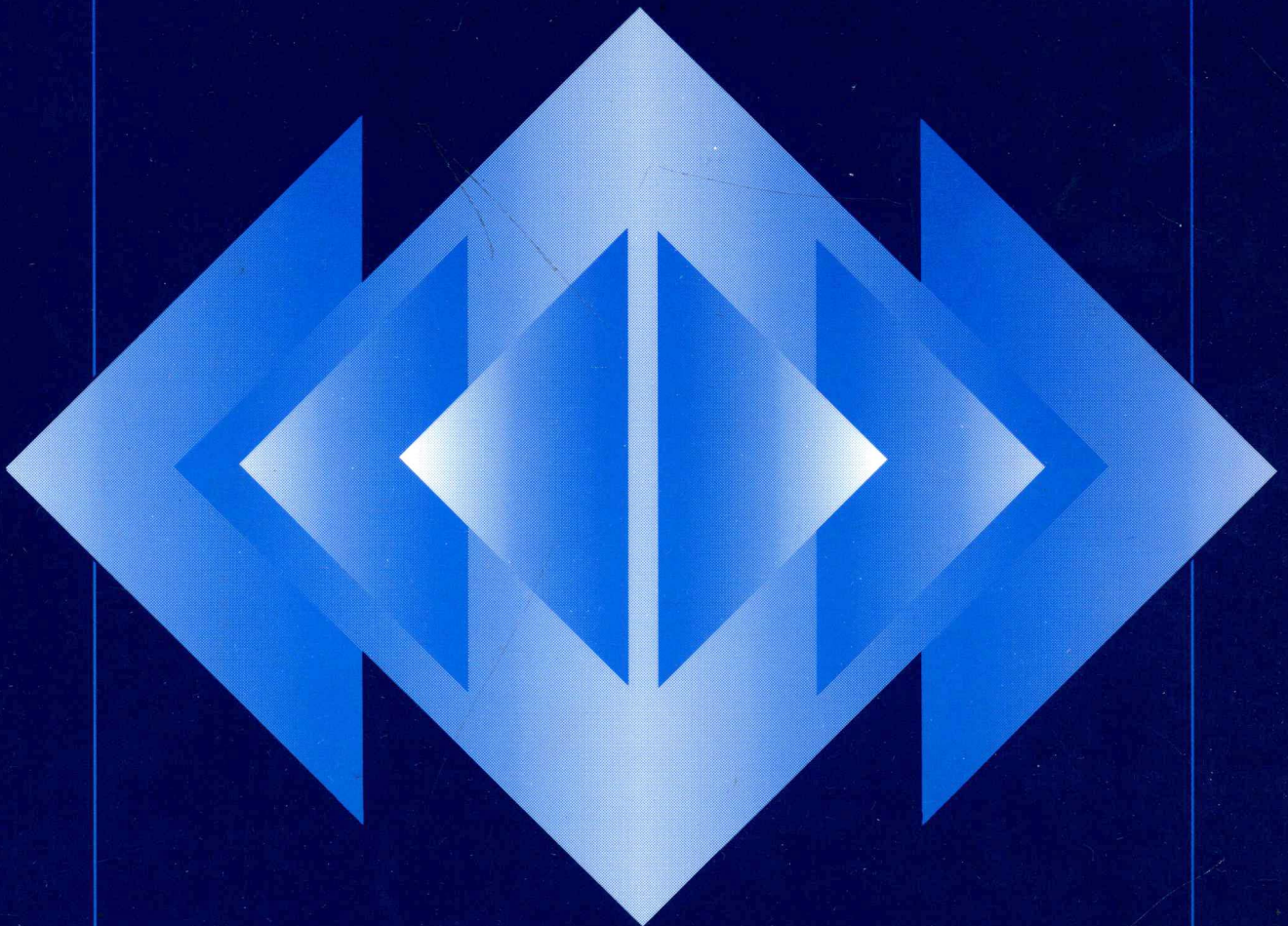


STUDY GUIDE TO ACCOMPANY

Corley / Reed / Shedd

**THE LEGAL
AND REGULATORY
ENVIRONMENT
OF BUSINESS**

NINTH EDITION



O. Lee Reed

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O. Lee Reed

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PREFACE

For most of you studying The Legal and Regulatory Environment of Business, this will be your first law-related course. Because the basic tool of law is words, this course requires much reading and a great deal of thinking about words. In preparing your text, the authors realized that a guide to help direct student reading and study in law would be especially important. The publisher agreed, which led to preparation of the following study guide.

