different viewpoint is **legal realism**⁷, which is the belief that the law itself is far less important than the consideration of who is in the position to enforce the law. Like positivists, legal realists believe that law is the product of human making. However, unlike positivists, they believe that the outcome of any issue that arises under law is dependent on the person, such as a judge, who is in the position to exercise power under the mantle of the law. Additionally, realists believe that social and economic considerations should be brought to bear in legal disputes, which may very well be “extra” considerations that are not captured by the written law itself.

If a realist brought a dispute before a particular judge who was known to be unsympathetic to that particular type of dispute, the realist would believe that the judge’s decision would reflect that leaning. For example, if a dispute arose under the Clean Water Act, and the defendant was a legal realist who believed that the judge was unduly harsh with environmental offenders, the legal realist would not look to the actual words of the Clean Water Act itself to determine a likely outcome. Instead, the defendant would view the judge’s personal and professional beliefs about water pollution as determinative factors. Moreover, if the plaintiff in the same case were a realist who did not believe that the Clean Water Act was very strong, that plaintiff might hope that the judge would consider the social importance of clean water to human health, natural environment, and nonhuman animals.

Critics of legal realism point out that those who are in the position to exercise the power of the law over others should not circumscribe the checks and balances of our system of government by considering factors outside of legitimate sources of law when making decisions. For instance, they argue that judges should not use any factors other than the written law when rendering decisions. Legal realists, however, point out that judicial interpretation not only is necessary but also was contemplated by our Founding Fathers as a built-in check and balance to our other branches of government.

Natural law⁸ is the idea that humans possess certain inalienable rights that are not the products of human-made law. Therefore, we can say that natural law differs from both positivism and realism in this important respect. Humans are able to reason, and therefore they are able to discover moral truths on their own. They are not automatons who require a sovereign power to tell them right from wrong. Natural law adherents do not reject human-made law. However, they recognize that human-made law is subordinate to natural law if the two types of law conflict.

Civil rights activists often rely on natural law arguments to advance their platforms. This is true today as well as historically. For example, a civil rights

7. A belief that the law itself is less important than who is in the position to enforce it.

8. A belief that humans possess certain inalienable rights that are not the products of human-made law.

advocate might point out that regardless of what the law “says,” discrimination based on race is simply wrong. If the written law allowed racial discrimination, natural law adherents would not recognize the law as valid.

Each theory of jurisprudence can inform our understanding of legal issues by allowing us to see the same thing from many different perspectives. Moreover, depending on philosophical perspective, there may be several possible outcomes to the same legal dispute that are equally supportable. This understanding can help us identify common ground among disputants as well as points of departure in their reasoning.

KEY TAKEAWAYS

Different theories of jurisprudence inform our understanding of what the law is. Examining legal issues through the lenses of different theories of jurisprudence allows us to see how different outcomes can be defended.

EXERCISES

1. Read “The Case of the Speluncean Explorers” at <http://www.nullapoena.de/stud/explorers.html>. Identify the justice’s opinion with which you most closely agree. Name the different theories of jurisprudence used by each justice in reaching his or her opinion.
2. What are some examples of natural law in our legal system or system of governance?
3. Is it more important for you to follow the letter of the law or to follow the spirit of the law? In what circumstance would you believe the opposite to be true?
4. Can you think of any examples of law in which the threat of force or power is not needed?
5. Do you believe that morals are a part of our law, or do you believe that morality and law are separate concepts?

1.2 Sources of Law

LEARNING OBJECTIVES

1. Differentiate between social customs and law.
2. Become familiar with primary sources of law in the United States.
3. Understand the difference between public law and private law.
4. Understand the relationship between state and federal systems of government.

Hyperlink: Supreme Court Friezes

<http://www.supremecourt.gov/about/north&southwalls.pdf>

Along the north and south walls of the Great Hall at the U.S. Supreme Court, friezes representing the great lawgivers in history are carved in marble. Among them are Hammurabi, Moses, Solomon, Draco, Confucius, Muhammad, Napoleon, and one American. Click the link to find out who he is.

Where does the law come from? How do you know right from wrong? Certainly your caretakers taught you right from wrong when you were a child. Your teachers, community elders, and other people who were in the position to help shape your ideas about appropriate manners of behavior also influenced your understanding of which behaviors are acceptable and which are not. Additionally, employers often have very firm ideas about how their employees should comport themselves. Those ideas may be conveyed through employers' codes of ethics, employee handbooks, or organizational cultures.

Of course, actions that are considered “wrong” and inappropriate behavior are not violations of the law. They simply may represent social norms. For example, it is generally not acceptable to ask strangers about their income. It is not illegal to do such a thing, but it is considered impolite. Imagine that you are interviewing for a position that you really want. Can you imagine yourself asking your potential employer how much money he or she makes? It would not be illegal for the

employer to refuse to hire you based on your lack of social skills. However, it would be illegal for the employer not to hire you based solely on your race.

So what is the difference? One type of “right from wrong” is based on societal norms and cultural expectations. The other type of “right from wrong” is based on a source recognized as a holding legitimate authority to make, and enforce, law within our society. These are two types of rules in our society—social norms and laws.

