Lynn M. Forsythe • Jacquelin J. Curry

Business Law

Principles and Cases in the Legal Environment

FIFTH EDITION

ASPEN PUBLISHING

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Principles and Cases in the Legal Environment

Fifth E dition

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I want to dedicate this book to Daniel Davidson, who has been my co-author on the last four editions of this book. With this edition, I welcome Jacquelin Curry to the author team. I also want to dedicate this book to our students, past, present, and future. I want to thank my family for their encouragement, support, and love, especially Jim and Mike Poptanich and Aileen Zollweg.

—Lynn M. Forsythe

I would like to dedicate this book to Lynn Forsythe. She is an exceptional mentor and writing partner. I am very thankful for her guidance. I also want to dedicate this book to our students who often amaze me with their creativity and resilience. I am thankful to my family for believing in me and encouraging me to pursue my love of writing.

—Jacquelin J. Curry

We dedicate this Fifth Edition to Daniel V. Davidson, who co-authored the first four editions. Dan was a pleasure to work with because of his positive approach to writing. He always stayed true to the mission of the text—to provide a comprehensive business law text that is accessible and engaging for undergraduate students. Dan made many creative contributions to the development and design of the book. He played a significant role in the development of our thread case and You Be the Judge boxes. We are pleased to continue the traditions he started with this edition.

—Lynn M. Forsythe
—Jacquelin J. Curry

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Preface

A BUSINESS-ORIENTED TEXT

The fifth edition of *Business Law: Principles and Cases in the Legal Environment* provides students with a business-oriented introduction to the legal and ethical topics that affect business. This perspective may seem obvious. However, not all business law textbooks focus on the *practice* of business. Some fail to show students how the law will affect their future careers as businesspeople. Our goal as business law and legal environment instructors is not to teach lawyers, but to teach future businesspeople. The book is not organized along the lines of law school classes—for example, administrative law, agency, and remedies. Instead, it is organized along the lines of how businesspeople should think about the law. For example, torts material may be in the agency chapters and remedies material may be in the contracts chapters.

Businesspeople need to be able to anticipate and avoid legal problems. If legal problems occur, businesspeople need to know how to recognize the nature of these problems and how to work with lawyers to achieve solutions. Legal problems, including lawsuits, are business problems that can and should be strategically managed.

Our goals in this text are:

- To present in a student-friendly fashion a current and comprehensive introduction to the legal topics relevant to business;
- To demonstrate how these topics apply to business enterprises and transactions;
- To offer legal strategies for business leaders;

- To provide approaches for analyzing legal topics encountered in the practice of business; and
- To develop critical thinking skills and habits.

We also support the students and instructors using this text. Aspen offers a wide variety of supplementary materials for students and instructors.

Cyber Guardian Business Cases

We have included an integrated, continuous business case or scenario. The Cyber Guardian case is threaded throughout the text. The individual threads profile the experiences of a hypothetical business, Cyber Guardian, owned and operated by a "local" group of student entrepreneurs. The entrepreneurs and their artificial intelligence (AI)–based business are introduced before Chapter 1. Each chapter begins with an Agenda that highlights some major legal issues from the chapter that are likely to be relevant to Cyber Guardian (and many real businesses). Within each chapter there are at least three Cyber Guardian application boxes that address particular legal issues and call for students to offer guidance to the firm. Each application box is categorized by the relevant functional area of business—accounting, finance, international business, management, manufacturing, marketing, personal law, and sales. Application boxes pose questions including Business Considerations and Ethical Considerations. These questions ask students to go beyond the text and apply the concepts to a business entity. Many of the questions ask students to make strategic business decisions informed by their knowledge of the law.

Students in business schools often focus on one subject at a time. When they are in accounting class they think about accounting problems, and when they are in business law they focus on business law. Operationally, problems in a business generally overlap more than one functional area. A problem can be both a business law problem and a marketing problem. The problems are interdependent, not separate. In addition, business problems do not arise with labels

attached. Businesspeople need to be able to identify the subjects that are involved. Working with the Cyber Guardian thread cases helps students recognize the interdependent nature of business problems and business decision making. Students may not be able to provide a full answer to some of the questions posed. Some questions might require additional information or research to fully respond.

Cyber Guardian thread cases are not intended to encourage business students to practice law without a license. (It is illegal to practice law without a license, and we are not advocating that students break this or any other law.) However, application is an important aspect of mastering material. Knowledge of the law is of little use if students do not know how or when to apply the knowledge. College students should ask themselves: "How can I use this information?" The Cyber Guardian case provides an opportunity for students to practice applying their knowledge of the law. Like our Cyber Guardian entrepreneurs, businesspeople do not call their attorneys to discuss every decision that may have legal ramifications. They often rely on their own knowledge and the information they gain from their colleagues, friends, and the internet. (As we know, not all colleagues, friends, or internet sites are well informed, and they do not always provide up-to-date and/or accurate information.)

Exhibits

There are numerous exhibits in the text. These exhibits assist students in comprehending the material, but they are not intended to replace the text. They provide a visual aid to comprehension and learning.

TOPICAL COVERAGE

Our first goal is to present a current and comprehensive introduction to the legal topics relevant to business in a readable, accessible style. To achieve this goal, the book is divided into seven parts based on the typical topical coverage of undergraduate business law courses.

Part I: Foundations of Law and the U.S. Legal System Part I presents an overview of law and the legal system. Chapter 1 discusses different ways to look at the law. It includes a discussion of theories of jurisprudence and how the law is viewed in different countries. Chapter 2 focuses on how businesspeople might apply ethical theories in making business decisions. Chapter 3 examines the U.S. court system and how courts obtain jurisdiction over cases. Chapter 4 introduces a civil trial through a hypothetical accident involving our Cyber Guardian entrepreneurs. It also discusses alternatives to the court system that businesspeople can use. Chapter 5 discusses the constitutional bases for government regulation of business. Chapter 6 examines potential liability for torts. Chapter 7 addresses business crimes including computer crimes, espionage, and the Racketeer Influenced and Corrupt Organizations Act (RICO). Chapter 8 deals with international business and various topics of international law.

Part II: Contracts Part II examines contract law and its importance in business transactions. The material includes an in-depth discussion of the common law of contracts and information about how contract law is changing in response to the increase in e-commerce. Chapter 9 is an introduction to the law of contracts. Chapter 10 covers offer, acceptance, and consideration. Chapter 11 deals with capacity to contract, the reality of consent, and illegal contracts. Chapter 12 addresses contract writings, including techniques courts use to interpret contracts. Chapter 13 discusses the rights and obligations of third parties. Part II concludes with Chapter 14 discussing discharge, breach, and available remedies.

Part III: Debtor–Creditor Relations Chapter 15 examines debtor–creditor relations by looking at secured transactions under Article 9 of the UCC with its significant revisions. Next is Chapter 16 dealing with other credit transactions. This discussion includes payday loans, credit businesses may extend to their customers, and credit businesses may use to purchase assets or inventory. Chapter 17 addresses the federal protections available for honest debtors under

the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The discussion compares Chapters 7, 11, and 13 of the Bankruptcy Act.

Part IV: Agency Part IV explains the agency relationship and its importance in operating a business. Chapter 18 includes a discussion of the distinction between employees and independent contractors and why it is critical to correctly categorize workers. This is an important issue that is evolving as the gig economy grows and the political pressures to treat gig workers as employees increase. Chapter 19 emphasizes the liability of the principal and agent for contracts entered into by the agent. Chapter 20 focuses on the liability of employers and employees for torts and crimes committed by employees. Policies underlying the rules are also addressed. The discussion includes how to protect the business's confidential information and when the employer can use covenants not to compete.

Part V: Business Organizations Part V treats the various types of business organizations in a unique manner. Rather than have separate chapters dealing with each business form, the text treats the types of organizations in a compare-and-contrast fashion within the chapters. Chapter 21 deals with forming the business enterprise. Chapter 22 discusses how the enterprise operates, and Chapter 23 explains how the business terminates or merges with other enterprises. The focus is on the strategic advantages and disadvantages of the different structures for the operation of a business. The coverage includes the more traditional business forms, such as sole proprietorships, partnerships, and corporations. It also includes the newer business forms such as limited liability companies, limited partnerships, limited liability partnerships, and limited liability limited partnerships. Part V also includes a discussion of securities regulation in Chapter 24 and antitrust law in Chapter 25.

Part VI: Government Regulation of Business Part VI addresses the regulatory issues commonly faced by businesses. Chapter 26

explains how the law regulates products and protects consumers. Chapter 27 is devoted to consumer credit and stresses concepts that relate back to Chapter 16. Chapter 28 addresses many of the major environmental statutes. Chapter 29 examines the rights and responsibilities of businesses to their employees. It includes laws dealing with operation of unions. It also discusses laws prohibiting discrimination in employment.

Part VII: Property Protection Chapter 30 addresses the types of property and the rights that property owners have. It also discusses government regulation of real property. It includes a discussion of the forms of joint ownership and transfer on death ownership. It also explains bailments of personal property. Chapter 31 focuses on types of intellectual property, including copyrights, patents, trade marks, and trade secrets.

APPLICATIONS

Our second goal is to demonstrate how the legal topics presented in the text apply to the practice of business. In addition to the thread case, *Business Law* includes the following features:

Court Cases

Each chapter contains two court cases. After the learning objectives, chapter outline, and Cyber Guardian Agenda, the chapter begins with a Classic Case. This is an older court case, often a landmark legal decision. Each chapter then ends with a Contemporary Case, a more recent decision showing how courts today are applying legal concepts to current disputes.

All the court cases show how the courts apply chapter concepts to actual disputes between litigants. Many of them are also illustrative on how the parties could have avoided the dispute in the first place, such as avoiding ambiguities in drafting a contract or a deed. Court cases are organized into the following parts:

- Facts—the facts of the case
- Issue(s)—the question(s) that the court is deciding
- Holding(s)—the court's answer(s) to the issue(s)
- Reasoning—the reasoning the court used in analyzing the question(s), reaching a decision, and explaining the decision to the public

The reasoning is excerpted from the language of the court. We have summarized the other three parts of the case.

You Be the Judge

After the Contemporary Case, each chapter has a You Be the Judge box. Many of the You Be the Judge boxes take their materials directly from current events, focusing on cases that encourage students to think critically about a variety of topics. Examples include (1) when a transportation network company, like Uber, should be held vicariously liable for its drivers (Chapter 20), and (2) whether a planned condominium community must allow an emotional support animal that does not comply with its pet policy (Chapter 30). The boxes ask students to prepare an opinion that applies the law to the facts presented in the box. Students have the opportunity to play the roles of trial judges, appellate justices, and legislators offering them different vantage points to view the issues. By doing so, students will gain a greater appreciation for the difficulties involved in considering the alternatives and drafting an opinion or statute.

Discussion Questions and Case Problems and Writing Assignments

Each chapter concludes with five Discussion Questions that ask students to test their knowledge of chapter material. The first Discussion Question aids students in improving their skills in critically using artificial intelligence. The Discussion Questions are followed by three Case Problems and Writing Assignments. These questions ask students to apply ethical and legal concepts to actual situations. All

the end-of-chapter materials can be used as study tools in reviewing the material, as class or small-group discussion material, or as writing assignments.

SUPPLEMENTAL RESOURCES

Instructor resources for this text include a comprehensive Instructor's Manual, Test Bank, and PowerPoint slides. Please visit the product page that accompanies this book at *aspenpublishing.com* for additional resources, including additional cases, You Be the Judge boxes, and end-of-chapter questions.

AACSB CURRICULAR STANDARDS

In 2020, the AACSB implemented new accreditation standards with the adoption of the AACSB 2020 Guiding Principles and Standards for Business Accreditation, effective July 28, 2020. The AACSB Guiding Principles and Interpretative Guidance were updated February 28, 2025. The Curriculum Standard says, "The school delivers content that is current, relevant, forward-looking, globally-oriented, aligned with program competency goals, and consistent with its mission, strategies, and expected outcomes. The curriculum content cultivates agility with current and emerging technologies." (Curriculum Standard 4.1, at 40.) We believe *Business Law: Principles and Cases in the Legal Environment, Fifth Edition*, uniquely satisfies these standards in a readable yet rigorous format that aligns well with the goals of most business schools.

Under the standards, one important guiding principle for accredited schools is to nurture a Global Mindset. According to the standards, "The curriculum imbues the understanding of other cultures and values, and learners are educated on the global nature of business and the importance of understanding global trends. The school fosters sensitivity toward a greater understanding and acceptance of cultural differences and global perspectives." (*Id.*, at 17.)

Global issues are treated in several areas, beginning with Chapter 1 and its introduction to different legal systems, including those based on various religions, and international examples. Chapter 4 covers international alternate dispute resolution. Global issues continue in Chapter 8, International Business Law. Chapter 31 addresses international dimensions of intellectual property. Chapter 2, Business Ethics, addresses the ethical theories and how they can be applied in business. It stresses the importance of recognizing that individuals have varying ethical perspectives. Ethics questions follow each of the thread cases.

We engage students with emerging technologies with the AI question at the end of each chapter. We also discuss the legal aspects of using AI in several chapters.

We have created a text that we hope is intuitive, engaging, and oriented toward providing the legal skills students will need in the business world. The pedagogical features are intentionally designed to support this approach.

Acknowledgments

Writing a textbook is a rewarding endeavor. However, it is also a significant undertaking. It would not have been possible without the help and support of several people along the way. We have enjoyed working together on this project. We each prepared about half of the chapters and commented on the drafts prepared by our co-author. We hope this team effort has been successful and that you enjoy using this book as much as we have enjoyed writing it.

This book would not have been possible without the support of Denise Clinton, Managing Editor of Aspen Publishing, who encouraged and supported us along the way. Natalie Danner also provided significant support. We are also indebted to our developmental editor, Kathy Langone of The Froebe Group. Kathy's wise guidance improved the text as it evolved from the first draft to the final product. We also appreciate Suzanne Rapcavage, our copy editor, and Lisa Connery, our production editor, who so carefully and adeptly supervised the final stages of production. We appreciate their patience. They greatly improved the final product. We have enjoyed working with each—and all—of them. We also want to thank Daniel V. Davidson, who worked on the first four editions of this text. He made a significant contribution to the book.

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A sincere thank you to our adopters, who trust us enough to use our text, and to the students who are using it. We approach our work based on our experiences in the classroom, to provide a text that

contains the essential material and is user friendly, readable, and enjoyable.

We also appreciate the encouragement and support of our students and colleagues.

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Professor Forsythe is the author or co-author of numerous articles on business law and business law pedagogy. She served as a part of the author team on four textbooks. She has held the positions of editor-in-chief, staff editor, and reviewer for *The Journal of Legal Studies Education*. She received numerous best paper and best presentation awards from the Western Academy of Legal Studies in Business. Professor Forsythe is active in the Academy of Legal Studies in Business. She has served on the Executive Committee, the House of Delegates, and as the chair and vice-chair of the Business Ethics Section of the Academy. She has served in the officer ranks of the Western Academy of Legal Studies in Business first from 1983-1987 and again from 2006-2009. Professor Forsythe is a member of Beta Gamma Sigma and a Life Member of Alpha Kappa Psi.

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Part I

Foundations of Law and the U.S. Legal System

"Ignorance of the law is no excuse." The basic truth of this old adage seems simple and obvious. However, it can be difficult to understand the law. Each citizen—and resident—of this country has "constructive notice" of the law. This means that each person is expected to be aware of, and to abide by, *all* the laws of the land. The enormous scope of "the law" makes this expectation virtually impossible. No one person can realistically be expected to know *all* that the law entails, yet every person is expected to obey *every* aspect of the law—or to face possible sanctions for failing to do so.

Part I of this book will first help you to understand what law is, how it operates, and how it affects business. To prevent legal problems and successfully handle the legal problems that do arise, a businessperson needs to understand how the U.S. legal system operates. This part describes the powers and limitations of the federal government outlined in the U.S. Constitution and the constitutional bases for government regulation of business. It

describes the court system and how cases progress in the courts through the anatomy of a hypothetical civil suit involving Cyber Guardian and its owners. Part I also discusses alternatives to using the courts to resolve disputes and why businesses may want to use these alternatives. It examines the differences between private wrongs, such as torts, and public wrongs, called crimes.

Each part of this text will offer insights into various aspects of the law, especially the area of business law. A thorough knowledge of the law takes years of specialized study. However, this text will help you begin to understand the law, and it will provide references to other sources for you to explore. While you may not intend to become a lawyer, we hope this text will help you understand how the law operates and how it affects the business that you own or that employs you.

Overview

Cyber Guardian Needs Your Help!

What Is Cyber Guardian? Many people dream of owning their own business, of being their own boss, and of becoming successful entrepreneurs. Three close friends in college share this dream. Danica Evanko, Asher Katz, and Mai Vang are students at the local college. Their business concept started one day after their information systems class when they were discussing the need for improved security for internet-based businesses. The professor had mentioned that artificial intelligence (AI) can be used to efficiently scan computer systems for vulnerabilities and cyberattacks. Danica mentioned a recent cyberattack of her dentist's office. Patient records were stolen, and she is concerned about potential identity theft. Asher revealed that his father's accountant also suffered an attack. The three of them knew that a business needs to secure customer and client records, trade secrets, and business plans. They thought they had the skill set to create a proprietary AI program

and provide monitoring services to other businesses. Consequently, Asher, Danica, and Mai decided to start their own business. Asher's expertise is in entrepreneurship and computer engineering, Danica's is in information systems, and Mai's is in marketing.

Their business model is to be primarily a business-to-business enterprise. They plan to provide security for online and cloud-based businesses through their software and active monitoring. Their proprietary AI platform and software will provide much of the security. In most situations, they plan to lease their software to their customers, rather than sell it. In other words, it will be software as a service (SaaS). The firm's first software, Cyber Defense Suite, is now on the market. In rare cases, they may sell customized software to their clients. The nascent entrepreneurs plan to expand their offerings to provide secure virtual private networks (VPNs) to businesses and consumers. They are also developing an integrated system that includes their software with a modem that will connect clients to the internet. Their slogan is "On Guard 24 Hours a Day." Part of their marketing plan is to build their brand identity. They are, of course, hoping for financial success. They are implementing their business plan, but they know that they will need help and advice along the way.

Asher, Danica, and Mai's exit strategy is to grow the business and eventually be acquired by a large corporation. Of course, Cyber Guardian will need skill, luck, and legal advice to be successful.

The People Behind Cyber Guardian Danica Evanko is majoring in business information systems with a minor in artificial intelligence. She is currently a sophomore at their college.