Many student study guides are written by someone other than a text author. However, as co-author of The Legal and Regulatory Environment of Business, I am proud to bring to bear on the study guide knowledge gained from research and writing of the text. I believe that students will benefit more from a text author's personal attention to this important guide than if its preparation were left to someone substantially unfamiliar with the writing of the text.

The guide does not replace a thorough reading of the text, but if used to assist your reading and study, it can prove a very valuable tool. Each study guide chapter corresponds to a text chapter. It contains an outline that summarizes principal points of each chapter, using the same section headings found in the chapter. Major terms and concepts are underlined to highlight them.

Following the outline are completion exercises, true-false choices, multiple choice selections, and a discussion analysis. At the end of the study guide are answers to the various exercises. Also included is a suggested development for the discussion analysis. Careful attention to the exercises and discussion analysis should aid self-measurement and exam preparation significantly.

Woodrow Wilson noted, "Every citizen should know what law is, how it came into existence, what relation its form bears to its substance, and how it gives to society its fibre and strength and poise of frame." For the business professional, whose decisions are heavily influenced by legal considerations, an understanding of the legal environment of business is especially important. This study guide, used along with your text, can make a significant contribution to that understanding.

O. Lee Reed

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PART ONE

THE LEGAL ENVIRONMENT OF BUSINESS: CONDUCT AND DISPUTE RESOLUTION

The twenty chapters of this study guide are divided into four parts. This first part contains four chapters:

1. Chapter 1: role of law in business.
2. Chapter 2: court system.
3. Chapter 3: litigation (lawsuits).
4. Chapter 4: alternative dispute resolution (alternatives to litigation).

Chapter *1*

Law and Business

STUDY GUIDE AND OUTLINE

Just as an understanding of the profit motive in our competitive economic system is essential for an educated businessperson, so is knowledge of the law, its processes, our legal system, and the legal environment. Chapter 1 covers:

1. Law and its sources.
2. Legal sanctions (the methods that force compliance with the law).
3. Profit, ethics, and social responsibility.

LAW AND ITS SOURCES

I. Definitions of Law

- A. There are many definitions of law.
- B. Criminal law commands individuals, telling them what they may or may not do. Civil law (for example, the law of contracts) does not usually command. Instead, it imposes liability and damages for failing to comply with the law.
- C. Law is made up of three elements:
 1. Formal legislation, including constitutions, statutes, and treaties.
 2. Rules of law announced by the courts in deciding cases.
 3. The system of legal concepts which forms the basis of judicial action.
- D. Oliver Wendell Holmes defined law as "a statement of the circumstances in which the public force will be brought to bear through courts." The statement illustrates the importance of the courts to the legal system.
- E. Law may also be regarded as a scheme of social control. Thus judges are in a sense social engineers.
- F. Roscoe Pound defined law in terms of justice. He said that law is "that organized body of knowledge that has to do with the administration of justice by public or regular tribunals in accordance with principles or rules of general character and more or less uniform application."

II. The Rule of Law

- A. John Adams described our political system as "a government of laws and not of men."

- B. Lincoln described law as the "political religion" of our country.
- C. The study of law essentially concerns "rules of law." A rule of law is a statement that if certain facts exist, the courts will take action or refuse to take action at the request of someone involved. Facts create legal issues that are resolved by using rules of law. Be aware of the tremendous importance of facts to the law. The usual function of the jury is fact finding.

III. Classifications of Law

- A. There are several ways of classifying legal subjects.
- B. Public law and private law.
 - 1. Public law includes constitutional law, administrative law, and criminal law. In public law the interests of society are represented by the state.
 - 2. Private law involves those legal problems which exist between individuals, as contrasted with those in which society is concerned. Private law is divided into the law of contracts, the law of torts, and the law of property.
- C. Substantive law and procedural law.
 - 1. Substantive law defines legal relationships between people or between individuals and the state. The rules of contract law and statutes prohibiting possession of drugs are examples of substantive law.
 - 2. Procedural law deals with the means by which substantive law is made and administered. Rules involving the method of conducting trials, appeals, and enforcement of judgments are examples of procedural law.
- D. Civil law and criminal law.