A Question of Ethics

In January 2010, Haiti, the poorest country in the Western Hemisphere, was struck by a massive earthquake that killed tens of thousands—maybe even hundreds of thousands—of people. Rescue workers rushed to remove survivors from the rubble, but in the days following the earthquake thousands of people wandered the streets without food or shelter. Some instances of looting and violence occurred as survivors grew desperate for sustenance.

In the meantime, Royal Caribbean operated a cruise line that made a regular stop at Haiti, at a private beach where it had previously spent millions of dollars in improvements to ensure that the vacationers on its cruise ships would enjoy themselves during their overnight stops. Within a week of the disaster, Royal Caribbean was seeking to assure its customers that the stop in Haiti was not unethical. It pointed out that bringing tourist dollars to Haiti was actually an ethical thing to do, despite the thousands of dying and injured just a short distance away.

If you were scheduled to begin a vacation on a Royal Caribbean cruise ship that docked at its private beach during the week following the earthquake, would you go? If you decided to go, how would your friends and family react to your choice? If Royal Caribbean was not legally required to issue refunds for nonrefundable tickets, should it be willing to issue refunds anyhow?

Check out a video of Royal Caribbean’s CEO discussing his company’s involvement in bringing emergency supplies to Haiti, as well as the potential for using ships as hotels or hospitals in the interim.

<http://cnn.com/video/?/video/world/2010/01/18/ct.anderson.haiti.cruise.cnn>

Social customs may be violated on pain of embarrassment or ostracism. Someone may choose to ignore social customs, but there are usually negative social or professional consequences to doing so. A person who violates social customs may be said to be a boor, or people may try to avoid that person because his or her actions and comments make others uncomfortable. However, no legal repercussions follow violating social customs.

Violations of law are different. Violating the law carries penalties, such as liability or loss of liberty, depending on the type of violation. While we may generally decide whether or not to conform to social customs, we are compelled to obey the law under threat of penalty.

Law can generally be classified as public law or private law. **Public law**⁹ applies to everyone. It is law that has been created by some legitimate authority with the power to create law, and it has been “handed down” to the people within its jurisdiction. In the United States, the lawmaking authority itself is also subject to those laws, because no one is “above” the law. If the law is violated, penalties can be levied against the violator. These penalties are also “handed down” from some recognized source of authority, like the judiciary. Of course, people in the United States may participate in many law-creating activities. For instance, they may vote in elections for legislators, who, in turn, create legislation. Likewise, if people have a legal claim, their case may be heard by the judiciary.

It’s important to note, however, that not all law is public law. **Private law**¹⁰ is typically understood to be law that is binding on specific parties. For instance, parties to a contract are involved in a private law agreement. The terms of the contract apply to the parties of the contract but not to anyone else. If the parties have a contract dispute, they will be able to use dispute-resolution methods to resolve it. This is because both parties of the contract recognize the judiciary as a legitimate authority that can resolve the contract dispute. However, regardless of the resolution, the terms of the contract and the remedy for breach will apply only to the parties of the contract and not to everyone else.

9. Law that applies to everyone.

10. Law that is legally binding on parties who agree to it, such as a contract.

11. The legal rules that must be followed by government officials in the execution of law.

12. The actual substance of the law or the merits of the claim, case, or action.

Additionally, some law is procedural and some law is substantive. **Procedural law**¹¹ describes the legal rules that must be followed. In other words, it details the process or rules that are legally required. For instance, the U.S. government must generally obtain a warrant before searching someone’s private home. If the process of obtaining the warrant is ignored or performed illegally, then procedural law has been violated. **Substantive law**¹² refers to the actual substance of the law or the merits of the claim, case, or action. Substantive law embodies the ideas of legal rights and duties and is captured by our different sources of law, like statutes, the Constitution, or common law.

Sources of Law

In the United States, our laws come primarily from the U.S. Constitution and the state constitutions; from statutory law from Congress, the state legislatures, and local legislative bodies; from common law; and from administrative rules and regulations. Executive orders and treaties are also important sources of law. These are all **primary sources of law**¹³. As is true in any democracy, U.S. law reflects the will of the people who vote for representatives to make the law. In this way, U.S. law is also a reflection of public policy.

Secondary sources of law¹⁴ include restatements of the law, law review and journal articles, uniform codes, and **treatises**¹⁵. These sources are created by legal scholars rather than by a recognized, legitimate law-creating authority. However, these sources are read by and often influence those who are in the position to create law. Members of the judiciary, for example, may consult a restatement of law or law-review articles when making decisions. Likewise, state legislatures often adopt whole or parts of uniform acts, such as the **Uniform Commercial Code (UCC)**¹⁶. When a body of secondary law is formally adopted by a legitimate lawmaking authority, then it becomes primary law. In this example, adoption of the UCC by a state legislature transforms the UCC from a secondary source of law (a model code) to a primary source of law in that state—namely, a statute.