George Evanko is Danica's brother and a good friend of Asher and Mai. He is not a part of the Cyber Guardian team, but he is interested in becoming an entrepreneur and he has offered to provide free advice to Cyber Guardian.

Asher Katz is a junior majo ring in entr epr eneurship. He is concurr ently working on a minor in computer engineering.

Mai Vang is curr ently a junior majoring in mark eting. She recently compl eted an internship in social media mark eting at a local public r elations firm.

What Is Your Role in Cyber Guardian? Asher , Danica, and Mai ar e just star ting their busines s. While the y will ha ve an att orne y to whom the y can turn on various legal issues, the y do not want to call their at torne y ever y time a question arises. The y realiz e that the y will be billed for each consultation with their lawy er, and mone y will be tight as the y begin their business. Instead, the y would lik e to ask *you* to be their consultant, since you ar e learning about business law . When a pr oblem with busine ss law implications arises, the frien ds would lik e to consult with you, asking you for advice and suggestions. Ob viously , the y do not want you to "practice law" (which would be illegal), but the y would appr eciate your help in determining whether an issue might h ave ser ious legal implications, how the y might avoid legal pr oblems, and when the y should consult with their att orne y.

Cyber Guar dian is, of course, a fictional company cr eated and operated by fictional people. But the use of this fictional business will illustrate how the legal concepts discussed in each chapter might apply in the business envir onment. Each chapter will begin with an "Agenda, " which highlights some of the major business law issues that ar e discus sed in that chapter . Within each chapter ther e ar e se veral diff er ent scenarios, each addr essing a par ticular issue that might arise in a business setting. For each, you ar e ask ed to pr ovide guid ance and advice to the firm about the legal implications inv olv ed in that scenario, and to assess the business and ethical issues inv olv ed. You will become a mor e educated consultant as you pr ogr ess thr ough the text. The pr oblems you confr ont will inv olv e many diff er ent func tional ar eas of business besid es law—accou nting, finance, international business, management, mark eting, and sales—and even a few personal issues. Although the scenarios ar e not labeled as entr epr eneurship, most of the m also relate to that discipline. This

appr oach is intended to help you recogniz e the interr elationships between the various busine ss subjects. This recognit ion is impor tant to a business' s success. Business courses should be viewed not in isolation but as integrated resour ces that, when pr operly combined, can help a business to maximiz e its chances for success.

You ar e the co nsultant who will pr o vide advice and guidan ce on potential issues that the business encounters during its de v elopment. Despite the dedication and exper tise of the thr ee entr epr eneurs, Cyber Guar dian is less lik ely to succeed without your help, so be pr epar ed!

1

Introduction to the Law and Its Role in Business

Learning Objectives

After completing this chapter, you should be able to:

- Identify why it is important for businesspeople to understand the law
- Contrast substantive law and procedural law
- Restate the functions of the law
- Discuss the different theories of jurisprudence
- Explain the role of precedents in U.S. law
- Describe the sources of U.S. law
- Compare law and equity
- Recognize that legal systems and processes can vary in other countries

Outline

- Business and the Law
- Legal Systems
- Jurisprudence
- Sources of Law
- Classifications of Law

Agenda

Asher , Danica, and Mai need to understand what types of law will affect Cyber Guardian. Will Cyber Guardian be subject to federal regulation? To state regulation? How will these regulations impact Cyber Guardian and its success? Most of the legal issues in business law involve civil law. Should the members of the firm also be concerned with criminal law? How does criminal law influence business?

What happens when a party to a lawsuit asks the court for a particular action as the remedy? Why are U.S. lawyers and courts so interested in prior court decisions?

These and other questions will arise as you read this chapter. Be prepared! You never know when the firm or one of its members will seek your advice.

Classic Case

In this Classic Case, the U.S. Supreme Court dealt with an alleged criminal libel. It also addressed the old adage that ignorance of the law is no excuse. The case involves a sugar exporter, Barlow , who claimed on the export register that he was exporting refined sugar. If this was true, Barlow was entitled to have the duties reduced, which was called a drawback. If this was not true, Barlow would have committed a criminal libel(an untrue statement treated as a crime) and he would forfeit the sugar. Barlow claimed that he could not be found guilty since he was unaware (ignorant) of the law: He thought that the sugar he was exporting met the legal definition to be classified as refined sugar.

BARLOW v. UNITED STATES

32 U.S. 404 (1833)

FACTS Joseph Barlow allegedly made a false denomination (entry) of sugar in the office of the duty collector, with the intent to defraud the government of its revenue. Barlow admitted that he made the entry to obtain a drawback on the export duties, but he denied that the entry was made by a false denomination. Barlow claimed that the sugars are truly refined sugars as he listed them. Under the statute, goods are subject to forfeiture to the federal government if a false entry is made. Barlow argued that the federal statutes did not apply. He claimed that the sugar was refined sugar, as he understood the term, and that under the statute he was entitled to the refined sugar drawback.

ISSUE Is Barlow excused because he was ignorant of the law?

HOLDING No, ignorance of the law is no excuse. Barlow cannot avoid the forfeiture of the sugar.

REASONING Excerpts from the opinion of Justice Story:

. . . The . . . question is whether the sugars were . . . entered by a false [label.] . . . They were entered by the name of "refined sugars." They were, in fact, sugars known by the appellation of "bastard," or "bastarded" sugards [sic], which are a species of sugars of a very inferior quality, of less value than the raw material; they are the residuum or refuse of clayed sugars, left in the process of refining, after taking away the loaf and lump sugar. . . . The question is, whether this species of sugar is, in the sense of the acts of Congress, "refined sugar." These acts allow a drawback "on sugar refined within the United States."

It has been contended . . . that all sugars which have undergone the full process of refining, after they have arrived at the point of granulation, are properly to be deemed refined sugars. . . . In a certain sense, they may certainly be . . . deemed to be refined; that is, in the sense of being . . . clarified and freed from their feculence. But the question is, whether this is the sense in which the words are used in the acts of Congress.

The acts of Congress on this subject, are regulations of commerce and revenue; and there is no attempt in any of them to define the

distinguishing qualities of any of the commodities which are mentioned therein. Congress must be presumed to use the words in their known and habitual commercial sense; not indeed in that of foreign countries, if it should differ from our own, but in that known in our own trade, foreign and domestic. . . . [I]f among buyers and sellers generally in the course of trade and business, the appellation "refined sugars," is exclusively limited to . . . lump and loaf sugar, and never includes bastard sugar, the acts of Congress ought to be construed in this restrictive sense. . . . [W]e think that there is a decisive and unequivocal preponderance of evidence to establish, that bastard sugar is not deemed . . . "refined sugar." The appellation is exclusively limited to . . . white refined loaf or lump sugars. This is established, not merely by the testimony of merchants and grocers, and persons in the custom house, but by the testimony of sugar refiners. . . . [A delivery of bastard sugars would not satisfy a contract for the sale of refined sugars. This] puts an end to the question, whether the sugars in controversy were entered by a false denomination. . . .

There was no accident in the case. . . . [Barlow] knew what the article was when he entered it. The only mistake, if there has been any, is a mistake of law. The party in the present case has acted . . . with his eyes open. . . . He has not been misled; and his conduct . . . is not . . . free from . . . suspicion. . . . He has made every effort in his power to obtain the drawback, by passing off, as refined sugars, what he well knew were not admitted to be such by the . . . government officers.

. . . [This case] presents the broader question, whether a mistake of law will excuse a forfeiture in cases of this description. We think it will not. . . . It is a common maxim, familiar to all minds, that ignorance of the law will not excuse any person, either civilly or criminally; and it results from . . . the extreme danger of allowing such excuses to be set up for illegal acts to the detriment of the public. There is scarcely any law which does not admit of some ingenious doubt; and there would be perpetual temptations to violations of the laws, if men were not put upon extreme vigilance to avoid them. There is . . . [no] reason to suppose that the legislature . . . had any intention to supersede the common principle. The safety of the revenue, so vital to the

government, is essentially dependent upon upholding it. . . . [I]t is the opinion of the court that the judgment of the circuit court ought to be affirmed. . . .

BUSINESS AND THE LAW

Business

This book is about the legal environment of business. An organized society is established, to a significant extent, on duties. Members of the society have certain duties imposed on them, while they voluntarily assume other duties. Businesses are a part of the society in which they operate, and the businesses also must honor their duties as members of the society.

U.S. society relies on businesses to satisfy many of its needs and desires. Most people in the United States are not self-sufficient. They purchase electricity, food, gas, and water. They rent apartments and vehicles. Most of the things they acquire, they purchase or rent from businesses. Residents in the United States provide the labor and skills needed by businesses so they are also the employees of businesses. Employees earn wages so that they can purchase goods from businesses. Even nonprofit organizations operate like businesses and are subject to many of the same laws. Statutes and regulations define the obligations of each party to others. The emphasis throughout the book is to provide an understanding of the legal environment from the perspective of businesspeople.

Law

Before we begin our study, we must answer a basic question: What is *law*? Many definitions exist, ranging from the philosophical to the practical. Plato (427-347? B.C.), a Greek philosopher who studied and wrote in the area of philosophical idealism, said law was *social control*. Sir William Blackstone (1723-1780), an English judge and legal commentator, said law is the set of rules specifying what is right and what is wrong. For our purposes, we shall define law as "rules that

must be obeyed." People who disobey these rules are subject to sanctions such as paying a fine or going to jail.

U.S. society has many kinds of rules, but not all rules can be considered "law." For example, rules in games or sports are not laws. What differentiates a law from other types of rules? A person who violates a "mere" rule does not face sanctions from the government. The person may be subject to peer pressure, ridicule, even "shunning," but the person does not face legal penalties. People who break laws can be held accountable for their actions through court-imposed sanctions, such as fines, imprisonment, or forfeitures. Laws are enforced by the government through the legal system. Mere rules are not enforced this way.

Many different types of legal rules exist. One type defines a specific way to create a legal document, for example, a contract or a will. A second type forbids certain kinds of conduct; criminal law is an excellent example of this kind of legal rule. (*Criminal law* is the body of law dealing with public wrongs called crimes.) A third type of legal rule was created to compensate people who have been injured because someone else breached a duty by committing a tort. (*Tort law* is the body of law dealing with civil wrongs for which the victim is entitled to remedies.) For example, when an automobile manufacturer negligently builds a car, and the manufacturer's negligence is the direct cause of an injury, the manufacturer may have to pay the injured person monetary damages. (*Negligence* is the failure to do something a reasonable and prudent person would do or doing something that a reasonable and prudent person would not do.)

Rules that describe binding contracts, define crimes, and specify legal duties are generally rules about substantive law. *Substantive law* is that part of law that creates and defines legal rights. It is distinct from *procedural law*, which is the law specifying the methods used to enforce legal rights or obtain compensation for the violation of these rights. U.S. courts establish rules to take care of their everyday business. For example, all states have a rule concerning the maximum number of days defendants have to answer a civil lawsuit; this is an example of a procedural law. The distinction between substantive law and procedural law is important.

Exhibit 1.1

A Comparison of Tort Law, Criminal Law, and Contract Law

Question	Tort Law	Criminal Law	Contract Law
How is the obligation created?	Tort law imposes duties on all people to respect the rights of others	Criminal law imposes duties on all people to respect the social order; prohibits or requires certain conduct of all people	Individuals agree on a contract and voluntarily assume duties under the agreement
Who enforces the obligation?	Suit by an injured plaintiff	Prosecution by a government entity	Suit by a party to the contract
What is the burden of proof in court?	Preponderance of the evidence	Beyond a reasonable doubt	Preponderance of the evidence

Question	Tort Law	Criminal Law	Contract Law
What happens if the defendant loses?	Defendant can be required to pay for the injury caused	Defendant can be imprisoned, sentenced to probation, and/or fined	Defendant can be ordered to perform the contract or pay for the injury caused
Who can appeal the decision?	Either party can appeal	Generally, only the defendant can appeal	Either party can appeal

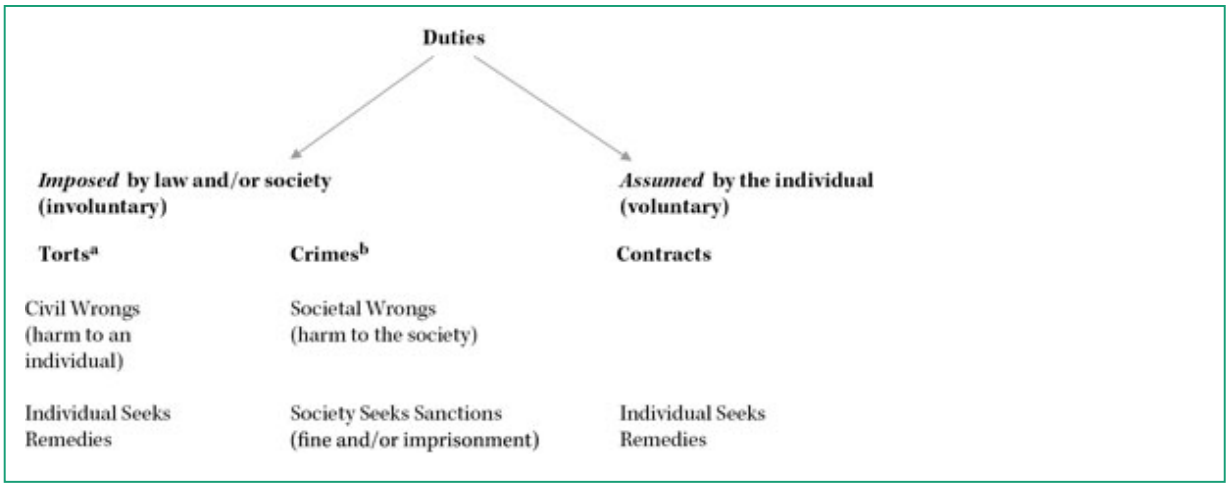
Source: Courtesy of Lynn M. Forsythe, © 2026.

Exhibit 1.1 compares some of the major areas of law discussed in this book. A *plaintiff* is the one who files a civil lawsuit. The *defendant* is the one who responds to the suit.

We will view the law as a body of rules that establish a certain level of social conduct, or of *duties*, that members of society must honor. One way to view these duties is shown in Exhibit 1.2. The party or parties who are injured can seek enforcement against the wrongdoer. The wrongdoer may be forced to (1) pay money as damages or as a fine; (2) perform an act or refrain from performing an act (one type of equitable relief); or (3) go to jail or prison.

Exhibit 1.2

Duties in a Society



[a] Some torts may also be crimes. The victim of the crime can seek civil remedies while the government will seek criminal sanctions. Criminal sanctions can include restitution.

[b] Most crimes not only harm society but also harm one or more individuals. The individuals who are harmed can seek civil remedies under tort law.

Most of the U.S. legal system is based on voluntary compliance. People are assumed to know the law, as in the Classic Case of *Barlow v. United States.* [1] In the United States, we also expect people to comply with the law. For example, drivers generally stop at stop signs and red lights. We expect other drivers to stop. When a driver stops at a red light and then drives through it, we are surprised because most drivers obey the rules of the road. Similarly, U.S. tax law is based on voluntary compliance. This does not mean that you can choose whether to pay income tax. What it means is the taxpayer is supposed to fill out an accurate tax return and submit it to the government. (Some countries do not expect accurate tax returns. The tax form is merely the starting point for negotiations between the taxpayer and the government.)

Why Study the Law of Business?

Law is crucial to the way we conduct business in the United States. Businesspeople need to be aware of the legal implications of their actions. They need to know when they can sue and when they may be sued. They need to realize the potential for recovery if they file suit and the possible liability if they are sued. An understanding of the law

allows businesspeople to know (or learn) the limits society imposes on their actions. Some specific examples include:

- **Contracts.** The law provides that valid contracts will be enforced. A business can establish a plan for the future, secure in the knowledge that its contracts with customers and suppliers will usually be performed. This means that both parties will do what they agreed to do in the contract. If a party does not do what it agreed to do, the other party can sue for its losses. A business will also be liable for its contracts with others if it does not perform, so it should live up to its contractual obligations. Some form of contract law is essential if a business is to operate in an efficient manner.

  Imagine a society where people could choose whether or not to perform their contracts. Would this be hard on businesses? Why?

- **Employment law.** The law provides rules and regulations regarding employment. These rules and regulations provide standards to ensure some protections for employees. For example, there are minimum wage laws, maximum hour laws, workplace safety rules, and employment discrimination rules. Businesses that do not comply may be subject to lawsuits and/or fines.

  Imagine a society where businesses are not obligated to provide safe workplaces. Would businesses be likely to invest funds to protect their workers? What would happen to the workforce? Would this be hard on workers? How would it affect business?

- **Intellectual property (IP) law.** IP law provides protection to a business that has acquired intellectual property. For instance, a business can apply to the government for a patent for its invention. If the patent is granted, the business receives a government-sanctioned monopoly for the length of the patent. Once the patent is issued, the business can prevent others from using its invention in the United States

without permission. Businesses can then license the invention to others who pay for the right to use the invention.

Imagine a society where inventions cannot be protected by patents. Would businesses be less likely to invest their resources in research and development? Why? Would the society have fewer advances and less technology? How would this affect the economy?

- **Government regulations.** The social contract theory states that businesses exist because society allows them to exist. It also holds that society can change "the rules of the game" at any time, forcing businesses to adapt to the new rules or face sanctions. These sanctions may include losing the right to continue in existence. Many of the government regulations affecting business are an outgrowth of the social contract theory. For example, antitrust laws, consumer protection laws, environmental laws, and securities laws all originated to some extent from public pressure on government to address these issues.

  Imagine the United States without these laws. Would businesses voluntarily engage in practices that protect consumers or the environment? How would that behavior affect public goods like clean air or water? In some cases, you can examine history before the laws were enacted to see how society would be different.

Think about the role of law in business decision making. Law plays a significant part in the success or failure of many business enterprises.

You need to understand the legal implications of your actions as a businessperson, a business owner, and a consumer. Otherwise, your actions may have unexpected legal consequences. If you can apply your legal knowledge to specific business situations, you may also save yourself great expense. It is helpful to understand the legal environment in which a business operates. If businesspeople "scan" the legal environment, they can often identify trends. Sometimes a business or industry may impact the direction of a change. When a business takes direct action, it is called being proactive. (*Proactive*

means to identify potential problem areas and actively participate in resolving them.) For example, industries may decide to self-regulate in an attempt to avoid government regulation. The video game industry created a rating system for games at least in part to avoid potential legislation.

When a business is *reactive*, it waits to see what develops and *then* reacts. It does not initiate change. It changes only when it is forced to do so. A business or industry may be proactive on some subjects and reactive on others. As you will learn, the law of business is a practical subject.