IV. Sources of Law

- A. Our law comes from four basic sources:
 - 1. Constitutions (state and federal).
 - 2. Legislation (state and federal).
 - 3. Judicial decisions (state and federal).
 - 4. Rules, regulations and decisions of administrative agencies (state and federal).
- B. Constitutions are the basic and supreme law.
- C. Most of our laws are found in some form of legislation.
- D. Judge-made (judicial decisions) law is often called common law. Common law has its origins in England. Common law is based on the principle stare decisis, which means that in present cases courts follow decisions (precedents) laid down in prior cases. In a sense, courts also "make law" when they interpret constitutions, statutes, and regulatory rules and decisions.

LEGAL SANCTIONS

The methods for forcing obedience to the law are called sanctions. Sanctions are a form of punishment. The 14th Amendment to the Constitution guarantees that we will not be punished ("deprived of life, liberty, or property") by the state without a "due process" of law. One sanction enables a person to take another's money or property. This sanction is known as a remedy. Consider the following sanctions for:

Chapter 1

1. Criminal conduct.
2. Breach of contract.
3. Tortious conduct.
4. Violating statutes and regulations.

V. For Criminal Conduct

- A. Criminal law involves wrongs against society that the state punishes. Sanctions for crime include:
1. Death.
 2. Imprisonment.
 3. Fine.
 4. Removal from office.
 5. Disqualification from holding office and from voting.
- B. Criminal law is generally divided into felonies and misdemeanors.
1. Felonies are punishable by fine or imprisonment of one year or more.
 2. Misdemeanors are punishable by a fine or imprisonment of less than one year.
 3. Violations of traffic ordinances, building codes, and other local ordinances are sometimes called petty offenses.
- C. White-collar crime is on the increase. White-collar crime is nonviolent crime conducted by businesspersons. There have been many proposals made for reducing crime in general and white-collar crime in particular.

VI. For Breach of Contract

- A. A contract is a legally binding agreement between persons. Courts recognize that persons have a duty to live up to their contracts, and the law provides remedies for breach of contracts.
- B. When one party to a contract fails to do what he or she agreed, a breach of contract occurs.
- C. The usual remedy for a breach of contract is a lawsuit for dollar damages. These damages are called compensatory damages and are designed to make the victim "whole" again for all losses that arise directly and foreseeably from a contract's breach.
- D. Breach of contract cases may also award consequential damages when the breaching party had reason to know of special circumstances that would cause the other party to suffer additional damages if the contract were breached. Example: X contracts to sell Y a ditch digger, knowing that Y has a contract with Z to dig ditches. The digger that X supplies is defective, Y cannot dig the ditches for Z, and Y loses Z's business. Y sues X. The damages required to fix the defective digger are compensatory damages. Y's lost profits on the contract with Z are consequential damages.
- E. When the parties agree in their contract as to what damages for breach will be, these are called liquidated damages.
- F. Other remedies for contract breach include:
1. Cancellation and rescission (cancelling the contract and giving back what each person has received).
 2. Specific performance (requiring the breaching party under certain circumstances to perform the contract).

VII. For Tortious Conduct

- A. A tort is a non-contractual civil wrong for which the law gives a right to recover damages. The same act may be both a tort and a crime, e.g., an assault.

- B. Tort liability assumes that in a civilized society people will not intentionally injure others or their property, and that all persons will exercise reasonable care in their activities.
 - 1. Intentional torts include assault and battery, false imprisonment, libel, trespass and conversion.
 - 2. Negligence liability arises from an injury caused by a failure to exercise the duty of reasonable care.
- C. If the plaintiff wins a tort case, he or she is awarded damages. These damages may include:
 - 1. Compensatory damages that compensate for medical expenses, loss of income, and pain and suffering.
 - 2. Punitive (exemplary) damages that punish the defendant when the defendant's conduct is intentional, fraudulent, or reckless.
- D. Major areas of tort litigation today include:
 - 1. Malpractice, which is professional negligence by persons like accountants, lawyers, physicians, and engineers.
 - 2. Products liability, which is the area of torts involving injuries arising from defectively designed or manufactured products.