Hyperlink: The U.S. Constitution

http://www.archives.gov/exhibits/charters/constitution_transcript.html

Read the U.S. Constitution at this link.

13. Actual laws; these include constitutions, statutes, and judicial opinions.
14. Interpretations of law. These include restatements of law, journal articles, and treatises.
15. An exposition or summary of an area or body of law.
16. A model statute that seeks to provide uniformity to contracts law among the different states. It is not a law until state legislatures adopt it as law.
17. The supreme law of the land. It created the structure of the U.S. federal government.

The **U.S. Constitution**¹⁷ created the structure of our federal government. Among other things, it sets forth the three branches—the legislative, executive, and judicial branches.

It provides organizational and procedural requirements, defines the boundaries of each branch's jurisdiction, and creates “checks” on each branch by the other branches. For example, look at **Note 1.26 "Hyperlink: The U.S. Constitution"**. As you can see, in Article II, Section 2 the president is the commander in chief of the several armed forces, but he does not have the power to declare war. That duty falls to Congress.

The first ten amendments to the U.S. Constitution are known as the Bill of Rights. Some of the Founding Fathers did not believe that a **Bill of Rights**¹⁸ was necessary because the power granted to the federal government created by the U.S. Constitution was expressly limited. Any powers not expressly granted to the federal government by the U.S. Constitution are reserved to the states. This means that if the U.S. Constitution does not state that one of the federal branches of government has jurisdiction over a particular area, then that area falls to the states to regulate.

Despite the limited power granted to the federal government by the U.S. Constitution, as a condition of ratification, many states insisted on a written Bill of Rights that preserved certain individual civil rights and liberties. Today, business entities that are treated as legal persons under the law, such as corporations, enjoy many of these rights and liberties, just as if they were natural human beings.

Each state also has its own constitution, and those constitutions serve essentially the same function for each individual state government as the U.S. Constitution serves for the federal government. Specifically, they establish the limits of government power, create protections for fundamental rights, and establish the organization and duties of the different branches of government at the state level.

This dual system of government present in the United States is called **federalism**¹⁹, which is a governance structure whereby the federal government and the state governments coexist through a shared power scheme. State laws may not conflict with federal laws, including the U.S. Constitution. This is because the U.S. Constitution is the supreme law of the land.

Statutory law²⁰ is law created by a legislative body. Congress is the legislative body at the federal level. The states also have legislative bodies, most of which are **bicameral**²¹, like our federal system. The state legislatures' names vary by state. For instance, in Indiana, the legislature is known as the General Assembly. In North Dakota, it is the Legislative Assembly. In New York, it is called the Legislature. Nevertheless, their purposes are the same. They are the legislative branches of their respective state governments.

Congress is composed of a Senate, with 100 members, and a House of Representatives, with 435 members. The forefathers who wrote the Constitution deliberated and argued over how to compose the legislature, and the result is a deliberative body that doesn't always respond quickly to the will of the majority. Since population numbers from the census taken every ten years determine how many House seats a state receives, smaller states are sometimes disproportionately represented in the Senate. Alaska and Delaware, for example, have only one representative in the House, but each has two senators. Senators serve six-year

18. The first ten amendments to the U.S. Constitution.

19. A system in which power is divided between two or more forms of government.

20. Law created by legislative bodies.

21. A term used to describe a legislature in which two bodies exist, such as the U.S. Congress, which is composed of the Senate and the House of Representatives.

terms, and members of the House of Representatives serve two-year terms. There are no term limits for either senators or members of the House. One benefit of having no term limits is that institutional knowledge and wisdom can be carried forward in perpetuity. One drawback is that elected officials may hedge their votes on important issues in a calculated way, to ensure reelection. If term limits were imposed, then vote pandering would not be a problem, but the Congress would be forever laboring with many inexperienced lawmakers.

As you can see from [Note 1.32 "Hyperlink: How a Bill Becomes a Law"](#), a bill may be introduced in Congress through the Senate or through the House of Representatives. Both the House of Representatives and the Senate have many committees, and these are related to all areas under the purview of Congress to legislate. After a bill is introduced, it is sent to an appropriate committee in the chamber of the Congress where the bill originated. If the committee moves forward with the bill, it modifies the bill as it sees fit to do, and then it sends the bill to the house of origination (either the Senate or the House of Representatives) for a vote. If the bill passes, then it is sent to the other house (again, either the Senate or the House of Representatives), where it undergoes the same process. If the other house votes to approve the bill, then the bill goes to the joint committee, which is composed of members of both the House of Representatives and the Senate, where final work is completed. After that, the bill is sent to Congress for a full vote. If the bill passes, it is sent to the president. If the president signs the bill, then it becomes a statute.

The president may veto a bill. A presidential veto is an executive “check” on the legislative body. However, if the president vetoes a bill, the legislature can override the veto by a supermajority vote. A congressional override is a legislative “check” on the executive branch. These checks are built into our U.S. Constitution.