Another reason to study the law of business is because it will help you develop valuable decision-making skills. This book will introduce you to the legal style of analysis, which can be used in business decision making. This study will also alert you to particular situations in which you may need the assistance of a lawyer. Legal counsel can be helpful in preventing problems and in seeking remedies. For example, in the sale of commercial real estate the buyer or seller needs the assistance of a lawyer *before*, rather than after, a contract is signed.

We will focus on prevention, including (1) how to recognize potential legal problems; (2) how to avoid legal problems if possible; and (3) how to resolve them as quickly as possible if they do arise. *Preventive law* is law designed to prevent harm or wrongdoing before it occurs. Many statutes are intended to prevent certain conduct by providing for sanctions against people who violate the statutory provisions. *Remedial law* is designed to deal with problems that do arise.

Legal Language The study of law requires learning legal terminology. Your text defines many of the terms for you. Remember to read in context and to be aware of legal meanings. These three rules will help improve your mastery of this material:

1. Legal terms may appear to be synonyms with everyday words, but often they are not.
2. Legal terms may have more than one legal meaning.
3. Some legal terms have no relation to everyday language.

You will see examples of these rules in later chapters as you encounter more legal language.

Cyber Guardian 1.1 Management

HEALTH INSURANCE FOR CYBER GUARDIAN EMPLOYEES

When Asher, Danica, and Mai began Cyber Guardian, they did not consider providing health insurance benefits for its employees. The young entrepreneurs purchased their health insurance through their college. The firm has grown and expanded. Several of the employees have asked Asher about a benefits package that would include health insurance coverage. Asher is also concerned about changes that will make it more difficult for individuals to obtain health insurance on their own. Asher has asked you whether the firm should provide health insurance for the employees. What are the consequences of this decision? What advice will you give him about providing health insurance?

BUSINESS CONSIDERATIONS Should Cyber Guardian provide health insurance as a benefit for its employees? What are the business implications if such coverage is provided? What are the business and legal implications if such coverage is not provided?

ETHICAL CONSIDERATIONS Would it be ethical for Cyber Guardian to provide coverage for Asher, Danica, and Mai but not for other employees? What are the ethical implications of denying health insurance to the firm's employees to increase profits?

Role of the Attorney Legal issues can be serious in all businesses. Whether the business is facing litigation or practicing preventive law and attempting to avoid legal problems, attorneys can be important allies in running a business. One of the primary purposes of this text is to assist you in working with your attorney and to enable you to more fully understand what the attorney says. There may be situations when

you are able to represent yourself in legal matters, such as negotiating a lease for a residence. When you represent yourself in court, it is called appearing *pro persona*, or *pro per* for short. It can also be called *pro se.* There are many situations, when it is unwise to represent yourself and you should hire a competent attorney.

LEGAL SYSTEMS

When people refer to "the law" they are really referring to a legal *system*, which consists of some combination of law, order, and justice. Each legal system involves a variety of people, rules, and processes. Every culture and every society is built around its own system, including its own rules, expectations, and provisions for enforcement. Each legal system provides a structure for enforcing the rules in order to meet the expectations of that specific society.

Traits of a Legal System

Order Order has different meanings in different contexts, and "an order" is significantly different from "order." The law usually considers *an order* as a legal command issued by a judge, while *order* is the absence of chaos. We are using *order* in this second sense. *Chaos* is confusion and total disorganization, producing a disorderly society. If the laws of a society were always followed and never broken, there would be perfect order. No crime would exist, and everyone would be safe. No society with perfect order has ever existed.

The words *law* and *order* are often linked together. It is natural to link them because, when the law is followed, there is order. However, because the law is not followed all the time by all the people, perfect order does not exist. Society is always *somewhat* chaotic and disorganized. One of the reasons people do not always obey the law is that they may not be aware of what the law is in a particular situation. However, the U.S. legal system *presumes* that everyone *is* aware of the law and what it requires. If society did not presume that everyone knows the law, individuals accused of breaking the law would have an excellent defense: They could argue that they did not know they were breaking the law, and the society would then have to prove the person's

knowledge of the law before imposing sanctions. The presumption that everyone knows the law also creates an incentive for citizens to study the law. The educational system also plays an important role in helping us to learn the law.

Justice Justice is a difficult term to define. Different theories of justice exist, and individuals have varying beliefs about justice. When we speak of *justice*, we normally mean "fairness." Although perfect justice *is* fair, there is more to the concept of justice than merely being fair. Justice, as used in the Anglo-American legal system, refers to both the *process* followed and the *results* obtained in the process. Courts try to administer justice in conformity with the laws. From a social perspective, justice may be affected as much—or even more—by appearances than by results. This means judges and lawyers are required to avoid the *appearance* of impropriety in their dealings. If the public perceives that the system is not just, they are less likely to accept the results the system provides. This perception can lead to the destruction of the order developed in society through its laws and their enforcement.

The goal of any legal system should be attaining justice by continually searching for fairness and equity. Fairness is less abstract than justice and is easier to address on a practical level. Most people have a basic concept of "fairness" that can be applied to any given situation. For example, when you see a bully pick on a victim, you probably believe that this conduct is not fair. In this type of situation, the conduct is clearly unfair *and* unjust. In most situations, it is difficult to determine what a fair-and-just result would be. For example, suppose that a wealthy individual is accused of committing a crime. That wealthy individual hires the best attorneys the person can find, and is found not guilty by the jury in a very public trial. Many people might question whether this result is *fair*. While there may be doubts about the fairness of the result, the process followed in the legal system tries to assure that the result of the trial is *just*.

The Needs of a Legal System

The Need to Be Reasonable A legal system needs to be reasonable. It should rely on reasonable conclusions based on facts. Laws prohibiting texting while driving are reasonable because we can prove that texting while driving increases the number of accidents. Similarly, laws requiring the use of face masks during a pandemic are reasonable when we can prove that the use of masks reduces the spread of the illness.

In addition to being reasonable, laws need to be applied in a reasonable manner. A law stating that Juana, a car buyer on credit, will have the car taken away from her if she does not pay for the vehicle is certainly reasonable. It would be an unreasonable law if Juana's children were taken away from her if she stopped making payments on the car. In the second situation, there is no reasonable connection between the conduct and the penalty.

The Need to Be Definite The law needs to be definite, not vague. For example, a law stating that all contracts "for a lot of money" must be in writing would be unclear and confusing. By comparison the Statute of Frauds states that all contracts for the sale of goods costing $500 or more must be in writing, which is very clear. If one has a contract for $499.99 worth of goods, it need not be in writing; but if the contract is for $500 or more of goods it must be in writing to be enforceable.[2] There is a definite point at which the law requires a writing.

Sometimes the law is unable to state precisely what a person must do. In such cases, the law applies the standard of *reasonable* behavior rather than setting precise boundaries. If an automobile hits a pedestrian and causes injury, the pedestrian may sue the driver of the vehicle. The law does not state that a driver will only be at fault if the driver is driving over a certain speed. If the only information you had was that the speed limit was 55 miles per hour and the car was going 50 miles per hour, is the driver at fault? Under these conditions, the law would ask the question: Was the driver's conduct reasonable under the circumstances? If so, the driver is not liable for damages. If the driver's conduct is not reasonable, the driver is liable to the pedestrian. In the final analysis, the law provides an answer and is definite.

The Need to Be Flexible To say that the law needs to be both definite and flexible seems like a contradiction in terms. The law needs to be definite in order to establish a standard. In other respects, the law must be flexible so that it can be applied in many different situations. For example, if a drunk driver kills a family wage earner and the family files a wrongful death lawsuit, recovery would be based on the future earning capacity of the wage earner. (*Wrongful death* is unlawful death. It does not necessarily have to involve a crime.) It would not be based on a table of damages. Another aspect of flexibility is the need to adapt to changes in technology. For example, old laws are now being applied to activities on social media, such as Facebook, Instagram, SnapChat, TikTok, WhatsApp, X, and YouTube. If trees did not bend in the wind, they would break. The U.S. legal system is like those trees: It must bend without breaking. However, because of this flexibility, our legal system loses some of its predictability.

The Need to Be Practical Because people depend on the law to guide their actions, the law needs to be practical and oriented to action rather than to thought. The law must deal with real issues created by real people. For example, most U.S. courts will only decide real disputes between the parties. They will not decide hypothetical cases. Courts will also avoid cases where the issue is *moot* (abstract; not properly submitted to the court for a resolution; not capable of resolution) or where there is no real case or controversy. (A *case or controversy* is a case brought before the court where the plaintiff and defendant are really opposed to one another on significant issues.) When the plaintiff and defendant really agree with each other and are trying to get a court decision confirming their position, there is no real case or controversy.

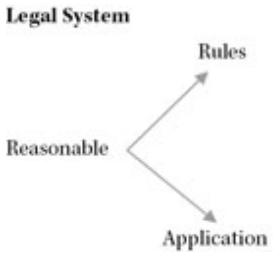
The Need to Be Published If we had the best set of laws imaginable but no one knew about them, they would be virtually worthless, and we would have chaos. Although ignorance of the law is generally no excuse, the legal system does try to provide notice of the rules and laws. In traffic law, for example, speed limits need to be posted so drivers know how fast they can legally drive. Posting also limits arbitrary enforcement by police. People cannot voluntarily comply with secret laws and rules. Consequently, all laws need to be published.

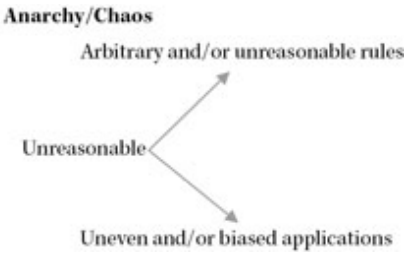
Once a law has been published, we presume that all people know it. Consequently, ignorance of the law is no excuse. For example, even if you did not see the posted speed limit, the police will still enforce it. Statutes are a good example of published laws.

The Need to Be Final If a controversy exists and the parties use the legal system to resolve it, at some point in time the matter will be resolved. It may not be resolved to the full satisfaction of the person who "won" the case, but it will be resolved. Parties who are unhappy with the results can appeal, but eventually the appeals end and the decision is final. Exhibit 1.3 outlines the needs of a legal system.

Exhibit 1.3

The Needs of a Legal System





Definite rules and limits	Vague or unclear rules, no definite standards
Flexible standards—to keep up with changes in society and technology	Rigid and unbending standards; "St one-Age" rules in a modern world
Practical rules based on reality	Hypothetical or impractical rules based on wishful thinking
Published—communicated	Unpublished—"surprise" rules

Final—to put an end to a case at a particular time	Ongoing, continuous—never seeming to end

Compliance with the Law

Despite our assumption about voluntary compliance, people do not always comply with the law. When you observe people in your community repeatedly doing something, you might conclude that this behavior is lawful. This assumption may be unwise. For example, on some freeways the flow of traffic may be faster than the posted speed limit. During your study of business law, you should try to distinguish these three distinct questions:

1. What is the law about this topic?
2. How do people and businesses generally behave?
3. What should the law be on this topic?

Answers to these questions will vary based on the state or region under analysis. The most variance will occur about what the law should be. Individuals will disagree based on their views and ethical beliefs. Proactive businesspeople may suggest answers that will benefit their particular situation.

The Purposes of a Legal System

Achieving Justice Justice basically equates to fairness. Sometimes we achieve it and sometimes we do not. To some, the rule of *caveat emptor* (let the buyer beware) is a fair rule. The buyer who did not examine the goods does not receive damages in the courts for defects that would have been revealed by an inspection.

Providing Police Power Because justice is the ultimate purpose of a legal system, providing police power may be viewed as an intermediate purpose of a legal system. When you see the term *police power*, you may envision a uniformed police officer. That is just one part of what we call police power. Police power allows the government to create and enforce laws designed to protect the public's health, safety, and general

welfare.[3] Laws and ordinances concerning police, fire, sanitation, and social welfare stem from police power.

Maintaining Peace and the Status Quo One of the earliest purposes of the law was to "keep the King's peace." Most modern torts and crimes are based on a simple breaching of the King's peace. Today, laws that govern the relationships between private individuals, such as the laws governing assault, battery, false imprisonment, and trespass are private forms of keeping the peace. Closely associated with keeping the peace is the concept of maintaining the status quo—that is, keeping things the way they are. It is natural for the law to maintain the status quo unless changing things will benefit society. Under the proper circumstance, a court issues a preliminary injunction that maintains the status quo until the lawsuit is resolved. (A *preliminary injunction* is an injunction requiring a party to do something or refrain from doing something. It is granted before or during trial and maintains the status quo until there is a final decision in the case.)

Providing Answers On a practical level, the law should provide answers. A party may appeal a court decision to a higher court if the party does not like the answer. Assume Melanie sues Troy, a neighbor, because Troy is allegedly creating a nuisance on his property. (In this context, a *nuisance* is the unreasonable or unlawful use of a person's own property when it interferes with another person's use and enjoyment of that person's property.) If Troy wins the case in the trial court, Melanie can appeal the decision to the next higher court. In most states this higher court is called an *appellate court* (a court that has the power to review the decisions of lower courts). If an appellate court rules in favor of Troy, a further appeal may be taken to the state's highest court. In that court, Melanie may win or she may lose again. Regardless of the outcome, once the appellate process is completed, Melanie and Troy are provided with an answer.

Providing Protection The law protects all kinds of interests. The tort law of assault and battery is a classic example of protecting the individual. The law also protects people when it protects their civil rights. The U.S. Constitution and its amendments contain (1) the right

to be protected from unreasonable searches and seizures; (2) the right against compulsory self-incrimination of a crime; (3) the right to be indicted by a grand jury before being tried for a federal capital or infamous crime; [4] (4) the *right against double jeopardy* (a rule of criminal law that states that a person cannot be tried in court more than once by the same government for the same criminal offense); (5) the right to a jury trial; and (6) the right to bail. Most rights, even constitutional rights, have limits and restrictions.

The law is also concerned with the protection of property. All property is characterized as either real or personal property. *Real property* is land and whatever is affixed to land, such as a house. *Personal property* is all property except for real property. In general, if property is movable or intangible, it is personal property. However, personal property can have dual meanings in law. It can also mean property that is owned by individuals, as opposed to public property that is owned by the government or the community. The U.S. legal system has a variety of laws that protect property.

Cyber Guardian 1.2 Management

SECURITY ISSUES

Asher plans to visit Washington, D.C., next week for a conference on AI and related technology, including sessions on possible military uses of AI. Danica and Mai recognize that this trip is important to Cyber Guardian, but they are a little concerned because of the increase in protests and violent crimes in Washington, D.C. [5] Asher told them that there was little reason for concern since security around federal buildings has been strengthened. While Danica and Mai are thankful for the extra security, they do not understand why different rules seem to apply to federal buildings than apply in other areas of D.C. They have asked you to explain how or why this is permitted. What will you tell them?

BUSINESS CONSIDERATIONS Is it reasonable to have different legal rules about carrying weapons near federal buildings? Should other locations have special rules, too, such as outside the White House or the homes of federal judges? If so, which locations should have special rules? Why? Can a business impose different rules concerning the carrying of weapons on or around its workplace? What factors would cause a business to do so?

ETHICAL CONSIDERATIONS Is it ethical for the government to have different rules near ICE detention centers, the Pentagon, the White House, or other locations? What are the ethical implications of having special rules in certain specified areas or under certain conditions?

Enforcing Intent The law of contracts is based on freedom of contract. When we enter into a contract, we make our own "laws" of conduct. For example, suppose that you have found some merchandise that you can resell at a very good price. You want to make the contract today so that you can "lock in" the price. You have a cash-flow problem, and you cannot pay for the goods today. You are confident that you can quickly and easily resell the goods, so you enter into a contract promising to pay for the goods at the stated price, with payment due two weeks after delivery. Of course, if you cannot resell the goods as quickly as you anticipated, you will have a financial problem, and you may breach the contract. You might be sued, and you would probably be found liable for breach of contract. This potential problem is really an issue of your business judgment and not a question of law.

Providing Rehabilitation Both criminal law and civil law are directed toward rehabilitation. Criminal law should, among other things, rehabilitate the criminal. Civil law is also involved in rehabilitation to some extent. Contract law provides rehabilitation for a party harmed by a breach of the contract. Tort law provides for a form of rehabilitation of tort victims when they are awarded damages. The federal bankruptcy law is directed toward the rehabilitation of honest debtors.

Facilitating Commercial Transactions One of the major characteristics of the U.S. legal system is that it facilitates commercial transactions. Contract law allows for the use of credit to make sales. For example, very few automobiles would be sold in the United States if car dealers insisted on cash payment. The U.S. economy still relies on the automobile industry. The prosperity of the steel, energy, and transportation industries are directly related to that of the automobile. A loss of sales could hurt the U.S. economy, and not just the automobile industry. When U.S. automobile manufacturers suffered from the economic downturn in 2008-2009, the federal government offered bailout money to some of them.[6] Generally, the U.S. legal system fosters free and open competition and facilitates trade. Exhibit 1.4 outlines the purposes of a legal system.

Exhibit 1.4

The Purposes of a Legal System

Purpose	Reason
Achieving justice	To provide "justice" so that the needs of the members of society are addressed.
Providing police power	To provide a social structure so that "wronged" individuals do not have to resort to self-help; to provide for the health and welfare of the members of society.
Maintaining peace and the status quo	To provide members of society with feelings of personal security and a structure on which they can rely.
Providing answers	To achieve practical justice; permits the members of society to know what is

Purpose	Reason
	expected of them and what they may reasonably expect from others.
Providing protection	To define and establish social guidelines and protect the entire society if any of these guidelines are not followed and obeyed.
Enforcing intent	To provide some method for permitting private agreements and for ensuring that these agreements are honored or enforced.
Providing rehabilitation	To allow people who violate the guidelines of the society a second chance; recognizes that people make mistakes; reimburses people who are injured.
Facilitating commercial transactions	To support freedom of contract and private ownership of property; these concepts encourage and promote business transactions.

Legal Systems in Other Countries

You should not assume that other countries have the same or similar legal systems. A U.S. citizen may find that behavior that is tolerated in the United States constitutes a crime in a foreign country or is punished more severely there. For example, in 2009, Bernie Madoff was convicted of fraud for running a huge Ponzi scheme and he was sentenced to 150 years in prison. [7] Just a few years later in 2013, Zeng Chengjie, a real estate developer who has been called "China's Bernie Madoff," was also convicted of fraud and illegal fundraising. However, instead of a prison sentence, he was executed by lethal injection by the Chinese government. [8]

Many of the protections a citizen expects in the United States do not apply abroad. For example, Amanda Knox was retried in Italy for the murder of her roommate. [9] In the United States, the retrials would probably have been barred by the rule against double jeopardy.