VIII. For Violating Statutes and Regulations

- A. Statutes and regulations at both the federal and state levels often include sanctions to help prevent their violation. Sanctions can include:
 - 1. Fine and imprisonment.
 - 2. Damages, including triple (treble) damages.
 - 3. Seizure of property.
 - 4. Injunction, which is an order by the judge (court) to prevent future violations or correct past ones.
- B. Chapters in this text on employment law, labor law, securities law, and antitrust law will illustrate use of various forms of these sanctions.

PROFITS, ETHICS, AND SOCIAL RESPONSIBILITY

Means of social control other than law include:

- 1. Profit (economic incentive).
- 2. Ethics and social responsibility.

IX. Economic Incentives

In business, economic incentives (the profit motive) play an even more important role in overall decision making than does law.

X. Ethics

- A. Ethics is a formal system for evaluating morals, our concepts of right and wrong. The terms ethics and morals are sometimes used interchangeably.
- B. Ethical values often support legal values and precede them.

Chapter 1

- C. Chapter 11 of this text focuses on ethics. Throughout the various chapters, however, we have selected excerpts from a typical code of ethical business conduct: the one developed by the Caterpillar Tractor Company.

COMPLETION EXERCISES

1. Holmes said "Law is a statement of the circumstances in which the public force will be brought to bear through _____."
2. _____ defines those legal problems and relationships which exist between individuals.
3. _____ deals with the method and means by which substantive law is administered.
4. Law may be divided into criminal law and _____.
5. Criminal law is generally divided into _____ and _____.
6. Non-violent business crime is generally referred to as _____.
7. _____ concerns the legal relationships created between individuals by their own agreement.
8. A non-contractual civil wrong is a _____.
9. _____ is a breach of the duty to use reasonable care.
10. The damages in both contract and tort cases that are intended to make the plaintiff "whole" again are called _____ damages.
11. Damages for breach of contract that are agreed upon in the contract itself are called _____ damages.
12. Punishment damages for intentional, fraudulent, or reckless conduct are called _____ or _____ damages.
13. The four basic sources of law in our legal system are _____, _____, _____, and _____.
14. Judicial use of case law is based on the doctrine of _____.
15. In addition to law, basic forces shaping society are _____, _____, and _____.

TRUE-FALSE CHOICES

1. _____ John Adams described our political system as "a government of laws and not of men."
2. _____ Roscoe Pound defined law in terms of legal power.
3. _____ The study of law essentially concerns "rules of law."
4. _____ Uses of the word "law" are limitless.
5. _____ Civil law (such as the law of contracts) commands compliance.
6. _____ The number of lawsuits being filed today is declining.

7. _____ Sanctions are methods for forcing obedience to the law.
8. _____ An injunction is a court order concerning past or future behavior.
9. _____ Consequential damages are the usual remedy for breach of contract.
10. _____ Professional negligence is called malpractice.
11. _____ The same act cannot be both a tort and crime.
12. _____ The common law is basically statutory in origin.
13. _____ Ethical values are affected by economic considerations.
14. _____ The terms ethics and morals concern our concepts of right and wrong.
15. _____ Legal values often arise out of ethical values.

MULTIPLE CHOICE SELECTIONS

1. Select the incorrect statement:
 - a. Crimes are wrongs in society that the state punishes.
 - b. Felonies are punishable by imprisonment of one year or more.
 - c. Misdemeanors are punishable by imprisonment of less than one year.
 - d. White-collar crime is on the decrease.
2. Select the incorrect statement:
 - a. A contract is a legally binding agreement between persons.
 - b. The law recognizes that persons have a duty to live up to their contracts.
 - c. Negligence includes assault and battery.
 - d. A tort is a civil wrong.
3. Select the incorrect statement:
 - a. Statutory law is based on the principle of stare decisis.
 - b. Judge-made law is often called common law.
 - c. Constitutions are our most basic and supreme law.
 - d. In a sense, courts make law.
4. Select the most correct statement:
 - a. Private law includes administrative and criminal law.
 - b. Procedural law defines the legal relationship of people with other people.
 - c. Civil cases are also those which are not criminal actions.
 - d. A tort cannot also be a crime.
5. Select the most correct statement:
 - a. The ethics of society influence the law's content.
 - b. The law influences the ethical expectations of society.
 - c. Ethics may actually condemn that which the law allows.
 - d. All of the above are correct.

DISCUSSION ANALYSIS

What are the basic sources of law in our society? Discuss which of these sources you consider to be the most important overall.