Hyperlink: How a Bill Becomes a Law

http://www.lexisnexis.com/help/CU/The_Legislative_Process/How_a_Bill_Becomes_Law.htm

Check out the interactive flowchart for how a bill becomes law. Be sure to click on the different boxes for additional information about each step.

Importantly, Congress may not act outside of its enumerated powers. Many people wrongfully believe that Congress can do anything. That is simply not true. Look at Article I, Section 8, accessible through [Note 1.26 "Hyperlink: The U.S. Constitution"](#), for the enumerated powers of Congress. Remember that any power not granted to the federal government by the U.S. Constitution is reserved to the states. This means that if Congress passed a law in an area that was actually reserved to the states to regulate, Congress would have acted outside the scope of its powers. If challenged, the law would be struck down as unconstitutional.

As a practical matter, this means that many U.S. states have state laws that are very different from each other. For instance, in Oregon, certain terminally ill patients may legally commit suicide under the state's Death with Dignity Act. However, in many other states, such an act would be illegal.

Common law²² is judge-made law. Common law is a feature of most countries previously colonized by Great Britain, where it originated. In continental Europe, an alternative system called **civil law**²³ developed, where judges do not have the power to create law through interpretation. In civil-law jurisdictions, only the legislature may create law. A **jurisdiction**²⁴ is an area where power may be exercised.

In a common-law system, when an appellate court hears cases and writes opinions, rules of law are created, formed, and shaped. After a particular legal issue has been decided in a jurisdiction, there is a high probability that subsequent cases that present the same legal issue will use the same rule of law generated from already-decided cases regarding the same legal issue. This policy is known as **stare decisis**²⁵, or "let the decision stand." This is how a **precedent**²⁶ is formed, though precedents may shift or change over time. Precedents also may be entirely overturned, though that is rare. Precedents and stare decisis allow us to anticipate the behavior of others and to gauge the legality of our own actions.

Legal reasoning is used by attorneys to argue for a particular outcome in a case and by judges when rendering decisions. At its most basic form, legal reasoning involves first identifying the legal question, which is the issue in dispute. Then, the rule of law that applies to that issue is identified. The rule of law may be drawn from precedent, for example. The facts of the case are analyzed against the rule of law to reach a supportable conclusion. This method of legal reasoning is referred to as the IRAC method, which is an acronym for issue, rule, analysis, and conclusion.

Common law is an important source of law in those many areas that are reserved to the states to regulate. A state may exercise its **police powers**²⁷ to regulate the safety, health, and welfare of its citizens, for example. The laws implemented in these areas may give rise to laws in divergent areas, such as property law (e.g.,

22. Judge-made law.

23. A system of law in which only the legislature creates law.

24. An area where power may be exercised.

25. "Let what has already been decided stand." It is the principle that courts should follow precedents.

26. Existing interpretation of law, based on prior decisions.

27. The general power of states to regulate for the health, safety, and general welfare of the public.

zoning regulations), so-called **vice laws**²⁸ (e.g., restrictions on vice business activities in certain areas or during certain days), and domestic relations (e.g., laws relating to marriage and adoption). It's also important to note that precedents vary among different jurisdictions because precedents created by one jurisdiction are not binding in other jurisdictions.

Most administrative agencies are created by the legislature. At the federal level they are created by Congress, and at the state level they are created through the state legislative bodies. Administrative agencies may be thought of as a delegation of congressional authority to area experts in particular fields, so that those experts can engage in limited lawmaking, adjudicative procedures, and investigations within their particular purviews. Laws made by administrative agencies are called **rules or regulations**²⁹. Administrative agencies are created by **enabling legislation**³⁰, which sets forth the agencies' jurisdictional boundaries, rule-making procedures, and other information relating to agencies' scopes of power.

KEY TAKEAWAYS

The legal system in the United States is composed of multiple jurisdictions at the local and state levels and one federal jurisdiction. Local and state laws may not conflict with federal laws. Primary sources of law in the United States include constitutional law, statutory law, common law, and administrative law.

EXERCISES

1. Identify an action that would violate social norms but would not violate any laws. Can you identify any violations of law that would not violate any social norms?
2. What are three specific powers of Congress? What are three specific powers of the executive branch? Do you think that the powers of the judicial branch are well defined? Why or why not?
3. What areas of law have been reserved to the states to regulate? How do you know?
4. Identify a bill in either the House of Representatives or the U.S. Senate. What stage(s) of the bill process has it passed through? To be passed into law, what stages must it still pass through?
5. Which three federal administrative agencies affect you or your family the most? Why?

28. Laws targeted at regulating or prohibiting vice activities or businesses engaged in vice activities, such as gambling, prostitution, the consumption of alcohol, and pornography.

29. Created by administrative agencies and have the force of law.

30. Statutes created by Congress to create individual administrative agencies.

1.3 The Rule of Law

LEARNING OBJECTIVES

1. Understand what a rule of law system is.
2. Explore the U.S. rule of law system.

When you hear the term “rule of law,” what comes to mind? It may seem like an ambiguous term, but it is used frequently in legal and governance circles. **Rule of law**³¹ is a system of laws under which the people and the government are bound, which allows predictability and restraint of government action.