Other countries have different historical and sociological backgrounds. Citizens' values and government rules may differ from those in the United States. In Beijing, about 60 Chinese workers who were angry over a pay dispute held their U.S. boss, Chip Starnes, hostage for five days. Apparently, this action, which would be illegal under U.S. law, is a common practice in Chinese employment disputes and police are reluctant to intervene. [10]

Court decision making also differs from nation to nation. Common-law countries such as the United States and Great Britain rely on statutes and precedents in deciding cases. When courts use *precedents*, they look to prior, similar cases for guidance in how to decide this case. In common-law countries, courts tend to follow precedents unless there is a compelling reason to change.

By contrast, civil-law countries such as France and Germany do not rely on precedents. In these nations the court applies statutes without reference to how earlier courts decided similar cases. Each case is treated as unique, and the court tries to apply the law in a logical and fair manner to the facts presented in the case. Thus, precedent is not significant in civil-law systems. It is interesting to note that in the European Union (EU), the role of precedents is increasing even though the EU is primarily a civil-law system. For example, decisions made by the EU Court of Justice become precedents in all the member countries.

In the former Union of Soviet Socialist Republics (USSR), private ownership of property was limited due to the government's socialist philosophy. The primary goal of its legal system was to preserve state ownership of all means of production. Consequently, the USSR's law mainly consisted of public law such as criminal law. The law of property, contracts, and business organizations did not play a role. Many of the former Soviet republics are engaging in *privatization* (the process of going from government ownership of business and other property to private individual ownership), and a body of private law is

developing as these countries move toward a more traditional civil-law system. The new countries sometimes relied on consultants, like attorneys from the United States, to develop their systems of commercial law.

The Role of Religion There are several legal systems based on religious teachings. The Hindu legal system is one example. This system is a personal and religious law system which states that Hindus should act in accordance with this law wherever they live. The Hindu system has been recorded in law books called *smitris.* Most Hindu law applies to family matters. Anglo-Hindu law evolved in most Hindu countries while they were British colonies, and judges were applying a combination of English and Hindu laws. When India gained its independence from the United Kingdom, it replaced Anglo-Hindu law with a civil code primarily based on Hindu law.

Some Muslims believe in Islamic law or *Shari'a*, which is based on the Qur'an and other religious writings. For example, Saudi Arabia relies on the Qur'an as its constitutional authority.[11] In the United States it is common to charge interest on a loan, whereas interest on loans (known as *riba* in Muslim law) usually is prohibited under traditional Muslim law.[12] The following excerpt describes how one country applies Islamic law.

> *A 24-year-old Norwegian woman who was attending a business meeting in Dubai, United Arab Emirates (UAE), claimed that she was sexually assaulted by a co-worker. After the rape, she asked the hotel staff for help and asked them to call the police. The police came and arrested the victim for having sex outside of marriage. She was sentenced to 16 months in jail for the crime under the UAE's Islamic-influenced legal system. Her alleged attacker received a 13-month sentence for out-of-wedlock sex and alcohol consumption.*[13]

Other religions also have legal systems, including Catholicism and Judaism. These religions generally provide their own tribunals for resolving disputes.

JURISPRUDENCE

Jurisprudence can be defined as the "general or fundamental elements" of a legal system.[14] It is often thought of as the philosophy underlying the law. In Latin, jurisprudence means the "wisdom of the law." However, there are really many different "wisdoms" of the law reflected in different philosophical views; these views vary based on the values inherent in the law, the development of the law, and its proper role in society. The law continues to change, and knowledge of the legal philosophies will improve your ability to understand the law and predict future trends. Here is a brief introduction to some of the philosophical approaches that affect business. Note that sometimes philosophers who subscribe to the same basic theory disagree.

Natural Law Theory

The *natural law* theory holds that the law should be based on what is correct and moral. It is composed of these four concepts:

1. There are certain legal values or value judgments.
2. These values are unchanging because their source is absolute. Natural law theorists disagree about the sources. Theorists believe that the sources are Nature, God, or Reason.
3. These values can be determined by human reason.
4. Once these values are determined, they supersede any form of human law. Once the natural law is discovered, any contradictory human law is invalidated.

This theory rests on some significant assumptions—the world is perceived as a rational order with values and purposes built into it; the laws of nature describe how things should be; and humans should use reason to grasp what they should do. Many early Greek philosophers were natural law theorists. In the history of Christian thought, the dominant theory of ethics has been the theory of natural law,[15] best exemplified by St. Thomas Aquinas.[16] Natural law theory is found in the words of the Declaration of Independence, "We hold these truths to be self-evident, that all Men are created equal, that they are endowed by

their Creator with certain unalienable Rights. . . ." The natural law theory focuses on fairness and justice. Some disorder will result when individuals decide that the written law is not "natural law." Criticisms of natural law theory include (1) whose values are to be included in the natural law and (2) who determines whether a man-made law is unjust because it violates natural law.

Legal Positivism

Legal positivism is composed of three theoretical parts:

1. "[L]egal validity is ultimately a function of certain kinds of social facts."[17]
2. Social facts give rise to legal validity, which is authoritative due to some kind of social convention.
3. There is *no* overlap between notions of law and morality. This last part is in direct opposition to natural law theory.

Legal positivists disagree on how these three parts should be interpreted. One alternate statement proposed by some legal positivists includes these primary beliefs: (1) law is the expression of the will of the legislator or sovereign, and must be followed; (2) morals are separate from law and should not be considered in making legal decisions, for example, judges should not consider factors outside the legal system, such as contemporary community values; and (3) law is a closed system in which correct legal decisions are reached by reference to statutes and court precedents. Legal positivists believe that the law is the result of lawmaking by a legitimate government. In the United States, this is primarily executive orders, legislation, court opinions, and administrative regulations. Under this theory, legality and morality are separated. This is opposite from the natural law theory. The positive law approach promotes stability in the law and the supremacy of written laws. Criticisms of legal positivism include that it is too narrow and too literal-minded, and that its refusal to consider social, ethical, and other factors makes it static and unable to serve society well.

Legal Realism [18]

Legal realism is both a descriptive and prescriptive theory. *Descriptive theories* of jurisprudence explain what the law is. In other words, they describe the law. However, *prescriptive theories* state what the law should do or what should occur. In the prescriptive theory of legal realism, law *should* derive from social interests and public policy.[19] As a descriptive theory, legal realism looks at the reality of the law. Under the theory, most laws are *indeterminant* (lacking clarity or precision). Judges consider statutes and prior court decisions; however, written laws do not fully explain what judges do. In addition, there are often conflicting statutes and court decisions. When the written law does not provide a clear answer, the judge makes decisions based on the judge's political and moral convictions. Judges are also influenced by their cultural, political, and religious beliefs. "It is a sociological study of the Law as it is made, practiced, and interpreted by lawyers. It further seeks to explain the social processes through which the Law changes. . . ."[20] Law, then, is what judges and lawyers say it is. Realists contend judges create new law through their decisions more often than people commonly suppose. Judicial decision making is frequently guided by the judge's political and moral intuitions about the facts of the case, instead of by legal rules. This is especially true when the law on the case is ambiguous.

Jerome Frank said,

> . . . For any particular lay person, the law, with respect to any particular set of facts, is a decision of a court with respect to those facts so far as that decision affects that particular person. Until a court has passed on those facts no law on that subject is yet in existence. Prior to such a decision, the only law available is the opinion of lawyers as to the law relating to that person and to those facts. Such opinion is not actually law but only a guess as to what a court will decide. . . . [21]

Justice Cardozo was also a legal realist. He provided some examples of how the theory works. For example, in writing about contract law, he

said that when a judge is asked to determine whether one party to a contract exercised duress and undue influence in negotiating a contract (making the contract voidable), judges who are inclined to protect the weaker members of society will interpret the legal terms broadly to protect the weaker members from predatory behavior. Judges who favor stronger members of society will interpret those legal terms narrowly: They will allow the stronger members of society to benefit from their guile, knowledge, and skill.[22] Cardozo also noted that judges often have to decide between competing and contradictory principles that would yield opposite results.[23] Some realists argue that the law should serve the most fragile members of society.[24] Many realists believe that in practice the law represents the interests of the most powerful members of the society.

As a prescriptive theory, realists also believe that jurisprudence should follow the sciences and use empirical information and test hypotheses. The law should not merely rely on theoretical assumptions.[25]

Law and Economics Theory

Law and economics theory applies classical economic theory and empirical methods to explain legal doctrines and to predict judicial decisions. It argues for using economic analysis as both a description about how courts and legislators behave and as a prescription about how courts and legislators *should* behave. The law and economics theory is closely allied with the University of Chicago, where it originated. It is sometimes called The Chicago School. This theory is commonly used in areas such as contracts, property, and tort law. Under the theory, the legal system should be viewed as a system to promote the efficient allocation of resources in society. For example, buyers and sellers in the market exchange goods or services for money. The exchange is maximizing value for both the buyer and seller.

The proper goal of statutory and common law is to promote wealth maximization, which can be accomplished by facilitating the mechanisms of the free market. It is a conservative theory, and most proponents want to maximize the wealth of the society. They are not concerned about whether the wealth is distributed equally or fairly.[26]

Also, market transactions reflect rational individual judgments about the value of individual preferences. Critics contend that this theory tends to be politically conservative and generally rests on only one type of economic philosophy to the exclusion of others. Another criticism is that the theory could be acceptable as a *descriptive theory,* but it is not helpful as a *prescriptive theory.*

Exhibit 1.5 summarizes the approaches to jurisprudence.

Exhibit 1.5

Theories of Jurisprudence

Theory	Primary Characteristic
Natural Law	Source of law is nature, God, or reason.
Legal Positivism	Source of law is the legislature or sovereign.
Legal Realism	Source of judge's decisions includes the judge's cultural, political, and religious beliefs.
Law and Economics	Classical economic theory should be applied to the law.

SOURCES OF LAW

The U.S. legal system is based on the Constitution, treaties, statutes, ordinances, administrative regulations, common law, case law, and equity. Together they constitute the U.S. system. Although each of the elements is separate, the elements are interdependent. A change in one element will affect one or more other parts of the system. In a civil rights suit, a person may allege a violation of constitutional rights (Fourteenth Amendment), a statutory right (Civil Rights Act of 1964), an administrative regulation (Equal Employment Opportunity Commission

guideline), past decisions of the court (precedents), and equity (if all else fails, the person should win because it is fair).

Constitutions

A *constitution* is the fundamental law of a nation. It may be written or unwritten. The U.S. Constitution is written. It allocates the powers of government and sets limits on those powers. The Constitution places the power of the purse exclusively with Congress and the power of the sword with the executive branch. The judiciary, the third branch of government, has neither the power of the purse nor the power of the sword. However, it has the power to interpret the meaning of the U.S. Constitution and to decide the constitutionality of the laws passed by Congress.[27] We discuss the unique nature of the Constitution further in Chapters 3 and 5.

States also have constitutions, and they are the fundamental laws of those states. The U.S. Constitution is the supreme legal document in the United States and will take precedence over state constitutions if there is a conflict between them.

Treaties

Treaties are formal agreements between two or more nations. Treaties are often categorized by the number of nations involved. *Bilateral treaties* involve two nations, and *multilateral treaties* involve more than two nations. Treaties that are recognized by almost all nations, such as the Geneva Convention, are *universal treaties.*

The United States makes treaties for a variety of purposes including providing protection, for example, through the North Atlantic Treaty Organization (NATO), and promoting trade through the United States–Mexico–Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA). Treaties are the only elements of the U.S. legal system that do not stem from the Constitution. The power to make a treaty is a function of sovereignty and not one of a constitution. In most cases, treaties are negotiated by the President or the President's designee(s). The U.S. Constitution gives the Senate the power to approve treaties, and a two-thirds vote is

required for approval.[28] The President sometimes involves senators in the negotiation to make the approval process easier.[29] The Senate has rejected relatively few treaties.[30] However, sometimes the President withdraws a treaty rather than have it defeated.[31] Other times the treaty dies in a Senate committee or is amended or changed by the Senate. In these situations, usually the United States and the other country (or countries) continue their negotiations.[32] (The President can enter into executive agreements which are not subject to approval by the Senate.[33]) While the Constitution is the supreme law of the land for domestic issues, treaties are the supreme law of the land for international issues.

Statutes

Statutes are the acts of federal or state legislative bodies. They prohibit or command the doing of something. It is preferable to use the word "statute" when you are referring to a legislative act to distinguish it from other types of laws, such as ordinances, regulations, common law, and case law. A good example of state statutory law is the Uniform Commercial Code (UCC). The UCC is a set of laws designed to aid business. All 50 states, the District of Columbia, and the U.S. Virgin Islands have adopted at least portions of the UCC. Unfortunately for businesspeople, some states adopted modified versions of the UCC, so you should check on the law in your state.

Ordinances

Ordinances are laws passed by municipal bodies. Cities, towns, and incorporated villages have the power to establish laws for the protection of the public's health, safety, and welfare. Counties generally do not have legislative power, but they usually have the power to enforce state laws within their boundaries.

Administrative Regulations

Administrative regulations are rules promulgated by government agencies. At the federal level and in many states, there are *executive*

agencies (created by the president or governor) and *legislative agencies* (created by Congress or the state legislature). Examples of agencies include the Federal Trade Commission (FTC) on the federal level and the public utility commission on the state level. The rules and regulations of these entities have the full force and effect of law. They read very much like a statute.

Common Law

The term *common law* has multiple meanings depending on the context. In its broadest sense, it means the body of law derived from court decisions. Anglo-American common law is the body of English law that the colonists adopted and supplemented with their own local decisions and enactments. [34] All U.S. states except for Louisiana have a common-law system. Louisiana, like most European nations, has a code-based legal system. These code-based legal systems, commonly called civil-law systems, rely on statutory authority in deciding cases rather than following precedent. If there is no statutory authority to decide a case, the court cannot issue a ruling in a civil- law system. Courts in a civil-law system lack the authority or power to "make law" through judicial rulings that establish precedent. Courts in common-law countries do "make law" by establishing and following precedent.

Case Law

Case law comes from court cases that are reported in the law reports and is part of the common law. Quite often, the judges must interpret statutes to apply them to actual cases and controversies. You will not fully understand a particular statute until you have read both the statute *and* the cases that have interpreted it. *Case law*, then, is the law as articulated by judges.

The American Law Institute (ALI) is dedicated to clarifying the law, improving the administration of justice, and drafting the Restatements of the Law. *Restatements* are not actually part of the law; rather they are treatises that summarize the law on a subject. When there are conflicting approaches, the *Restatement* "recommends" one of the

alternativ es. *Restatements* bec ome par t of the case law when a cour t relies on a par ticular section in r eaching its opinion.

Star e decisis is an ancient doctrine that means the question has been de cided. For example, if a par ticular legal point is well settled in a cer tain jurisdic tion, a futur e case with substantially the same facts will be decided in accor dance with the principle that has already been adopted. This is one of the reasons that lawy ers do a gr eat deal of legal resear ch. The doctrine of *star e decisis* is also called pr ecedents. As the U.S. Supr eme Cour t said, "*Star e decisis* is the pr ef err ed course because it pr omotes the evenhanded, pr edictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and per ceiv ed integrity of the judicial pr ocess. "[35]

When a cour t follows pr ecedent, it is striving to mak e the law *definite* , satisfy ing one of the needs of a legal system. Howe ver, as times and situations change, cour ts need to be able to change. The law would not be *flexible* , another need of a legal system, if pr ecedents could ne ver be changed. Cour ts can ha ve a difficult time balancing the need to be de finite and the need to be flexible. *Br own v. Boar d of Education* [36] is an example of a cour t over turning pr ecedents. In tha t case, th e U.S. Supr eme Cour t over turned pr ecedents and decided that separating ch ildr en in public schools based on their race was unconstitutional. This over turned the pr ecedent that "separate but equal" schools wer e constitutional.

As pr eviously mentioned, the legal system does not remain static. A cour t will over turn pr ecedents when ther e is a str ong reason to do so. Generally , a pr ecedent remai ns in eff ect until it is changed. Lawy ers and petitioners in cour t ma y try to persuade the judge to modify pr ecedents, and sometimes the y ar e successful. When a cour t changes the pr ecedents, it w ill generally suppor t its decision with one of these thr ee r easons:

1. The prio r rule is out of date; it is not appr opriate to pr esent- da y society .
2. The prior case is distinguishable because the facts ar e diff er ent in one or mor e significant details.

3. The judge or justice who made the prior ruling was incorrect or wrong.

Judges may be reluctant to state that the prior ruling was in error, especially if they participated in making that ruling. It is easier to state that someone else made an error. Judges *sometimes* do admit that the rule they created earlier is not the appropriate response to a particular legal problem.

Dictum is language by a judge that is not necessary to the decision before the court. It is an observation or remark that is not necessarily involved in the case or essential to its resolution. These remarks or asides are not part of the precedents. Dictum can provide valuable clues about how that judge might decide future cases.

An opportunity to "make law" occurs when jurisdictions are in conflict over a point of law. For example, many states are divided into judicial districts, and courts in each of these districts may issue written legal opinions. If two or more districts have published conflicting opinions on a particular point, the issue is ready for the creation of a new statewide rule that will resolve the matter. Until the statewide rule is created, however, each court creates precedents for itself and for any courts directly under it. When there are no prior court decisions on a point of law, the case is one of first impression. *First impression* occurs when an issue is presented to the court for an initial decision; the issue presents a novel question of law and is not governed by any existing precedent.

Equity

Equity is a body of rules applied to legal controversies when no adequate remedy at law exists. Rules of equity were developed outside the common-law courts in England by an officer of the King called the chancellor. The primary reasons for developing equity were the unfair decisions made by the courts of law and the limited types of remedies available in them.

Today, law and equity are joined into one legal system. One of the main distinctions between them is the type of remedy available. Money damages is the primary remedy at law. An injunction is an example of

an equitable remedy. Before U.S. courts will issue an injunction, the person requesting it must prove that the remedy at law would be inadequate. For example, if your neighbors are burning rubber tires on their property and the wind carries the obnoxious odor directly across your property, their action will destroy the peaceful use and enjoyment of your land. You would not have an adequate remedy at law, since no amount of monetary damages would be sufficient to allow them to continue to burn the tires. You could request that the court issue an injunction to stop your neighbors from burning the tires.