Chapter

2

Courts

STUDY GUIDE AND OUTLINE

This chapter, which deals with our courts (or judicial system), is divided into three parts:

1. The organization of state and federal courts.
2. Court personnel, including judges, juries, and lawyers, and their duties.
3. The judicial process (powers and functions of courts), including judicial review, interpretation of the Constitution and legislation, and the making of case law.

ORGANIZATION

The federal court system, and courts in most states, contain three levels:

1. Trial courts.
2. Intermediate reviewing courts.
3. Final reviewing courts.

I. Jurisdiction

- A. Jurisdiction refers to a court's power over the parties to a lawsuit and over what the lawsuit is about (subject matter). Courts either have general or limited jurisdiction.
- B. Courts of general jurisdiction may decide cases on most subject matters, but may have geographic limitations (e.g., a state court has jurisdiction only within the state).
- C. Courts of limited jurisdiction are usually restricted as to the subject matter of the cases they decide (e.g., small claims courts lack jurisdiction over cases for more than a certain amount).

II. State Courts

- A. The basic trial court is frequently known as the circuit court. It may also be called the superior court, district court, or court of common pleas. In New York, it is called the supreme court. These trial courts have general jurisdiction which means that they have power to hear any type of case.
- B. Above the trial courts in most states are intermediate reviewing courts (appellate courts) and a court of final resort called the "Supreme Court of Appeals."

Chapter 2

- C. Courts of last resort in the state and federal systems (e.g., the Supreme Court) usually hear appeals in only the most important cases. Litigants (parties to a lawsuit) usually have a right to appeal the legal decisions of the trial judge to an intermediate appellate court, but most petition the court of last resort and ask it to hear an appeal. The procedure is called "petition for leave to appeal" in some states and "petition for a writ of certiorari" in others.
- D. Beneath the trial courts of general jurisdiction may be various specialized courts such as small claims courts. These courts have low court costs and simplified procedures. Usually, lawyers need not represent the litigants. Small claims courts are subject to a dollar limitation on the amount of claims which may be made. These courts handle the majority of litigation between businesses and their customers. One continuing problem is that many successful litigants are unable to collect their judgments.

III. Federal Courts

- A. Federal courts have limited jurisdiction. They have power over questions of federal law, the Constitution, matters in which the United States is a party, controversies between states, and diversity of citizenship cases (suits between citizens of different states).
- B. Article III of the Constitution provides that judicial power be vested in the Supreme Court and such lower courts as Congress may create.
- C. For diversity of citizenship purposes, a corporation is a citizen of its state of incorporation and also the place where it has its principal place of business.
- D. In diversity of citizenship cases, each federal plaintiff must meet the jurisdictional minimum amount, i.e., each plaintiff must claim at least \$50,000 in damages.
- E. Note that in a diversity of citizenship case each federal plaintiff must be diverse from each defendant, i.e., must live in a different state.
- F. Following a trial in federal court, litigants are entitled to one appellate review as a matter of right. Usually this appeal is made to a court called the "court of appeals."
- G. A losing federal litigant at a court of appeals can petition the Supreme Court for a writ of certiorari. Writs of certiorari are granted only in cases of substantial importance or when there is an obvious conflict between decisions of two or more courts of appeal. If certiorari is not granted, a party cannot have his or her case heard by the Supreme Court. In this event, a decision of the court of appeals is final.
- H. If a plaintiff files a lawsuit in a state court, and the case could have been brought into federal court, the defendant can have the case removed to the federal court. An example of this situation is when the case involves a plaintiff and a defendant from different states.
- I. A litigant may petition for certiorari the decision of the highest state court to the U.S. Supreme Court when a substantial issue of federal or constitutional law is involved.
- J. The federal courts apply both substantive and procedural law. The federal rules of procedure govern applicable procedural law. When federal questions are involved, the federal courts apply federal substantive law.
- K. In diversity of citizenship cases, the federal courts apply the substantive law of the state in which the federal court is sitting. When there is no clear state law in such cases, the federal courts can invoke the doctrine of abstention and direct the litigants to try their case in the state court system.
- L. Since federal courts use federal procedures and state substantive law in diversity cases, many decisions concern whether a given issue is one of substantive law or one of procedure. If the state rule law will affect the result of the case, the rule is always treated as substantive.