A rule of law legitimizes the law. It establishes clear rules of behavior, establishes (or captures) precedent, and seriously undermines any defense of ignorance of the law. Moreover, it holds people to the same standards, though in many ancient rules of law, the standards differed depending on the person’s classification. For instance, men often had different rights than women. Slaves were a different legal class than those who were free, and indentured servants were often a different classification altogether. When people are held to the same standards, we can see systems of fairness (that is, equal justice under the law) emerging, at least for those within the same class.

The Founding Fathers of the United States did not create our rule of law system out of thin air. Many rule of law systems existed prior to the founding of the United States. The U.S. rule of law system has many similarities with prior rule of law systems from which our Founding Fathers drew their ideas. We can trace elements of our legal genealogy back to ancient Babylon. For example, who has the right to govern, the legitimate sources of law, the organization of government, substantive and procedural legal responsibilities, processes for dispute resolution, and consequences for legal transgressions are all common foci for rule of law systems.

Can you imagine if we had no way to determine these things? Imagine that we did not know who had the legitimate right to govern or that we did not know which sources of law were legitimate. If we did not have a rule of law system that specified and legitimized these and other foundational issues, chaos would rule. There would likely be competing claims of authority between different factions of power if our U.S. Constitution and our state constitutions did not create our systems of government. Likewise, there would be competing sources of law—such as those based on religious texts, or others created by modern human beings—if our

31. A system of laws under which the people and the government are bound.

constitutions did not legitimize the manner in which laws were to be created. Also, there would be different methods of dispute resolution. Perhaps some people would favor a vigilante system, while others would prefer a procedural system. This type of unpredictability would result in a very unstable society. We should not take the American rule of law system for granted. It provides predictability and stability to our lives.

Rule of law systems establish authority, create expectations for behavior, and establish redress for grievances and penalties for deviance. Governance of conflict and the attainment of peace among the governed are primary goals of rule of law systems. For example, securing peace is a goal within the U.S. rule of law system. The U.S. Constitution's preamble states, "We the People...in Order to...insure domestic Tranquility." We see this same notion in the **English Bill of Rights of 1689**³², though the words used are somewhat different.

According to many rule of law systems, the attainment of peace relies on the establishment of a hierarchical authority structure. This recognition of the right to govern provides legitimacy. For instance, in the **Code of Hammurabi**³³ and the **Magna Carta**³⁴, these rights are derived from religious authority. In the U.S. Constitution and the English Bill of Rights of 1689, the power is derived from the people.

Note the difference between power and authority. Power is the ability to make someone behave in a predictable manner. Authority draws its strength from legitimacy. Imagine that your friend told you that his mother granted him the right to govern others. Would you believe him? Probably not. Why? Because it is unlikely that you would recognize your friend's mother as having a legitimate authority to bestow the right to govern on anyone, including your friend. Imagine, instead, the governor of your state. You probably recognize the authority of the governor to govern, because you recognize that the people, through representative government, have the authority to elect the governor to do so.

32. Contains the basis for many concepts contained in the U.S. Constitution, including the rights of the people to limit the sovereign.

33. The oldest record that we have of a seemingly complete rule of law system.

34. Contains the basis for many legal principles recognized in the U.S. Constitution, including due process and habeas corpus.

The rule of law of the federal government in the United States is composed of many different sources of law, including constitutional law, statutory law, rules and regulations promulgated by administrative agencies, federal common law, and treaties. Additionally, within the United States, several state and local jurisdictions exist, each having its own rule of law systems. Moreover, the U.S. system of governance is one of federalism, which allows different rule of law systems to operate side by side. In the United States, these systems are the federal government and the state governments.

Organizational structures for government—including who has the right to govern—are also set out in rule of law systems. For instance, the Code of Hammurabi identified a ruler: Hammurabi himself. The English Bill of Rights of 1689 required representative bodies. The U.S. Constitution organized the U.S. government by creating the legislative, executive, and judicial branches. These models minimally provide order and, in some cases, provide opportunities for the governed to participate in government, both of which create role expectations of the governed.

Notably, even though our Founding Fathers relied on prior rule of law systems when creating our Constitution, they were unable to resolve all challenges that exist when people live together. Today, for instance, one unresolved challenge is reflected in the tension between personal liberty and responsibility to state. We have many individual rights and personal liberties, but as some argue, we do not have many responsibilities to the state. We could have a system that requires greater duties—such as the legal duty to vote, to serve in public office or in the military, or to maintain public lands. Unresolved challenges highlight the fact that rule of law systems are not perfect systems of governance. Nevertheless, these systems create expectations for conduct, without which governance of conflict could not reasonably exist and peace could not be attained.