Equity developed a number of doctrines in an attempt to achieve fairness. One of those doctrines is the *clean hands doctrine.* A plaintiff should come into equity with clean hands, i.e., the plaintiff should not have committed fraud, deceit, unconscionability, or acted in bad faith in the plaintiff's treatment of the defendant. In other words, courts should not grant a plaintiff equity if the plaintiff has been unfair in the plaintiff's treatment of the defendant. (This is sometimes stated in the negative, i.e., the plaintiff will not receive equity if the plaintiff has unclean hands.)

In a larger sense, equity is a doctrine that results in the legal system's adhering to the principle of fairness. Exhibit 1.6 summarizes some of the differences between law and equity.

CLASSIFICATIONS OF LAW

Federal versus State Law

The U.S. legal system is divided into two branches: federal and state. Lawyers must learn not only the law of their state but also federal law. In addition, lawyers should know the majority rule. The *majority rule* is simply the rule that most states have adopted. Often there is also a *minority rule*, which a smaller number of states follow. Rarely do the various states agree on all aspects of a law. Exhibit 1.7 outlines the sources of law. Note that there is some overlap between case law and common law.

Exhibit 1.6

Distinctions Between Actions in Law and in E quity [a]

Characteristic	In Law	In E quity [b]
Type of r elief	Mone y t o compensate plaintiff for the plaintiff 's losses	Action, either in the form of or dering the def endant t o do or not t o do something, or in the form of a decr ee about the status of something [c], [d]
Natur e of pr oceeding	Mor e r estricted by pr ecedents	Mor e flexible and less restricted b y pr ecedents, supposed t o cr eate equity (justice)
Time limit for filing lawsuit	Applicable period fix ed b y the statute of limitations [e]	A r easonable period of time as determined b y the judge on a case-b y-case basis [f]
Decider of fact	Jur y trial, if requested b y a par ty	No jur y trial, judge decides the facts [g]
Enfor cing a decision	Plaintiff ma y begin an ex ecution of the judgment [h]	Plaintiff ma y begin contempt pr oceedings if the def endant does not per form as dir ected; def endant ma y be placed in jail and/or fined [i]

[a] Actions at law and those in equity are no longer as distinct as they once were. As a result, some states allow "combined" trials, with issues of law and issues of equity being tried together.

[b] Traditionally, a court of equity was called a court of chancery, and the judge was called a chancellor.

[c] Common equitable remedies include injunction, specific performance of a contract, rescission of a contract, and reformation (correcting or rewriting) of a contract.

[d] Courts would prefer to award monetary damages. Equitable relief is only granted when the plaintiff can convince the court that money would be inadequate.

[e] The statute of limitations period will depend on the state and the type of lawsuit. It will be a fixed period.

[f] If the plaintiff has waited too long to file suit under the circumstances, the judge will apply the doctrine of laches, and the suit will be dismissed.

[g] Some states permit the use of an advisory jury.

[h] In an execution, the clerk of the court issues a formal document and the sheriff seizes the defendant's money and/or other property. If property is seized, the sheriff will sell it and use the proceeds to pay the plaintiff.

[i] The court is authorized to place the defendant in jail until the defendant complies (or agrees to comply) with the court decree.

Common versus Statutory Law

The legal system consists of both common and statutory laws. Judges in the United States and England generally have the power to "make law" by interpreting statutes or applying precedents, and those interpretations become "common" law. Judges also apply the statutory law. Statutory law refers to the statutes passed by the legislative bodies. Common law is "unwritten" law developed over time by judicial action. It fills the gaps where other sources of law do not completely cover a particular topic.

Exhibit 1.7

The Sources of Law in the U.S. Legal System

Legend: F = federal; S = state		
Authority	**Source**	**Definition**
F, S	Constitution	Supr eme law of the land; fundamental basis of domestic law
F	Treaties	Formal agr eements between nations; fundamental basis of international law; not based on the Constitution
F, S	Statutes	Acts of the legislatur e that contr ol conduct; subject t o any limits imposed b y the Constitution
S	Or dinances	Laws passed b y municipal bodies and designed t o contr ol pur ely local pr oblems; subject to any limits imposed b y statutes or b y the Constitution
F, S	Administrativ e Regulations	Acts of administrativ e agencies that contr ol specific ar eas of conduct; subject t o any limits imposed b y statutes or b y the Constitution
F, S	Case Law	Pr ecedents; cour ts define and interpr et ar eas of law
F, S	Equity	Special rules and r elief when “the law” does not pr o vide a pr oper and/or adequate remedy

Civil versus Criminal Law

The U.S. legal system also separates civil and criminal law. In this context, *civil law* is private law that permits one person to sue another. *Criminal law* is public law in which a government entity files charges against a person. For example, if Bekah becomes violent, attacks another individual, and inflicts bodily harm, the district attorney may prosecute Bekah for assault. The district attorney is the government representative in state court. If convicted, Bekah may go to jail or prison. In addition, the person who was injured may sue Bekah in civil court for money damages. The additional suit would not constitute double jeopardy or its civil-law equivalent, *res judicata*, since two different theories of action exist: criminal and civil. (*Res judicata* is a rule of civil law that prevents a person from being sued more than once by the same party for the same civil wrong.) Some courts permit criminal cases and civil cases to be heard as part of the same trial.

There are several significant differences between civil and criminal law. One of the most significant differences is the burden of proof. In a civil case, the plaintiff must prove the plaintiff's case by a preponderance of the evidence. (A *preponderance of the evidence* means that the evidence on this side is stronger than the evidence on the other side. In other words, the plaintiff must provide evidence of greater weight than the defendant to win.) In a criminal case, the judge or jury must start with the presumption that the defendant is innocent, and the government must convince the judge or jury that the defendant is guilty *beyond* a reasonable doubt. (A *reasonable doubt* means a belief that there is another reasonable explanation for the crime based on the evidence presented.)

It is important to remember that the action itself does not necessarily tell you whether a case is civil or criminal. Exhibit 1.1 outlines some clues that can help you determine whether a case is a tort, a crime, or a contract dispute.

Cyber Guardian 1.3 Management

LOBB YING THE GO VERNMEN T ON BEH ALF OF CYBER GU ARDI AN

Thought leaders in the ar ea of AI ha v e suggested that use of AI should be regulated. F ederal and state legislatur es ha v e intr oduced pr oposals. Asher , Danica, and Mai ar e concerned that go vernment re gulation ma y restrict their oppor tunities to mak e mone y. Asher , Danica, and Mai would lik e to testify befor e the legislatur e to discourage it fr om passing legislation. The y ha v e turned t o y ou for advice. What will y ou tell them?

BUSINESS CONSIDERATION S What options ar e a vailab le to Cyber Guar dian under these cir cumstances? What can or should a busin ess do when it feels that pr oposed legislation will seriously impact its pr ofits?

ETHICAL CONSIDERATIONS W ould it be ethical for a firm to attempt to influence potential legislation? What ethical considerations arise when a firm decides to influence members of the legislatur e?

Substantiv e v ersus Pr ocedural Law

Substantiv e law deals with rights and duties giv en or imposed by the legal sy stem. *Pr ocedural law* is de v oted to h ow those rights and duties ar e enfor ced. F or example, th e law of contracts is substantiv e law . The law of pleading s describes the steps used to enfor ce tho se rights or duties. (*Pleadings* ar e formal statements filed in cour t identifying the claims of the par ties.) A contr oversy o ver the mental abil ity to form a valid contract is a substantiv e matter . Wher e one files the lawsuit, what must be alleged, how one n otifies the def endant, and how long the def endant has to answer the allegations ar e all examples of pr ocedural law . This book is de v oted primarily t o " substantiv e" law .

Public v ersus Priv ate Law

Private law is the body of law that deals with the property and relationships of private persons. It includes the areas of *property law* (ownership and transfer of assets), *contract law* (rights and duties that arise from enforceable agreements), *tort law* (other private wrongs such as negligence, invasion of privacy, and defamation), and *business relationships* (agency, partnerships, corporations, and similar entities). *Public law* deals with the relations between private individuals and the government. It also deals with the structure and operation of the government itself. *Constitutional law* (law relating to the government and its activities under the Constitution), *criminal law* (law relating to offenses against society), and *administrative law* (law relating to government agencies) are types of public law. Both private law and public law are very important to business decision making.

Contemporary Case

In this Contemporary Case, the courts are being asked to interpret §1964(c) of the federal Racketeer Influenced and Corrupt Organizations Act (RICO). For a more detailed discussion of RICO, see Chapters 6 and 7. The trial court granted a summary judgment to Medical Marijuana, basically saying that Horn could not recover. The court of appeals disagreed and the U.S. Supreme Court agreed to hear the issue. This is the Supreme Court's opinion. It is common for the Supreme Court's justices to disagree with each other. That occurred here. We include the majority opinion.

MEDICAL MARIJUANA, INC. v. HORN

604 U.S. 593 (2025)

FACTS[37] In 2012, Douglas Horn was working as a commercial truck driver when he crashed his truck and injured his back and shoulder. Months later, he was still suffering from chronic pain, and neither physical therapy nor traditional medicine provided relief. While searching for a natural alternative, Horn came across "Dixie X," a tincture infused with cannabidiol—more commonly known as CBD—

sold by Medical Marijuana, Inc. CBD, like its cannabis "cousin" tetrahydrocannabinol (THC), is a naturally occurring chemical compound found in the cannabis plant. Only THC, however, has the mind-altering properties associated with marijuana.

Because a positive drug test could cost him his job, Horn was wary of any product that might contain THC. But Dixie X seemed safe. It was described as a "CBD-rich," non-psychoactive medicine that is "0% THC." . . . Medical Marijuana's online FAQ page promised that Dixie X was "legal to consume both here in the U.S. and in many countries abroad." . . . Additional research, including a call to a customer-service representative, reinforced those representations. Satisfied that Dixie X was THC-free, Horn bought a bottle and gave it a try.

A few weeks later, Horn's employer selected him for a random drug screening. To his surprise, the test detected THC in his system. After Horn refused to complete a substance-abuse program—in his view, doing so would constitute "an admission to doing drugs," . . . his employer fired him. Horn then ordered another bottle of Dixie X and sent it to a third-party lab for testing. This test also came back positive for THC. In fact, the lab refused to mail the sample back to him, fearing that doing so would violate federal law.

ISSUES Can a plaintiff recover under civil RICO for a business loss that derives from a personal injury? (Civil RICO specifically denies a remedy for personal injury.) Is Horn entitled to a trial on whether he was injured in his "business"?

HOLDINGS Yes. Civil RICO does not prevent recovery for all business harms that are based on a personal injury. Yes. Horn was fired for using Dixie X. This could be considered an injury in his business under civil RICO.

REASONING Excerpts from the opinion of Justice Barrett:

The Racketeer Influenced and Corrupt Organizations Act (RICO) creates a cause of action for "[a]ny person injured in his business or

proper ty." . . . We must decide whether the statute . . . denies a remedy for business and proper ty loss that derives from a personal injur y. It does not. . . .

Horn sued Medical Marijuana in Federal District Court. . . . He alleged that Medical Marijuana was a RICO "'enterprise '" engaged in marketing, distributing, and selling Dixie X . . . (a RICO enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct"). He also asserted that Medical Marijuana 's false or misleading advertising satisfied the elements of mail and wire fraud and that those crimes constituted a "'pattern of racketeering activity .'" . . .

Section 1964(c) provides that "[a]ny person *injured in his business or proper ty* by reason of a violation of [RICO] may sue. . . ." . . . The ordinary meaning of "injure" is to "cause harm or damage to" or to "hurt." . . . The meaning of the relevant phrase is therefore straightforward: A plaintiff has been "injured in his business or proper ty" if his business or proper ty has been harmed or damaged. Section 1964(c) requires nothing more.

Even so, §1964(c) does not allow recovery for all harms. Instead, by explicitly permitting recovery for harms to business and proper ty, it implicitly excludes recovery for harm to one 's person. . . . But the "business or proper ty" requirement operates with respect to the *kinds* of harm for which the plaintiff can recover, not the *cause* of the harm for which he seeks relief. . . . In short, a plaintiff can seek damages for business or proper ty loss regardless of whether the loss resulted from a personal injur y. . . .

When a word carries both an ordinary and specialized meaning, we look to context to choose between them. . . . Here, context cuts decisively in favor of ordinary meaning. As an initial matter , the statute uses the word "injured" rather than "injur y." . . .

[In prior cases, we] adopted a contextual, fact-intensive inquir y that accounts for "the nature of the alleged injur y, the racketeering activity

that directly caused it, and the injurious aims and effects of that activity ." . . .

First and foremost is RICO's direct-relationship requirement. Time and again, we have reiterated that §1964(c)' s . . . language demands "some direct relation between the injury asserted and the injurious conduct alleged. " . . . The key word is "direct" . . . . Given the number of steps in Horn 's theory and the multiple actors involved, this requirement may present an insurmountable obstacle in his case. Indeed, even Horn concedes that he faces "a heavy burden on remand. " . . . There is, after all, some distance between the first link in the chain (Medical Marijuana 's misrepresentations) and the last (Horn 's job loss).

Second , pleading a RICO claim is not as simple as pointing to a business or property harm. A plaintiff must first establish a pattern of racketeering activity . . . . Doing so requires identifying two or more predicate crimes "within a single scheme that were related and that amounted to, or threatened the likelihood of, continued criminal activity ." . . .

Third, the reach of §1964(c) turns on more than the meaning of "injured. " "[B]usiness" may not encompass every aspect of employment, and "property" may not include every penny in the plaintiff 's pocketbook. Accordingly , not every monetary harm—be it lost wages, medical expenses, or otherwise—necessarily implicates RICO . . . .

[C]ivil RICO has undeniably evolved "into something quite different from the original conception of its enactors. " . . . More suits are brought against ordinary businesses than against "archetypal, intimidating mobster[s]" . . . . [G]iven this development, Medical Marijuana is not the first litigant to express concern about "the 'over-federalization ' of traditional state-law claims" . . . . But we respond today as we have before: If the breadth of the statute "leads to the undue proliferation of RICO suits, the ' correction must lie with Congress. '" . . .

The phrase "injured in his business or property" does not preclude recovery for all economic harms that result from personal injuries. We

ther efor e affirm the Second Cir cuit' s judgment and remand the case for fur ther pr oceedings consistent with this opinion.

It is so or der ed.

You Be the **Judge**

Hatem Kaisi operated a business selling vehicles. John Isaacs pr ovided accounting ser vices to him. He also pr epar ed Kaisi' s tax returns. Kaisi par ticipated in a "family ownership scheme. " Kaisi alleges the scheme was cr eated by Isaacs. In th e scheme Kaisi allegedly could a void tax es by div er ting income to Kaisi' s family m embers. P ar t of the scheme inv olv ed cr eating additional business entities. Kaisi was indicted for the crime of tax e va sion for impr operly repor ting income. He was also indicted for falsely claiming he was eligible for low-income Medicaid medical co verage.

Kaisi could ha ve pled not guilty and litigated the federal go vernment' s claims. If he had chosen that option, Kaisi could ha ve ar gued that he relied in good faith on the advice of his tax pr of essionals. Instead, Kaisi pled guilty to the char ge s. The plea agr eement included the following language, "because he is in fact guilty of the char ges. " Kaisi agr eed to the factual basis for the char ges and that he "willfully " par ticipated in tax e vasion. Kaisi receiv ed a prison sentence and was requir ed to pa y the federal go vernment some mone y.

Kaisi is suing Isaacs to reco ver for his losses for supposedly advising him to cr eate the scheme. Kaisi alleges se veral types of losses, including loss of reputation. (This case is being decided based on the civil complaint. Howe ver, Isaacs claims that Kaisi d id not follow all of his instructions.) Most of Kaisi' s claim is based on Issacs' malpractice as an accountan t. Should Kaisi be allowed to litigate his civil dis pute? Assume that Kaisi files his malpractice claim in *your* cour t. How will *you* d ecide? What decision would best ser ve the public policy? Why? What purposes of the legal system would be ser ved by

your approach? Why? [See *Kaisi v. Isaacs*, NO. 2023-CA-0511-MR, 692 S.W.3d 405 (Ky. Ct. App. Jun. 21, 2024).]

Summary

- The U.S. legal system seeks to balance law, order, and justice.
- The law has an artificial language system.
- Studying the law of business helps you learn how to avoid legal problems and when you should consult an attorney.
- A legal system needs to be reasonable, definite, practical, published, and final.
- A legal system focuses on achieving justice by properly using police power; by keeping the peace or maintaining the status quo; by providing answers; by providing protection; by enforcing intent; by rehabilitating people; and by facilitating commercial transactions.
- U.S. law and legal procedures can be very different from the law in foreign countries.
- There are various theories of jurisprudence concerning how the law works or how it should work.
- The sources of law in the U.S. legal system are constitutions, treaties, statutes, ordinances, administrative regulations, common law, case law, and equity.
- U.S. law consists of common and statutory law, civil and criminal law, substantive and procedural law, public and private law, and federal and state law.

Discussion Questions

1. Assume you are a business owner. Ask AI which types of law might apply to your chosen field of work. Be sure to specify exactly what your business does and where your business is located. This is up to you. Review the results. How many of the examples provided are statutes? Regulations? Court cases? If there are any areas of law not mentioned, ask AI whether laws in that

categor y apply to your business. How did you adjust your pr ompts to get information that was useful and r ele v ant?

2. What ar e the adv antages of ha ving cour ts follow pr eceden ts? What happens when a cour t changes a long-standing pr ecedent? How does that aff ect U.S. society? (Remember that not all legal systems follow pr ecede nts. In some countries, cour ts do not w rite and publish opinions because their decisions do not set pr ecedents.)

3. John R awls writes about justice and the elements that ar e necessar y for a just society . He describes the "Bar gaining Game, " a theor etical community of men and women who come together to bar gain for a completely new set of moral rules (laws) which the y must all obe y in the futur e. Once the rules ar e selected, the pla yers must adher e to the rules, e v en if the rules ar e not in their self-inter est in a par ticular situation. The pla yers choosing the rules do not kno w their own position in society , talents, or abilities. Rawls calls th is the v eil of ignoran ce.[38] R awls has be en interpr eted as sa ying, "In eff ect, the par ties choose principles for the design of society as if th eir places in it wer e to be determined b y th eir worst enemies. "[39] What rules do you think the pla yers would choose and why?