IV. Courts of Equity

- A. Aristotle defined equity as the "correction of the law, where, by reason of its universality, it is deficient."
- B. In our legal system equity has its origins in English law. Special courts called courts of chancery granted remedies such as specific performance of a contract when the legal (law court) remedy of damages was unfair (inequitable) to the plaintiff.
- C. When dollar damages is an adequate remedy, a suit in equity will be dismissed.
- D. Courts of chancery (or equity) use maxims instead of rules of law. Some typical maxims of equity include:
 - 1. "Equity will not suffer a right to exist without a remedy."
 - 2. "He who comes into equity must do so with 'clean hands.' "
 - 3. "He who seeks equity must do equity."
- E. The decision of a court of equity is called a decree, as contrasted with a judgment in a court of law.
- F. Once courts of law and equity were separate. Today, they are joined. Still, however, there is the difference between legal and equitable remedies.

PERSONNEL

Before we look at the judicial process and functions of courts, some background and understanding of the people who operate our court system is required.

V. Judges and Justices

- A. The judicial power is perhaps the most extensive power possessed by any branch of government. This power is exercised by trial court judges and reviewing court (appeals court) justices.
- B. Trial court judges try cases. They have direct contact with litigation and litigants.
- C. Justices hear appeals from the legal decisions made by trial courts. They give reasons for their decisions in written form, which becomes precedent and a part of our body of law. On review, justices are essentially concerned with issues of law. Issues of fact are resolved at the trial level.
- D. Judges and justices have judicial immunity. This means that they have almost total personal immunity from legal actions against them based on their judicial acts, even when these acts are malicious or exceed authority.

VI. Jurors

- A. The Sixth and Seventh Amendments to the Constitution guarantee the right of trial by jury in both criminal and civil cases. In civil cases this right is preserved in lawsuits at common law when the amount in controversy exceeds \$20.
- B. There are two basic types of juries: the grand jury and petit jury.
- C. A grand jury determines whether there is sufficient evidence of guilt to warrant indictment for criminal trials.
- D. A petit jury determines the facts at a trial. Historically, this jury consisted of 12 persons. Today many state and federal courts provide for smaller juries in both criminal and civil cases.

Chapter 2

- E. In most states a petit jury's decision must be unanimous. However, in some states less than a unanimous verdict is constitutionally permissible for a 12-person jury.
- F. "Mock" trials are being used increasingly by lawyers to help determine how real juries will respond to the presentation of evidence.
- G. Many states are expanding the lists of people eligible for jury duty and are reducing the list of occupations that exempt a person for jury duty.
- H. Many experts recommend that the right to trial by jury be abolished, especially in very complex civil cases.

VII. Lawyers

- A. As a practical matter, lawyers are required to represent most parties in most court cases.
- B. Corporations cannot come to court except through lawyers.
- C. A lawyer serves in three capacities: counselor, advocate, and public servant.
- D. The attorney-client privilege does not permit a lawyer to testify as to facts told him or her by a client.

THE JUDICIAL PROCESS

The sections that follow discuss:

- 1. The doctrine of judicial review.
- 2. The interpretation of legislation.
- 3. The problems of the common law system.

VIII. Judicial Review

- A. The doctrine of judicial review allows the courts to review laws passed by the legislature and actions taken by the executive branch and to declare them unconstitutional.
- B. The Constitution does not expressly give the courts this power. Chief Justice Marshall announced the doctrine of judicial review in the famous case Marbury v. Madison.
- C. An example of judicial review comes from the Watergate era when the Supreme Court ruled that it would be unconstitutional for President Nixon to refuse to hand over certain tape recordings to Congress. In another example the Court ruled that a legislative veto over acts of the executive branch of government was unconstitutional.
- D. As judges exercise the power of judicial review, they do so with varying attitudes and philosophies.
- E. Judges who believe that judicial review should not be used except in unusual cases are said to believe in judicial restraint. Those who think that judicial review should be used whenever the needs of society justify its use believe in judicial activism. All judges believe in judicial restraint and all are activists to some extent. Often a judge may be an activist in one area of the law and a firm believer in judicial restraint in another.
- F. Those who believe in judicial restraint think that constitutional issues are too important to be decided unless absolutely necessary and are to be avoided if there is another legal basis for a decision. They believe the proper use of their power demands that courts refrain from determining the constitutionality of an act of Congress unless it is absolutely required.