The **U.S. Constitution**³⁵ is the foundation on which the U.S. federal rule of law system rests. It asserts the supremacy of law. “We the people” is a very important part of the preamble, because it confers power on the people as well as on the states. Notably, unlike the Magna Carta and the English Bill of Rights of 1689, it does not focus on individual rights. Of course, the Bill of Rights does focus on individual rights, but those amendments were passed after the Constitution was written. (That is why they are called *amendments* to the constitution.) The U.S. Constitution implemented the supremacy of law using structure and processes. The Founding Fathers were particularly concerned about giving the government the power to do its job without encouraging tyranny. They built in processes to ensure the supremacy of law. Indeed, ours is “a government of laws and not of men,” John Adams wrote in the Massachusetts Constitution. Thomas Paine noted the same sentiment in *Common Sense*, when he wrote, “the law is king.”

35. The supreme law of the land. It created the structure of the U.S. federal government.

KEY TAKEAWAYS

Rule of law is a system of published laws under which the people and the government are bound, which allows predictability and restraint of government action. A rule of law system allows people to understand what is expected of them. It provides a system that allows many people with different beliefs and cultures to live together in peace, by providing methods by which conflicts can be resolved. The U.S. rule of law system contains many elements of prior rule of law systems.

EXERCISES

1. View the Code of Hammurabi at <http://avalon.law.yale.edu/ancient/hamframe.asp>. Scroll down slightly until you see the subheading “Code of Laws.” Find three laws that you believe are similar to laws that we have in the United States.
2. Given the long history of rule of law systems, why hasn’t any rule of law system been developed that resolves all problems? Name three social problems that our rule of law system does not address, or does not address adequately.
3. Are the Ten Commandments a rule of law system? How many of the Ten Commandments are illegal in your state today?
4. What problems would exist without a rule of law?
5. How does the rule of law affect business?

1.4 Importance of Rule of Law to Business

LEARNING OBJECTIVES

1. Determine why the rule of law is important to business.
2. Identify several areas of law that are especially relevant to business and the importance of the rule of law to those areas.
3. Identify how the rule of law limits government.
4. Identify how the rule of law protects people from harmful business practices.

As you may have guessed by now, the rule of law is important to business. Can you imagine trying to do business without being able to have any reasonable expectations of other people's behavior? Would you be willing to conduct business if you had no legal means by which to protect your property interests? And in the case of a dispute, without a rule of law system, there would be no established way of resolving it. Without the rule of law, business would be chaotic. This section provides some overarching examples of why the rule of law is important to business.

Before getting to those examples, imagine this: What if you did not know how to play chess, but you tried to play anyhow? You would probably become frustrated very quickly, because you would see no logic in the movement of your opponent's pieces, and you would not be permitted to move some pieces like you might wish to. Sometimes you would see your opponent move his or her knight two spaces in one direction and then one space in another. Other times, you would see your opponent move his or her bishop diagonally. Moreover, you would not understand what you were and were not permitted to do. You would also not know how to penalize an opponent who moved his or her pieces incorrectly to gain advantage or to take something of yours. This is analogous to what it's like to do business without understanding the rules of the game.

The rule of law establishes rules that people—and businesses—must follow to avoid being penalized. The rule of law not only allows people to understand what is expected of them in their personal capacities but also sets forth rules for businesses so that they, too, know what is expected of them in their dealings and transactions. In addition, it restrains government and others from infringing on property rights. Should disputes arise, the rule of law provides a peaceful and predictable means by which those disputes can be resolved.

The rule of law provides guidance and direction in every area of business. For example, it provides a means to bring a complaint against another party to a neutral decision maker so that a decision can be made regarding the dispute. Because of our rule of law system, we know that we are permitted to file a complaint in the proper court to commence litigation. Or we can try an alternative method of dispute resolution if we do not wish to engage in litigation. We know that we are permitted to do these things because our rule of law system allows us to do them. Moreover, we can expect some sort of resolution when we institute such a proceeding. This expectation is reasonable only because we have a rule of law.

Additionally, in the United States, the rule of law provides a sophisticated system of federalism, where state and federal laws coexist. This allows people and businesses to determine which system of government pertains to them and which jurisdiction they belong to. Imagine that you sell firearms in a retail capacity. You would be subject to both state and federal laws. You would be required to carry a federal permit from the federal administrative agency known as the Bureau of Alcohol, Tobacco, Firearms, and Explosives. You would be forbidden from engaging in illegal arms trading. According to state laws, you would likely have to ensure that each purchaser of a firearm held a valid permit for a firearm. You would be required to check identification, enforce waiting periods, and refuse to sell guns to people who were not permitted to carry them according to your state's laws. If we did not have a rule of law system, you might be uncertain how to conduct your business, and you would be subject to arbitrary enforcement of unstated or **ex post facto**³⁶ (retroactive) laws that affected your business.

The rule of law also governs contracts between people and between merchants. Under the common law system, certain elements of a contract must exist for the contract to be enforceable. Under the Uniform Commercial Code (UCC), merchants are governed by a separate set of rules that anticipate and allow for flexibility in contractual terms, to facilitate business needs. In the event that terms conflict in an offer and acceptance between merchants, the UCC allows "gap fillers" to complete the terms of the contract without need for the contract to be rewritten or for formal dispute resolution. Moreover, businesses rely on the rule of law to help them enforce contracts against contractors who fail to perform.