4. Consider the theories of jurisprudence discussed in this chapter . Which one do y ou agr ee with most? Why?

5. Ronald Lesnick took Brad Wi nter 's winning tick et fr om a gambling machine at the Wynn casino . Lesnick took the tick et to the main cage clerk at the casino, cl aiming that it was his. He receiv ed pa yment on the tick et. Lesnick was convicted of grand lar ceny for stealing the tick et fr om Winter and theft and commission of a fraudulent act in a gaming establishment for pr esenting the tick et for pa yment to the Wynn cage clerk. Lesnick claims that the multiple convictions v iolate his right to pr otection against double jeopar dy .[40] Do y ou agr ee? Why or why not?

Case Problems and W riting Assignments

1. Robyn Potter worked part-time as a registered nurse at a facility run by the Essentia Health (Essentia) integrated healthcare system. Essentia revised its flu vaccination policy in August 2017 to "help protect Essentia Health staff, visitors, patients, and families from acquiring and transmitting seasonal influenza disease." Under the revised policy, all employees, vendors, contractors, and volunteers had to receive the influenza vaccine "unless they qualified for a religious or medical exemption." Employees who wanted an exemption had to complete a request form which was reviewed by a committee. The committee "reviewed the exemption requests based upon legal standards and Equal Employment Opportunity Commission guidelines." There was also an appeal procedure for employees "whose exemption requests were denied." The requests of some employees were granted. Employees who did not either get the vaccine or an exemption were fired.

In November 2017, Potter filed an exemption request form which "indicated that she is Catholic and that the 'Bible, both the Old and New Testaments reference keeping [the] body blemish-free so [one] might have abundant life.'" She also said the policy discriminates against her "own personal beliefs." Her request was denied because the request "[did] not appear to be based upon any religious reasons." Her appeal was also denied. She was given a deadline for getting a vaccination. Potter was terminated in December 2017 when she did not obtain one. She then filed for unemployment benefits. The Minnesota Department of Employment and Economic Development (DEED) denied her benefits because they determined she was fired for employment misconduct. States do not provide unemployment benefits to employees who are fired for good cause. Potter appealed DEED's determination. An unemployment-law judge (the ULJ) held a hearing. Testimony indicated that Potter had received flu shots while she was in the military and she recently had other vaccinations. She said that some vaccines save lives but that she did not believe the flu vaccine could save lives. "Potter testified that her belief that the influenza vaccine is not effective is 'a personal belief based on numbers from the government.'" She could not quote any Bible passages or other church documents that indicated people should not be vaccinated. The ULJ decided "Potter

was driven by a personal, secular belief." "Potter is unwilling to inject what she considers scientifically ineffective impurities but is willing to inject what she considers scientifically effective impurities." "The ULJ determined that Potter's refusal to be vaccinated displayed a serious violation of the standard of behavior that Essentia had a right to reasonably expect." Were Potter's beliefs "sincerely held religious beliefs" entitled to protection? Why or why not? Is this an example of public law or private law? Why? [See *Potter v. St. Joseph's Medical Center*, A18-0736, 2018 WL 6729836 (Minn. Ct. App. Dec. 24, 2018) (unpublished opinion).]

2. Evangelist o Ramos was convicted of second-degree murder in the Louisiana trial court based on a 10-to-2 jury verdict. He was sentenced to life in prison without possibility of parole. Forty-eight states and the federal court system require a unanimous verdict in criminal cases. In those courts, Ramos would have been acquitted. However, Louisiana and Oregon punish suspects based on 10-to-2 verdicts. The Sixth Amendment right to a jury trial applies to the states under the Fourteenth Amendment. The Sixth Amendment does not say anything specific about what a trial by a jury includes. However, in 1791, when the Sixth Amendment was ratified, a trial by jury meant a trial by a unanimous jury. Ramos raises the issue of whether his trial complied with his constitutional right t o a jury trial.

"Louisiana first endorsed non unanimous verdicts for serious crimes at a constitutional convention in 1898. According to one committee chairman, the avowed purpose of that convention was to 'establish the supremacy of the white race,' and the resulting document included many of the trappings of the Jim Crow era: a poll tax, a combined literacy and property ownership test, and a grandfather clause that in practice exempted white residents from . . . these requirements. Nor was it only the prospect of African-Americans voting that concerned the delegates. Just a week before the convention, the U.S. Senate passed a resolution calling for an investigation into whether Louisiana was systemically excluding African-Americans from juries. . . . [Aware that courts] would strike down any policy of overt discrimination against African-American jurors . . . , the delegates sought to

undermine African-American participation on juries in another way. With a careful eye on racial demographics, the convention delegates sculpted a 'facially race-neutral' rule permitting 10-to-2 verdicts in order 'to ensure that African-American juror service would be meaningless.' "[41]

In 1972, the U.S. Supreme Court examined Louisiana's and Oregon's unconventional schemes in *Apodaca v. Oregon*[42] and *Johnson v. Louisiana*.[43] In both cases, it upheld the legality of the 10-to-2 jury verdicts in a badly fractured set of opinions with a four-Justice plurality. *Apodaca* did not provide an opinion in which the Justices agreed on the reasons. Four dissenting Justices determined that the Sixth Amendment requires a unanimous jury and that it applied to the states. The four Justices who made up the plurality said the real question was whether unanimous juries serve an important function in contemporary society. They then concluded that the cost of requiring unanimous juries outweighs the benefits to society, so they are not required. Justice Powell, the ninth Justice, argued that the jury trial requirement for the states can be less than the jury trial requirement for the federal government; his opinion disagreed with many cases of precedents that had already been decided.

When a court considers whether to follow precedent it generally considers (1) the quality of the reasoning; (2) the consistency with related decisions; (3) legal developments since it was decided; and (4) the amount of reliance there has been on the precedents.

When should the court follow precedents? Why? When a court overturns precedents, how does that affect whether the law is definite? Was Ramos deprived of his Sixth Amendment right to a trial by an impartial jury? How should the court decide this case? Be certain that you explain and justify your answer. [See *Ramos v. Louisiana*, 590 U.S. 83 (2020).]

3. On September 24, 2007, Sandra A. Sheldon and James J. Sheldon (defendants or mortgagees) signed a promissory note in which they promised to pay $182,000, plus interest, to GMAC Mortgage, LLC (GMAC). A short time later, they accepted GMAC's offer to join its bisaver program. Under the program, payments would be withdrawn

directly from Sandra Sheldon's checking account. GMAC started withdrawing the payments. GMAC ceased withdrawing the biweekly payments around August 2008. No reasons were given for this change. The missed payments were GMAC's fault. However, GMAC reported the nonpayments to several credit reporting agencies. This quickly damaged the defendants' credit. James Sheldon's credit cards were cancelled. Since he needed at least one credit card to travel out of town for work, he had to stop work and his income dropped significantly. Defendants complained to the state Department of Business Regulation, Division of Banking. "An officer there told GMAC that it 'screwed up and you gotta fix it.'"[44] A GMAC representative admitted that it was its fault for not withdrawing the payments. GMAC continued to report that defendants were in default to the credit reporting agencies.

On July 14, 2009, defendants and GMAC orally agreed that if defendants paid all their unpaid installments and made three regular payments that GMAC would restore their credit. The defendants lived up to these terms. GMAC did not restore their credit. At some point, GMAC did send the defendants a letter acknowledging its mistake and said the defendants could share the letter to try to fix their credit. The defendants did not believe this letter lived up to the terms of their 2009 agreement. The defendants stopped making future payments based on advice they received. GMAC resumed the negative credit reports.

On August 20, 2010, GMAC transferred the mortgage to Ocwen Loan Services, LLC. This transfer is called an assignment, and the new loan company stands in the legal position of GMAC. James Sheldon explained the background to Ocwen. Ocwen refused to restore their credit or consider the effect of GMAC's mistakes. Neither GMAC nor Ocwen sent letters to the credit reporting agencies acknowledging GMAC's error. Instead, under the terms of the mortgage, Ocwen accelerated the mortgage so that the entire unpaid balance was due. The poor credit rating continued to harm the defendants. In 2017, Ocwen began foreclosure proceedings.

Foreclosure on a mortgage is an equitable remedy. It is a more flexible approach. Courts of equity use the clean hands doctrine. Under the doctrine, plaintiffs may not obtain equity if the plaintiff has unclean

hands. There is no rigid rule for what is unclean hands. In the words of the court, to constitute misconduct, it must be "of such a character as to be condemned and pronounced wrongful by honest and fair-minded people."[45]

Should the mortgage company be allowed to foreclose on the property? Should the equitable remedy be disallowed based on unclean hands? How would you decide the mortgage company's foreclosure action? Why? [See *Ocwen Loan Servicing, LLC v. Sheldon*, 208 Conn. App. 132, 264 A.3d 106 (Conn. Ct. App. 2021).]

Notes

1. *Barlow v. United States,* 32 U.S. 404 (1833).
2. In 2003, the Uniform Law Commission (ULC) enacted proposals to raise the dollar amounts for the sale of goods and leases. States did not adopt the 2003 revisions to UCC Article 2 and 2A. The ULC withdrew both revised Article 2 and 2A (2003) in 2011. Henry Gabriel, "Uniform Commercial Code Article Two Revisions: The View of the Trenches," 23 Barry L. Rev. 130 (Issue 2, Article 4, 2018), *available at* https://lawpublications.barry.edu/barrylrev/vol23/iss2/4/ (last visited Jun. 11, 2025); and Legal Information Institute, Cornell Law School, "U.C.C.—Article 2A—Leases (2003 Revision—Withdrawn)," https://www.law.cornell.edu/ucc/2a/article2a (last visited Jun. 11, 2025).
3. *Drysdale v. Prudden*, 195 N.C. 722, 143 S.E. 530, 536 (N.C. 1928).
4. The grand jury requirement is included in the Fifth Amendment and applies to federal criminal cases. This is not a requirement at the state level under the U.S. Constitution, although it may be required under the state's constitution or statutes.
5. "Violent Crime in D.C. Surges in 2012," *The Washington Times*, Feb. 19, 2012, https://www.washingtontimes.com/news/2012/feb/19/violent-crime-dc-surges-2012/ (last visited Jun. 11, 2025).
6. John Paul MacDuffie and The Detroit Bureau's Paul Eisenstein, "The Auto Bailout 10 Years Later: Was It the Right Call?," Knowledge at Wharton Podcast, Sep. 12, 2018. https://knowledge.wharton.upenn.edu/podcast/knowledge-at-wharton-podcast/auto-bailout-ten-years-later-right-call/ (last visited Jul. 19, 2025).
7. Janet Morrissey, "The Penalty for 'Extraordinary Evil': Madoff Gets 150 Years," *Time*, Jun. 29, 2009, https://time.com/archive/6906194/the-penalty-for-extraordinary-evil-madoff-gets-150-years/ (last visited Jun. 11, 2025).
8. The businessman allegedly defrauded more than 57,000 investors out of approximately RMB 2.8 billion (US $460 million). Zeng's family claims that they were not notified by the Chinese government prior to his execution. Headsman, 2013: Zeng Chengjie, China's Bernie Madoff, Executed Today, Jul. 12, 2014, https://www.executedtoday.com/2014/07/12/2013-zeng-chengjie-chinas-bernie-madoff/ (last visited Nov. 1, 2025).
9. Jeffrey Scott Shapiro, "Amanda Knox Murder Conviction Reversed by Italian Court," *The Washington Times*, Mar. 27, 2015, https://www.washingtontimes.com/news/2015/mar/27/italian-court-decides-fate-amanda-knox-murder-case/ (last visited Jun. 11, 2025).

10. Starnes claimed that it was all a misunderstanding about layoffs and severance packages. Some workers had a different story, claiming that they were owed back pay. They also thought that the factory was going to be closed and everyone was going to be laid off. David McKenzie and Connie Young, "U.S. Businessman Held Hostage by His Workers in China, He Says," *CNN*, updated Jun. 25, 2013, https://www.cnn.com/2013/06/25/world/asia/china-us-businessman-hostage (last visited Jun. 11, 2025); Cy Xu and Holly Yan, "After 6 Days, U.S. Boss Held 'Hostage' by His Chinese Workers Freed," *CNN*, Jun. 27, 2013, https://www.cnn.com/2013/06/27/world/asia/china-us-businessman-freed/index.html (last visited Jun. 11, 2025).
11. See Anthony Shoult, *Doing Business with Saudi Arabia,* 88 (3d ed. 2006), as cited in Cooper C. Millhouse, "Injustice Anywhere: A Comparative Law Analysis of Saudi Arabia's Criminal Justice System," 47 UC L. SF Int'l L. Rev. 33, 35, Feb., 2024.
12. See Kerrie Sadiq and Ann Black, "Embracing Sharia-Compliant Products Through Regulatory Amendment to Achieve Parity of Treatment," 34 Sydney L. Rev. 189 (Mar. 2012).
13. After a public outcry and high-level discussions between Norway and UAE, Sheikh Mohammed bin Rashid Al Maktoum pardoned Dalelv. She was permitted to leave UAE. Nicola Goulding, Jennifer Z. Deaton, and Laura Smith-Spark, "Dubai Ruler Pardons Norwegian Woman Convicted after She Reported Rape," *CNN*, updated Jul. 22, 2013, https://www.cnn.com/2013/07/22/world/meast/uae-norway-rape-controversy/index.html (last visited Jul. 28, 2022). "In the United Arab Emirates, as in some other countries using Islamic law, a rape conviction can require either a confession or the testimony of four adult male witnesses." See Amena Bakr, Sami Aboudi, Kevin Liffey, Mirna Sleiman, and Balazs Koranyi, "Dubai Pardons Norwegian Woman Convicted After Reporting Rape," *Reuters*, Jul. 22, 2013, https://www.reuters.com/article/us-emirates-norway-pardon/dubai-pardons-norwegian-woman-convicted-after-reporting-rape-idUSBRE96L0TV20130722 (last visited Jul. 28, 2022).
14. Bryan A. Garner, *Black's Law Dictionary*, 7th ed. (St. Paul: West Publishing Co., 1999), at 858.
15. James Rachels, *The Elements of Moral Philosophy*, 2d ed. (New York: McGraw-Hill, 1993), at 50.
16. *Id.* More recently, John Finnis has written about natural law theory in *Natural Law and Natural Rights* (1980) and *Aquinas: Moral, Political, and Legal Theory* (1998). Richard W. Wright, "The Principles of Justice," 75 Notre Dame L. Rev. 1859 (2000), nn. 3 and 4.
17. Kenneth Einar Himma, "Natural Law," *The Internet Encyclopedia of Philosophy,* https://iep.utm.edu/natlaw/ (last visited Jul. 28, 2022).
18. There is both American Realism and Scandinavian Realism. We will only focus on American Realism.
19. Legal Realism, Cornell Law School, Legal Information Institute (LLI), Wex, Jun., 2023, https://www.law.cornell.edu/wex/legal_realism (last visited Jun. 26, 2025).
20. Noah Hornberger, "An Introduction to American Legal Realism," Northwestern Law Journal des Refusés, Vol. 1: Iss. 1, Article 4, https://scholarlycommons.law.northwestern.edu/nljr/vol1/iss1/4 (last visited Oct. 31, 2025), at p. 41. See also Legal Realism, LII, Cornell Law School, *id.*
21. Joel Feinberg, Jules Coleman, and Christopher Kutz, *Philosophy of Law* (9th ed.), p. 149. Copyright © 2010 and 2014, from Wadsworth, Cengage Learning. The Philosophy of Law anthology reprinted the paragraph from Jerome Frank, "Legal Realism," from the *Law and the Modern Mind* (New York: Doubleday and Co. Anchor edition 1963), pp. 46-52. Originally published by Brentanos. Inc., in 1930. Copyright © 1930, 1933, 1949 by Coward McCann.

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22. A modern example is whether the court should require an employee to arbitrate the employee's claims against the employer when the employee had no choice of whether to agree to the arbitration clause if the employee wanted the job.
23. Encyclopedia.com, Legal Realism, https://www.encyclopedia.com/law/encyclopedias-almanacs-transcripts-and-maps/legal-realism (last visited Jun. 12, 2025).
24. *Id.*
25. *Supra* note 19.
26. *Supra* note 23.
27. See *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 2 L. Ed. 60 (1803).
28. U.S. Constitution, Article II, Section 2. The case of *Missouri v. Holland*, 252 U.S. 416 (1920), established that statutes passed in accordance with a valid treaty cannot be declared unconstitutional.
29. United States Senate, "About Treaties/Historical Overview," https://www.senate.gov/about/powers-procedures/treaties/overview.htm (last visited Jul. 28, 2022).
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. Bryan A. Garner, *Black's Law Dictionary*, 11th ed. (St. Paul: West Publishing Co., 2019).
35. *Janus v. American Federation of State, County, and Municipal Employees, Council 31,* 138 S. Ct. 2448, 2478 (2018), quoting *Payne v. Tennessee,* 501 U.S. 808, 827, 111 S. Ct. 2597, 115 L. Ed. 2d 720 (1991).
36. *Brown v. Board of Education,* 347 U.S. 483 (1954).
37. The Facts for this case are quoted from the Court's opinion.
38. John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, Belknap Press, 1971).
39. Chandran Kukathas and Philip Pettit, *Rawls: A Theory of Justice and Its Critics* (Palo Alto, CA: Stanford University Press, 1990), p. 39.
40. *Lesnick v. State*, No. 84577, 528 P.3d 1135 (Nev. May 11, 2023).
41. Citations omitted. *Ramos v. Louisiana*, 590 U.S. 83 (2020).
42. *Apodaca v. Oregon*, 406 U.S. 404 (1972).
43. *Johnson v. Louisiana*, 406 U.S. 356 (1972).
44. *Ocwen Loan Servicing, LLC v. Sheldon*, 208 Conn. App. 132, 135, 264 A.3d 106 (Conn. Ct. App. 2021).
45. *Id.* at 146.

2

Business Ethics

Learning Objectives

After completing this chapter, you should be able to:

- Explain why ethics are important to business
- Describe the main ethical theories
- Distinguish consequential and nonconsequential theories
- Recognize the ethical perspective of an author or speaker
- Select an ethical theory and analyze a dilemma from the perspective of that theory
- Identify the stakeholders in a business decision

Outline

- Introduction
- Ethical Theories
- A Synthesis for Ethical Decision Making
- Informal Approaches
- The Evolution of Businesses as Ethical Entities
- Multinational Ethics
- A Recommendation for Business

Agenda

Asher , Danica, and Mai need to understand and appr eciate the ethical obligations and expectations under which the y will operate Cyber Guar dian. A business toda y is expected to act ethically , even if it has not adopted any par ticular ethical theor y or written a formal statement of its ethical principles. This expectation is lik ely to incr ease. The principals also need to realiz e that a business must satisfy the *social contract* it has with soc iety , even if th e business or its owners and managers ar en't awar e that the y ha ve enter ed int o such a "contract. " This is a significant por tion of the social responsibility of a business.

The principals must weigh their decisions, consideri ng the potential posit ive and negativ e impact on each of the firms' s constituent gr oups. The y ma y also want to decide how the y should measur e the ethical implications and impact of any business decisions. How does a mana ger know what society expects under the social contract theor y?

The y will need to know who the constituents of the business ar e and ho w the conduct of the business leaders can aff ect each of these diff er ent constituent gr o ups. These and other issues need to be addr essed in co vering the ma terial in this chapter . Be pr epar ed! You ne ver know when the firm or one of its members will need your advice.

Classic Case

In Chapter 1, the focus was on the law . In this chapter , the focus is on business ethic s. As you read the cases in this chapter , consider the ethics of th e par ticipants. F or examp le, in this Classic Case consi der the ethics of Jacobson and the city of C ambridge officials. In this decision, the U.S. Supr eme Cour t analyz ed whether the smallpo x vaccine requir ement was constitutional under the polic e power of the state. The Cour t consider ed whether one person had the right to refuse a mandat or y vaccination when the pr ogram was intended t o help the common good.

JACOBSON v. MASSACHUSETTS

197 U.S. 11 (1905)

FACTS Henning Jacobson lived in the city of Cambridge. Cambridge had a smallpox outbreak that seemed to be getting worse. The Cambridge Board of Health passed a regulation that required all adults to get the smallpox vaccination. The city provided the vaccinations for free. Jacobson refused to have the vaccination. He appeared to be healthy at the time of the regulation. Jacobson did experience a negative reaction to a vaccination as a child.

ISSUE Must adults within Cambridge comply with the Board of Health's regulation to have a smallpox vaccination?

HOLDING Yes. The vaccination requirement is constitutional.

REASONING Excerpts from the opinion of Justice Harlan:

. . . The authority of the State to enact this statute is . . . commonly called the police power—a power which the State did not surrender . . . under the Constitution. . . . [This court] has distinctly recognized the authority of a State to enact quarantine laws and "health laws of every description." . . . According to settled principles, the police power of a State must be held to embrace . . . such reasonable regulations . . . as will protect the public health and the public safety. . . . It is equally true that the State may invest local bodies . . . with authority . . . to safeguard the public health and the public safety. The mode or manner in which those results are to be accomplished is within the discretion of the State, subject . . . to the condition that no rule prescribed by a State, nor any regulation adopted by a local governmental agency . . . shall . . . [violate] the Constitution of the United States or infringe any right granted or secured by that instrument. . . .

The defendant insists that his liberty is invaded when the State subjects him to fine or imprisonment for neglecting or refusing to submit to vaccination; that a compulsory vaccination law is unreasonable, arbitrary and oppressive, and, . . . hostile to the inherent right of every freeman to care for his own body and health in such way as to him seems best. . . . But the liberty secured by the Constitution of the United States . . . does not

impor t an absolute right in each person to be, at all times and in all cir cumstances, wholly fr eed fr om restraint. Ther e ar e . . . restraints to which ev ery person is necessarily subject for the common good. . . . [A society] based on the rule that each one is a law unt o himself would soon be confr onted with disor der and anar chy . Real liber ty for all could not exist under the operation of a principle which recogniz es the right of each individual person [to mak e his own decisions] . . . regar dless of the injur y that ma y be done to others. . . . "[P]ersons and pr oper ty ar e subjected to all kinds of restraints and bur dens, in or der to secur e the general comfor t, health, and pr osperity of the State. " . . . "[A]ll rights ar e subject to such reasonable con ditions as ma y be deemed b y the go verni ng authority . . . essential to the saf ety , health, peace, good or der and morals of the community . Even liber ty itself, the gr eatest of all rights, is not unr estricted license to act accor ding to on e's own will. . . . It is . . . liber ty regulated b y law ." . . .

[T]he legislatur e of Massachusetts requir ed the inhabitants of a city or town to be v accinated only w hen, in the opinion of the Boar d of Health, that was necessar y for the pub lic health. . . . [I]t was appr opriate for the legislatur e to ref er that question . . . to a Boar d of Health, composed of persons residing in the locality aff ected and appointed . . . because of their fitness to determine such qu estions. To inv est such a body with authority o ver such matters was not an unusual nor an unr easonable or arbitrar y requir ement. . . . [A] commun ity has the right to pr otect itself against an epidemic of disease which th reatens the saf ety of its members. . . . [W]hen the regulation in question was adopted, smallpo x . . . was pr evalent . . . in the city of Cambridge and the disease was incr easing. . . . [T]he cour t would usurp th e func tions of another branch of go vernment if it adjudged . . . that the mode adopted . . . to pr otect the people . . . was arbitrar y and not justified b y the necessities of the case. . . . Ther e is, of course, a spher e within w hich th e individual ma y asser t the supr emacy of his own will and rightfully dispute the authority of any human go vernment . . . to inter fer e with the ex er cise of that will. But it is equally true that in ev ery well-or der ed society char ge d with the duty of conser ving the saf ety of its members the rights of the individual in respect of his liber ty ma y at times . . . be subjected to such restraint . . . as the saf ety of the general public ma y demand. . . .

[If there were two ways to protect the public from a disease, it is not the court's function to determine which one should be used.] That was for the legislative department to determine in . . . light of all the information it had or could obtain. . . . The state legislature proceeded upon the theory which recognized vaccination as . . . an effective if not the best known way in which to . . . suppress the evils of a smallpox epidemic. . . .

"It must be conceded that some laymen . . . and some physicians of great skill and repute, do not believe that vaccination is a preventive of smallpox. The common belief . . . is that it has a decided tendency to prevent the spread of this fearful disease and to render it less dangerous to those who contract it. While not accepted by all, it is accepted by the mass of the people, as well as by most members of the medical profession. . . ." A common belief, like common knowledge, does not require evidence to establish its existence, but may be acted upon without proof by the legislature and the courts. . . . "The fact that the belief is not universal is not controlling, for there is scarcely any belief that is accepted by everyone. The possibility that the belief may be wrong, and that science may yet show it to be wrong, is not conclusive. . . . "

We are not prepared to hold that a minority, residing or remaining in any city or town where smallpox is prevalent, and enjoying the general protection afforded by an organized local government, may . . . defy the will of its constituted authorities, acting in good faith for all, under the legislative sanction of the State. . . . While this court should guard with firmness every right appertaining to life, liberty or property as secured to the individual by the Supreme Law of the Land, . . . it should not invade the domain of local authority except when it is plainly necessary to do so in order to enforce that law . . . .

The judgment of the court below must be affirmed.

It is so ordered.

INTRODUCTION

Some people view "business ethics" as a contradiction in terms. Exchange is essential to business. We frequently purchase goods or services, from the cold drink at the fast-food restaurant to the Uber® or Lyft® ride. We

also enter into rental agreements for an apartment or a Bird® scooter. Sometimes we are the seller of the goods or services. Since we cannot avoid business transactions, we cannot avoid business ethics. Our ethics and those of the other party will be important in our transaction.

Recent corporate scandals and the resulting loss of trust by the public demonstrate that ethics is important in business. Even a *perceived* lack of ethics in a firm or in an industry can have devastating effects on the firm, the industry, or even the entire U.S. economy. Scandals in college admissions, entertainment, police forces, and politics have increased the public's awareness of and concern over ethical issues and attitudes in our society. These scandals often lead to additional government regulation. Remember the impact of these events, including the economic harm they cause, while studying this chapter.

Business ethics involves the ethics of individuals *and* the ethics of the organization to which they belong. For example, a chief financial officer (CFO) has ethics and the corporation has ethics. Or a senator will have certain ethics and the Congress as a whole has ethics. The individual's ethics may be the same or similar to those of the organization. Sometimes there is a mismatch between the two. Assume that Luciana is the CFO of Travel.com. If Travel.com frequently asks Luciana to do acts that she feels are not ethical, the views of the two do not match well. In this text, we will discuss the perspectives of both the individual and the organization.

Ethics and Law

Ethics and law are interrelated. For some individuals, ethics and law are synonymous. For example, when these individuals face an ethical dilemma, they ask whether the behavior that they are considering is legal. In their minds if it is legal, it is ethical. If it is not legal, it is not ethical. However, for many people, these questions are not identical. To illustrate the two positions, assume Clayton oversleeps and leaves for work late. Clayton is considering driving over the speed limit. If he believes that ethics and law are synonymous, he would believe that exceeding the speed limit is unethical *and* illegal. If he believes that they are separate questions, he would recognize that exceeding the limit is illegal. He may believe that speeding so that he can arrive at work on time is ethical. He may believe that speeding is not an ethical question at all. In this chapter, we will focus on ethics.

Some laws are based on the ethical beliefs of some members of society. Murder is a crime because most people believe that it is wrong to kill other human beings. The prohibition movement to prohibit alcohol consumption in the United States occurred because some people felt that consuming alcohol and drunkenness were unethical. The constitutional amendment and the related laws that enforced prohibition were not successful. Eventually, the laws were repealed. [1] One of the reasons for repeal was that many U.S. residents felt that the consumption of alcohol was not intrinsically unethical. Throughout the book it is important to pay attention to the interrelationships between ethics and law.

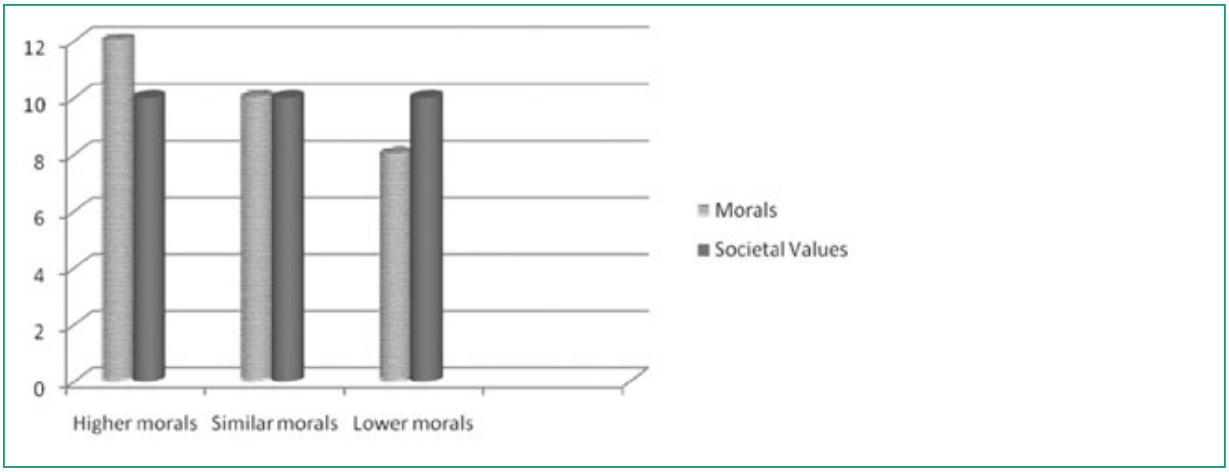
Ethics and Morality

It is fairly common for people to equate ethics with morality, and to use the words *ethics* and *morals* interchangeably. In so doing, they find it easier to discuss the topic of ethics. However, such usage is not altogether accurate. *Ethics* refers to a guiding philosophy—the principles of conduct governing an individual or a group. [2] By contrast, *morals* relate to principles of right and wrong behavior as sanctioned by or operative on one's conscience. [3] From the perspective of an individual, ethics and morals frequently have the same meaning. However, from the perspective of a group—including a society—it is more appropriate to speak of ethics. When we speak of ethics, we will be talking about societal values, the accepted standard of conduct within a given society. In contrast, when we speak of morals, we will be talking about individual values, a person's accepted standard of behavior for that individual.

Exhibit 2.1 provides a few examples of how ethics and morals may be compared.

Exhibit 2.1

Ethics and Morals: A (Limited) Comparison



Source: Courtesy of Daniel V. Davidson, © 2026.

An individual with higher morals than society's values is one whose actions exceed those that are generally accepted. For example, while society may frown on jaywalking, it does not consider such conduct unethical. The person with higher morals might consider jaywalking to be wrong and immoral. A person with lower morals than society's values is one whose actions, or at least whose accepted values, fall below those of society at large. Such a person may see nothing wrong with looting during a riot or robbing a convenience store.

Different societies may have different ethics, but the morals of any given individual should remain relatively constant no matter which society that person should happen to be in at any point in time. Ethical conduct is conduct that is deemed right—or at least accepted as not wrong—within a societal setting. Moral conduct is conduct that the individual considers right—or at least does not consider wrong—without regard to the attitude of the society.

To further complicate this issue, societies also have standards that go beyond ethics. The ethical standards of a society reflect what is considered "right" and "wrong" within that society in a general manner. Some wrong behavior may be merely a matter of rude conduct, frowned on within the society. However, it is not so severe as to merit more than a social dislike of the conduct. For example, conducting a loud cell phone conversation in a public place is likely to be considered rude, but it is not likely to merit an official sanction. Other "wrong" conduct may be considered to be much more serious; this conduct may be so inappropriate that society fines or even incarcerates the person who acts in this "wrongful" manner. For

example, kidnapping a person is a crime. To help ensure that people within a society act in a socially acceptable manner, the society enacts laws and regulations. Society usually imposes penalties for violations of the laws or regulations. These laws provide a minimum standard of behavior that is expected from each member of that society.

Although it is a broad generalization, conduct that violates a law or a regulation of a society is generally deemed unethical by that society. This is not to say that all unethical conduct is also illegal; rather, it says that all illegal conduct is generally viewed as unethical. Of course, there are situations where some members of a society will act in a manner that violates a law or a regulation to force the society to reconsider its official position and change the law. One such example involves Dr. Martin Luther King Jr., who encouraged civil disobedience in the 1950s and 1960s. Much of his conduct was illegal at the time. People who view ethics and legality as the same would also view his conduct as unethical. The civil rights movement ultimately changed the laws regarding equal rights and racial discrimination and changed the social values in the United States. In retrospect, many believe that Dr. King acted in a *moral* manner by helping to change laws that they believe were unethical. There is a potential problem when an individual's personal morals call for conduct prohibited by society's ethics. For example, suppose Sydnie feels that stealing is moral *if* the victim of the theft is wealthy. Sydnie will encounter problems if she acts on this moral value by stealing from a wealthy person. If Sydnie decides to steal from the wealthy, she may be acting morally (adhering to her personal values), but she will be considered to have acted unethically by society (violating the society's values). U.S. society has decided that theft is both an illegal and an unethical act. Sydnie will find that her morals conflict with society's ethics and its law.

ETHICAL THEORIES

It is important to begin with an introduction to some of the more widely used ethical theories and principles. This section introduces several of these ethical theories and compares them to one another. Each theory has proponents who argue for its use. Each also has critics who point out the weaknesses of the theory. The theories are also evolving as ethicists look at the weaknesses and attempt to improve the theory. As we study these ethical theories, remember that we do not have consensus on what is the

"best" ethical theory. Each individual and each organization must choose the theory that best suits their beliefs, morals, and values. Even people who are applying the same theory may come to a different conclusion as to what they should do. Some people combine theories or look at an ethical problem from the perspective of several different theories.

Although a business may be recognized as a legal person, the business is not a "particular person." It is really a collective of people. Generally, one individual is not a significant influence in providing moral or ethical guidance for the firm. The group to which a business belongs is generally too diverse to have a single system or code of morals.

Similarly, "business" is not a single profession, like accounting or law, which could adopt a single code of ethical conduct. The study of business ethics often comes down to the morals of a particular person, the specific businessperson whose conduct is being evaluated. Unfortunately, the ethical standard often applied in this situation is the ethical standard of the onlooker and not that of the person being observed. To properly treat the ethical issues of a businessperson, some kind of analytic framework must be established and some basic understanding of the ethical parameters of business needs to be developed.

Cultural Relativism

Cultural relativism holds that what is good or bad depends on what is approved by the majority of a given society. It is a descriptive theory.[4] (*Descriptive theories* explain what people actually do.) Cultural relativism claims that ethics is a product of the culture. For example, the death penalty is a socially acceptable punishment in some societies, but not in others. Two societies may hold ethical views that are opposed to one another, and there is no clear way to resolve the differences. No culture is superior to any other culture. Other societies are different, but they are not "wrong." Cultural relativists view themselves as being tolerant of the differences.

Critics of cultural relativism say that there are universal norms or hypernorms: Many diverse societies prohibit the same things, such as lying, stealing, adultery, and killing human beings. Critics also say that if a society does not prohibit something, such as killing other human beings, it is acceptable to judge that society and to point out that the society is defective.

Consequential and Nonconsequential Principles

Many ethical theories are based on either consequential (teleological) principles or on nonconsequential (deontological) principles. Consequential principles judge the ethics of a particular action by the *consequences* of that action. Consequential ethics determine the "rightness" or the "wrongness" of any action by comparing the amount of good to the amount of evil that the action will produce. A person using consequential ethics needs to evaluate each possible choice, measuring the good (and the evil) that is likely to result from the alternatives. The "right" action is that action that will produce the greatest amount of good compared to evil. The major theories applying consequential principles include ethical egoism and utilitarianism. These theories will be examined in more detail later in this section.

Nonconsequential principles tend to focus on the concept of *duty* rather than on the results of the action. Nonconsequential ethical theories are rule-based. Under the nonconsequential approach, a person acts ethically if that person is faithful to the person's duty, regardless of the consequences that follow from the person's action. The nonconsequential ethical theories are likely to reflect the values of the society. Remember that society imposes duties (in the form of rules and regulations) to maximize the values it wants. By meeting those duties, the individual is furthering the interests of that society. The *categorical imperative* advanced by Immanuel Kant and the *veil of ignorance* advocated by John Rawls are two of the best-known nonconsequential theories. Both of these theories will be discussed in detail later in this chapter.

Ethical Egoism

Ethical egoism is a prescriptive theory that says the proper goal of all people is their own self-interest.[5] (*Prescriptive theories* state what people should do.) Ethical egoism says you should do those things that maximize your own self-interest. (Do not confuse an *egoist*, a person who follows the ethical theory of egoism, with an *egotist*, a person who has an exaggerated sense of self-importance.) In ethical egoism, each person is expected to act in a manner that will maximize that person's long-term self-interests. In so doing, society will benefit because when each individual acts in a manner that produces the greatest good for that individual, the sum of all of these individual acts will produce the greatest total good for the society. Under

this theory, an action is morally right if it maximizes the actor's self-interest. It does not need to do anything else.