Additionally, because we have a rule of law system, employers know the rules of the game regarding their relationship to employees, and employees know the rules with respect to their obligations to employers. Likewise, business partners, members of boards of corporations, and members of limited liability companies all know what is expected of them in their roles vis-à-vis the business and other people within their organizations. When someone does something that is not permitted, there is legal recourse.

36. A type of law that is applied retroactively to its passage.

The rule of law also provides protection for property. Imagine if we did not have protection for nontangible property, such as intellectual property like trade secrets, trademarks, or copyrights. It would be very difficult to protect this type of property if we did not know the rules of the game. People would not have the incentive to create or share new intellectual property if they had no reasonable expectation of being able to protect it or of being rewarded for their creations. Likewise, the rule of law allows us to protect tangible property without having to go to extraordinary measures. For instance, if we had no rule of law system to convey and maintain legal ownership to us for our real or personal property, we might be forced to hire expensive private security forces to guard our property when we could not be there to physically protect it ourselves.

Businesses also rely on the rule of law to govern their debtor and creditor relationships. And, if financial matters do not go as anticipated, our legal system allows businesses to ask the court for protection from creditors under our bankruptcy law. This allows businesses to protect their property from creditor repossessions or foreclosures while they get back on track financially.

The rule of law also protects people from businesses. For example, Congress has enacted antitrust legislation that prevents certain anticompetitive practices, such as colluding and price fixing. Additionally, businesses are prohibited from using deceptive advertising and are held responsible when they manufacture or sell defective products that cause injury.

The rule of law also protects businesses from government. Since everyone is subject to the rule of law, this means that government itself may not overextend its reach when regulating or investigating businesses. Government must play by the rules, too. For example, imagine that our government could do anything, without any limits or jurisdictional restraints. A business operating in such a climate might find itself subject to government closure on a whim, or excessive taxes, or requirements to pay bribes to gain permits to do business. Our rule of law system prevents such abuses.

Without a rule of law system, people would have to exact satisfaction for the wrongs committed against them on their own. They would have to physically protect their own property. This would lead to a breakdown in social structure, and it would result in vigilante justice and physical strength playing primary roles in dispute resolution.

KEY TAKEAWAYS

The rule of law system in the United States sets the rules of the game for doing business. It creates a stable environment where plans can be made, property can be protected, expectations can exist, complaints can be made, and rights can be protected. Violation of the law can result in penalties. The rule of law protects business, protects consumers from harmful business practices, and limits government from engaging in abusive practices against businesses.

EXERCISES

1. Have you ever played a game in which you did not know all the rules? Have you ever tried to speak a language in which you weren't fluent? What was the outcome?
2. What incentive or motivation would exist to work for your employer if you were not certain that you would be paid for your efforts and your time? What incentive would you have to invent something new, create a work of art, or write a book if you had no legal expectation that you would be able to protect your creation?
3. Imagine that you are an entrepreneur. What type of business would you open? Would you know what types of permits were required to conduct your business and which government entities had jurisdiction over your business? If not, how could you find out?
4. What would business be like in a land without any rule of law system? Be specific.

1.5 How Law Affects Business Disciplines

LEARNING OBJECTIVES

1. Identify the relevance of law to business disciplines.
2. Understand the relevance of law to the study of business.
3. Identify how the rule of law protects people from harmful business practices.

Foundational courses taken by undergraduate business students usually include accounting, finance, management, and marketing. An understanding of the legal environment of business is relevant—indeed, essential—to functioning well within each of those disciplines. Additionally, a solid understanding of the legal environment can help avoid liability or at least minimize risk. In business, it is not enough to comport yourself and your business ethically. You must also ensure that you understand the legal environment in which you are working. Therefore, it is important to you, to your employer, and to all the other people who may be relying on your business expertise—such as your employees and your family—to understand the legal environment. Such an understanding will help you avoid or lessen the likelihood of liability exposure, enabling you to manage your business affairs successfully, unhampered by unmanaged legal liability risks. This section provides some examples of how law affects specific business disciplines.

During the last several years, accountants have been in the limelight due to culpable behavior of some members of the profession during well-known business scandals, such as Enron. Largely as a result of the fallout from the Enron case, Congress passed the Sarbanes-Oxley Act (SOX) of 2002, which imposed stringent oversight requirements on accounting and auditing firms. The requirements seek to ensure competence, compliance with security laws, and conduct consistent with generally accepted accounting principles.

Of course, the Enron scandal and SOX were both fairly dramatic examples of how law can affect accounting. Other ways in which law affects this discipline are through regulation. For example, the U.S. Securities and Exchange Commission's (SEC) mission is to protect investors and to maintain a fair market, among other things. Accordingly, the SEC enforces accounting and auditing policies to allow investors to make decisions based on accurate information. The SEC pursues charges of accounting fraud and oversees private regulation of the accounting profession.

The law also affects finance. Like accounting professionals, many who work in finance are also regulated by the SEC. The SEC is concerned that investors receive accurate information to make investment decisions. Moreover, the SEC enforces prohibitions against insider trading and pursues claims of other types of securities fraud, such as **Ponzi schemes**³⁷.

Similarly, several statutes protect consumers in financial transactions. For example, the **Truth in Lending Act (TILA)**³⁸ requires lenders to accurately provide information concerning the costs involved in offers of credit. TILA and its corresponding **Regulation Z**³⁹ are administered by federal banking agencies.

Law also affects those in management. For instance, knowledge of employment law is essential to those in human resources. **Title VII of the Civil Rights Act**⁴⁰ prohibits discrimination related to protected characteristics in hiring and employment practices. Those in management also must be aware of the potential liability that demands on employees might create. For example, in Oregon, McDonald's was found to be liable for injuries resulting when an off-duty, off-premises worker fell asleep while driving. *Faverty v. McDonald's*, 892 P.2d 703 (Or. Ct. App. 1995). The employee had worked three shifts during a twenty-four-hour period. The court held that employers have a duty to avoid conduct that creates a foreseeable risk of harm to others.

If your field is marketing, the law also relates to your work. Marketers must be particularly attuned to tort law, consumer protection law, and intellectual property law. For example, to avoid charges of libel, those in advertising need to take care not to defame another person, business, or product. It might be tempting to do so, especially if you were engaged in serious competition with another company that sold a similar product. Likewise, marketers must take great care not to engage in deceptive advertising practices, lest their employer run afoul of the **Federal Trade Commission's (FTC)**⁴¹ policies or the FTC Act. Additionally, marketers must be aware of other people's intellectual property to avoid copyright or trademark infringement in their own work product.

These are a few examples of how the law relates to specific business disciplines. Of course, this is just an overview. It is incumbent on each business professional to become familiar with the legal environment in his or her profession. Employers may provide training regarding legal environment issues, such as anti-sexual harassment training or anti-insider trading training, but ultimately, becoming familiar with the legal environment is each person's individual responsibility. Remember that a defense of "I didn't know the law!" is no defense at all.

37. A type of investment fraud similar to a pyramid scheme.

38. A federal statute that requires lenders to provide accurate information concerning costs involved in offers of credit.

39. The regulation that implements the Truth in Lending Act.

40. The act that prohibits discrimination related to protected characteristics in hiring and employment practices.

41. A federal agency that protects consumers.

KEY TAKEAWAYS

The law is relevant to every business discipline. Minimizing liability exposure is a primary concern of business, and an understanding of the legal environment relevant to each disciplinary perspective helps business practitioners minimize their risk of incurring liability to themselves or to their employers.

EXERCISES

1. Which business discipline is your favorite? Find a newspaper article that illustrates a legal problem pertaining to that discipline that could have been avoided with a better understanding of the legal environment of business.
2. How can employers use knowledge of the legal environment of business to minimize liability exposure? Identify three concrete ideas.
3. How can employers stay current with the legal environment of business? For example, how would other employers in Oregon find out about the case of the off-duty, off-premises worker mentioned in this section? If you were an employer in Oregon, how might this case change your business practices?
4. Do you think that if employers train their employees how to behave on the job, those employers should be absolved from legal liability resulting from employees' actions? For example, imagine that an employer provides training to its employees regarding how to avoid sexual harassment in the workplace, but an employee ignores the training and sexually harasses a colleague. Should the employer bear liability in that situation? Why or why not?

1.6 Concluding Thoughts

This chapter provides an introduction to the legal environment of business. Knowledge of the legal environment of business is essential to successful business practices. This involves understanding what the law is, where it comes from, and specifically how it relates to business. Moreover, different philosophies of law exist. Approaching a problem from different perspectives allows for multiple outcomes to be explored. Additionally, when people approach the same problem from different legal philosophies, reasonable minds can disagree on the outcome. Familiarity with government structure and an understanding of rule of law are essential to successful business operations. Ultimately, businesspeople should be able to recognize legal situations, minimize liability exposure, and know when to consult an attorney.

As you embark on your study of the legal environment, try to remain oriented. Ask yourself questions like “Where does this piece of law fit in the business world?” and “Why is it important for me to know this?” Studying the law can, at times, seem like studying pieces of a very large jigsaw puzzle. You may not immediately see how individual pieces fit together, but with protracted study of law, it will become clear. Often, with that understanding, the depth of law becomes apparent.

Additionally, it is very helpful if you try to find contemporary examples of the concepts that are discussed in this book. When surfing the Internet, watching movies, or reviewing current events, try to “issue spot.” In other words, try to identify the legal issue raised by the particular problem presented. Try to figure out which jurisdiction would have authority over the issue. State government? Federal government? Both? Try to determine which type of law would control or be determinative of the outcome. Is it a statutory issue? A constitutional issue? A regulatory issue?

Also, try to ask yourself why the dispute was raised. Will the parties involved be able to work it out on their own? If not, why not? Has the issue entered into litigation? How could the issue have been avoided with better planning and greater familiarity with the legal environment?

This little game can give you practice in orienting yourself as you gain footing in the study of law and the legal environment of business. We wish you every success in your course!