One common misconception about egoism is that all egoists are hedonistic pleasure-seekers who emphasize instant gratification. This interpretation treats one's pleasure as being equal to one's best interests.[6] Most egoists take a broader view of what is in "one's best interests." Consequently, many egoists may decide to act in a manner that appears to be "selfless" because doing so will further their long-term self-interest. These egoists may be willing to make a personal sacrifice today to receive some benefit in the future. Doing so is perfectly consistent with the doctrine of egoism. An egoist may cooperate with others so that others will cooperate with the egoist in the future. So, an egoist may decide that it is in the egoist's interest to live up to a promise so that others will accept the egoist's promises in the future or so that others will not sue the egoist for breach of contract. One weakness with ethical egoism is whether a person can accurately choose what is in the person's best interest. The actor may not be able to foresee the good or bad consequences of an act.

An organization may follow egoism in the same manner that an individual can. From an organizational perspective, egoism involves those actions that best promote the long-term interests of the organization. A corporation using egoism may establish a college internship program. This program may advance the long-term interests of the corporation by (1) improving its public image; (2) reducing social tensions; or (3) providing skilled employees in the future. The short-term expenses incurred in such a program can be offset by future benefits. So the program may appear to be generous and public-spirited, when in reality, the program is undertaken for self-interested reasons.

Utilitarianism

The second major consequential approach is utilitarianism. To a utilitarian, the proper course of conduct in any given setting is the course that will produce the greatest good (or the least harm) for the greatest number.[7] Rather than focusing on the interests of the individual (as an egoist would), the utilitarian focuses on the overall interests of the group. The ethical course of conduct is the alternative that best serves the interests of the social group as a whole, regardless of the impact on any individuals or any subgroups of the social system. Classical utilitarians equated good as pleasure and bad as pain. Under this hedonistic approach, the amount of

good created would be the amount of pleasure minus the amount of pain.[8] Many utilitarians today use a broader definition of good. Most utilitarians do not care if the "good" is felt immediately or if it is felt later. One weakness of the theory, though, is determining at what point in time the "goodness" should be measured. In other words, should the goodness be measured next week, next year, or ten years from now. There are two primary types of utilitarianism, act utilitarianism and rule utilitarianism.

Act Utilitarianism Act utilitarianism is concerned with individual actions and the effect of those actions on the social group. The decisions are made on a case-by-case basis. A proponent of act utilitarianism expects each person to act in a manner that will produce the greatest net benefit for the group. An act utilitarian makes each ethical decision by examining the options and selecting the option that will maximize the goodness. To an act utilitarian, telling a "little white lie" may be the most ethical course of conduct in a given situation: Telling the lie may produce more total good than would be obtained by telling the truth, by avoiding the answer, or by any other alternative.

Despite some of its attraction, act utilitarianism is not particularly easy to apply. Act utilitarians do not agree among themselves on several key issues. As previously mentioned, one of the main problems with the theory is deciding which "future point" should be used. Utilitarians also disagree on how you define and measure benefit and goodness. (Hedonists would define it as pleasure.) Another point on which act utilitarians disagree is whether the "good" should be the expected good or the actual good. Many utilitarians take the first approach, called the "foreseeable consequence" approach. For example, they would decide that saving a life is good because the foreseeable consequence would be positive. Sometimes it turns out that saving a life was actually bad because the person saved does something very heinous in the future like commit mass murders. Another weakness of the theory is the difficulty in deciding how large the group is. An act utilitarian needs to decide if the "group" is a town, a state, or the world. In practice, some act utilitarians use a rule-utilitarian process to make decisions.[9]

Rule Utilitarianism A rule utilitarian also wants to maximize goodness. The person takes a different approach to do so. A rule utilitarian believes that the morality of a decision should be determined in reference to moral rules. Moral rules are those that create the greatest good. There are two

parts to the theory: (1) an action or behavior is morally justified if it complies with a justified moral rule; and (2) a rule is morally justified as part of the moral code if it would create more utility than other possible rules or no rule at all. The rule utilitarian then acts in accordance with the moral rule.

A rule utilitarian would (1) make a list of every possible combination of moral rules (the lists can be very short or very complex, with different circumstances and contingencies); (2) select the set of rules that would maximize the utility if everyone followed them all the time; and (3) decide moral questions by asking, "Is the action I am contemplating permitted by the rules? If so, I may do it." The best rule is the rule that causes the best consequences. However, the best rules may not be simple because they may have a long list of exceptions. For example, the formulation for promise-keeping might be "always keep your promises, except . . . " followed by a long list of exceptions. [10] "The rule utilitarian measures the consequences of the act repeated over and over again through time . . . as a rule whenever similar circumstances arise."[11] One criticism of rule utilitarianism is that when it is extended, it becomes the same as act utilitarianism. [12]

The key difference between act and rule utilitarianism is that act utilitarians apply the utilitarian principle directly to the evaluation of individual actions while rule utilitarians apply the utilitarian principle directly to the evaluation of rules and then evaluate individual actions by seeing if the act obeys or disobeys those rules whose acceptance will produce the most utility.

Kant and the Categorical Imperative

The nonconsequential ethical theories are best exemplified by the categorical imperative developed by Immanuel Kant, an eighteenth-century German philosopher. Kant thought that certain universal moral standards existed without regard to the circumstances of the moment or the values of any particular society.[13] Under Kant's theory, when people follow these universal moral principles, they are acting morally and ethically. When people do not follow these universal principles, they are acting unethically. Individual variations and consequences are irrelevant. The universal moral principles impose a duty on each person, and the performance of that duty is what determines the "rightness" or the "wrongness" of any action.

Based on his theories, Kant developed his *categorical imperative*. The categorical imperative says that each person should act in such a manner that the person's actions could become the universal law. In other words, the actor should ask "Am I willing to have everyone act this way even if the action is directed at me?" The rules to be followed are unconditional, and adherence to these rules is imperative. If each person carries out the person's duty by following these "universal rules," society will be properly served by each individual.

Kant's approach is also applicable to organizations. An organization is judged in the same manner as an individual. The organization is expected to obey the categorical imperative, just as an individual is expected to obey it. The organization is to act according to its duty, with its actions being judged against the "universal law" standard: Would such conduct be proper if all organizations were to act in the same manner? The organization is expected to act in a manner that discharges its duty to every aspect of society, which would include recognition of the rights of others and the duty owed to others.

Kant also believed that there were perfect duties and imperfect duties. Perfect duties are those things a person must always do or refrain from doing, such as the duty of a merchant to never cheat a customer. Imperfect duties involve things a person should do, but not necessarily things a person must do. For example, a person should contribute to charities, but a person is not required to contribute to all charities. A person does not have to contribute to any particular charity every time that charity requests contributions.

Feminist Philosophy

The feminist philosophy is also sometimes called the ethics of caring. Advocates of this theory argue that men and women have different attitudes about how social life should be organized and how ethical conflicts should be resolved. The theory is based on the concept that everyone is interdependent. The feminist philosophy gives a high priority to (1) empathy; (2) healthy and harmonious relationships; (3) caring for one another; and (4) avoiding harm. This ethical theory specifies that particular attention should be paid to the effect of decisions on individuals, especially those individuals in a close relationship with the decision maker.[14] This philosophy focuses on character traits such as sympathy, compassion, loyalty, and friendship. Important factors are social cooperation and the

realization that in many situations the parties are not of equal power or ability. The social context of the decision is important. The structure of the society must be protected, and the rights and interests of the less capable people should be protected as well.

This philosophy is not considered to be a consequential theory due to its approach. All the theories continue to develop, although this philosophy may be developing more than others. During the evolution of the feminist philosophy, some aspects are more important to some philosophers than others. For example, some argue that this approach is a human strength and both men and women should be trained to use it. This approach with its focus on relationships may be difficult to use in business.

Virtue Ethics

Virtue ethics is also not categorized as a consequential theory. Virtue ethics emphasizes moral character. In Western thought, most versions of virtue ethics are based on the teachings of Aristotle and Plato.[15] As the name implies, virtues are central to this theory. A virtue is an excellent character trait. Some examples of virtues are honesty, courage, compassion, generosity, fidelity, integrity, fairness, self-control, and prudence. (As with the law, these terms have special meanings to virtue ethicists. They are not the same as common usage.) Virtues are desirable habits. A person develops virtues through learning and practice.

Once a person acquires the habit it becomes a character trait of that person. Habits are not acquired in isolation. They are acquired in community with others. People are influenced by the traits that their community prizes. Consequently, people should pay attention to the traits their communities value, including the traits portrayed in the media, e.g., literature, movies, and television.

As with the other forms of ethics, different versions of virtue ethics have developed. Most modern forms of virtue ethics consider (1) arête (excellence or virtue); (2) phronesis (practical or moral wisdom); and (3) eudaimonia (usually translated as happiness or flourishing). A virtue is an excellent trait of character. It is a deep-seated, complex mindset. A significant aspect of this mindset is the wholehearted acceptance of a virtue as a reason for action. For example, many actors may choose to tell the truth. That does not mean that the actors believe in virtue ethics. A person who subscribes to virtue ethics believes that one should always tell the truth. The person would not be impressed by someone who gets ahead

in life by telling falsehoods. These are individuals that value honesty and would surround themselves with other honest people whenever possible. The person would be shocked or distressed when people close to the actor do something dishonest.

Possessing a virtue is a matter of degree and most people are not 100 percent successful with it. They may have blind spots where they fall short. Virtue ethicists consider why they fall short. Is it due to their circumstances and/or an inner conflict? Virtue ethicists distinguish between full or perfect virtue and strength of will (called continence). "The fully virtuous do what they should without a struggle against contrary desires; the continent have to control a desire or temptation to do otherwise."[16] For example, the continent person may emotionally be unwilling to admit to making a mistake. Consequently, the person may have to struggle against a desire to be dishonest in a particular situation. A virtuous person acts and feels as the person should.

Phronesis is a Greek term for moral or practical wisdom. Children and adolescents lack phronesis. "It is part of practical wisdom to know how to secure real benefits effectively."[17] "Correct application requires situational appreciation—the capacity to recognize, in any particular situation, those features of it that are morally salient."[18] "Those who have practical wisdom will not make the mistake of concealing the hurtful truth from the person who really needs to know it in the belief that they are benefiting him."[19] Practical wisdom is the knowledge or understanding that enables the actor to "do the right thing." It comes with the experience of life. Practical wisdom includes being knowledgeable about human beings and human life. The wise actor can determine what features of a situation are most relevant.

Virtue ethicists acknowledge that most ethical decisions are complex. A person who is not virtuous may perform a right action. On the other hand, a person who is virtuous may perform a wrong action. To determine if a person possesses a virtue, the observer would need to know why the person did the action. For example, people subscribing to various ethical theories might do the same thing. Virtuous agents pay attention to the consequences of their possible choices. If they acted otherwise, they would be reckless, thoughtless, and short-sighted which are vices. Virtue ethics encourages thoughtful reflection on what we as human beings have the potential to become.

All the modern versions of virtue ethics agree that virtue is central and practical wisdom are important. They combine them in different ways and

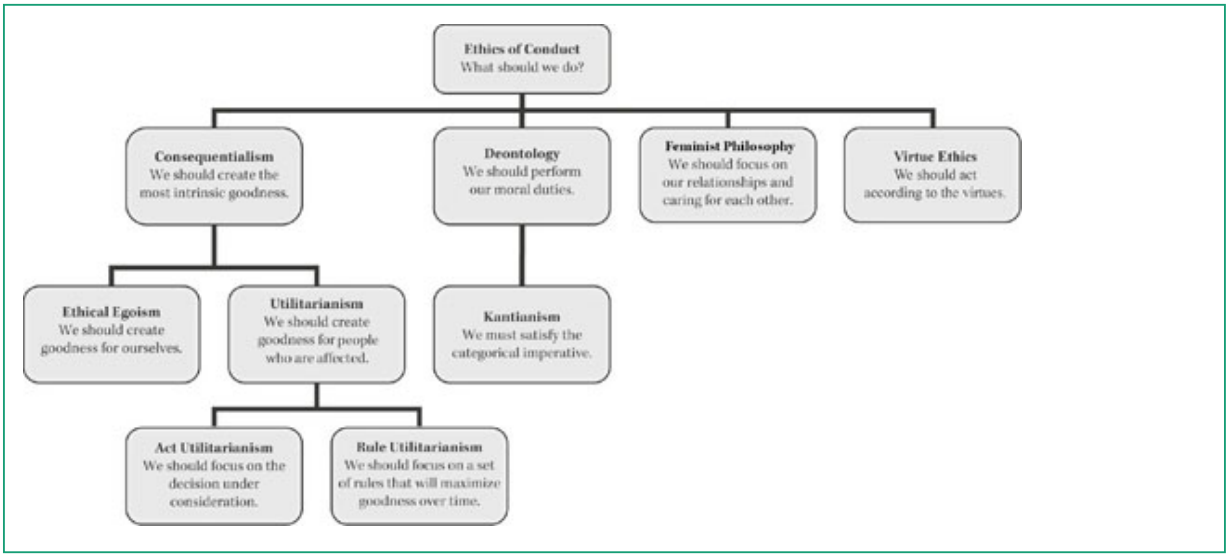
add other concepts to their theories. Modern virtue ethics theories also emphasize the importance of moral education. Some of the modern versions minimize the role of eudaimonia.

Objections to virtue ethics include that morality is supposed to be about other people. Virtue ethics is self-centered because it focuses on the character of the actor. Critics complain about the versions that focus on the actor's well-being and having a flourishing life. Virtue ethics is also criticized as not providing helpful advice on how to behave. It is too imprecise. Another objection is that it requires some degree of moral luck. For example, an individual may need friendships with other moral agents in order to develop a good moral character.[20]

The relationships among these ethical theories are summarized in Exhibit 2.2.

Exhibit 2.2

Ethics of Conduct*



* This exhibit only includes prescriptive theories.

Rawls and the Veil of Ignorance

John Rawls based much of his work on Kant as he developed his own theory about what constitutes a just society. Rawls described his theory,

called *Rawlsianism*, by using the "Bargaining Game," a theoretical community of men and women who join together to bargain for a completely new set of moral rules (laws) that they must all obey in the future. The players start from the "Original Position." Once the rules are selected, the players must adhere to the rules, even if the rules are not in their self-interest in a particular situation. The players choosing the rules do not know their own positions in society, talents, or abilities. Rawls calls this the *veil of ignorance*.[21] Rawls argued that a society developed behind this veil of ignorance would be a just society. Since the people making the rules were wholly ignorant of their own unique combination of race, religion, color, gender, wealth, age, and/or education, they would enact rules they would be willing to live under regardless of which combination of factors they might, theoretically, possess. Assume the people were deciding if the society would provide health care for everyone, they would have to ignore whether they could afford to pay for health care for themselves. Rawls has been interpreted as saying, "In effect, the parties choose principles for the design of society as if their places in it were to be determined by their worst enemies."[22]

True justice can be obtained by the society, with each member willing to live under the rules developed behind the veil. A proper constitution will be adopted; an appropriate method for legislation based on the constitution will be created; and a proper method for dispute resolution will be developed.[23] The rules will be applied by judges and administrators and generally followed by the citizens. Rawls is often considered a political philosopher. Rawls' articles and presentations helped to revive the social contract theory, which will be discussed later in this chapter.

These theories and their relationship to business are summarized in Exhibit 2.3.

Exhibit 2.3

Comparison of Prescriptive Ethical Theories

Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
Ethical Egoism [24] (Consequential theory—An act is ethical when it promotes the best long-term interests of the firm.)	1. Provides a basis for formulating and testing policies. 2. Provides flexibility in ethical decision making for a business. 3. Allows a business to tailor codes of conduct to suit the complexity of its particular business dealings.	1. May ignore blatant wrongs. 2. Incompatible with the nature and role of business in society. 3. Cannot resolve conflicts of egoistic interests. 4. Introduces inconsistency into ethical decision making.
Utilitarianism [25] (Consequential theory—The most ethical decision is the one that produces the greatest good or the least harm.)	1. Provides a basis for formulating and testing policies. 2. Provides an objective manner for resolving conflicts of self-interest. 3. Recognizes the constituent groups of a business.	1. Ignores conduct that appears to be wrong in and of itself. 2. May be in conflict with the principles of justice. 3. May be difficult to determine which constituent groups

Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
	4. Provides the latitude in ethical decision making that business seems to need.	should be considered.
Kant and the Categorical Imperative[26] (Nonconsequential theory—Only when we act from a sense of duty do actions have ethical value.)	1. Takes the guesswork out of ethical decisions. 2. Introduces a needed humanistic dimension into business ethics decisions. 3. Concept of duty implies the ethical obligation to act from a respect for rights and the recognition of responsibilities.	1. Provides no clear way to resolve conflicts among duties. 2. Provides no compelling reason why certain rules should be absolute.
Feminism Philosophy[27] (The ethics of caring—Recognizes the importance of personal	1. Provides a basis for formulating and testing policies. 2. Provides an objective	1. Places undue emphasis on those closest to the decision maker.

Ethical Theor y	P ositiv e Aspects in a Business Context	Negativ e Aspects in a Business Context
relationships in decision making.)	manner for resolving conflicts of self-inter est. 3. Recogniz es the constituent gr oups of a business. 4. Pr o vides flexibility in ethical decision making for business.	2. Ma y be mor e concerned with the community than with the business. 3. Difficult to formulate satisfact or y rules.
Vir tue Ethics [28]	1. Flexible and sensitiv e to the par ticular situation. 2. Encourages act ors to beha ve vir tuously and a v oid the vices.	1. Tak es time to fully de v elop a moral character . 2. Some act ors do not ha v e the experience of lif e. 3. Moral learning is a lif e-long pr ocess. Some individuals ar e not successful in the pr ocess. 4. Does not resolv e

Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
		conflicts of virtues. 5. Does not provide direct guidance on how to act. 6. Focuses on what kind of person I should be and not what I should do.
Rawls and the Veil of Ignorance [29] (Nonconsequential theory—Rational agents, unaware of their personal characteristics or places in society, choose the principles they wish to have govern the society.)	1. Takes the "guesswork" out of ethical decisions because the rules have been established. 2. Introduces a needed humanistic dimension into business ethics decisions. 3. Implies the ethical obligation to act from a respect for rights and the	1. Uses the better-off members of society to assume the welfare of the worse-off. 2. Provides no compelling reason for following universal principles that are agreed to by members of the society.

Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
	recognition of responsibilities.	

Source: Courtesy of Daniel V. Davidson and Lynn M. Forsythe, © 2026.

A SYNTHESIS FOR ETHICAL DECISION MAKING

Each of these ethical theories provides a possible framework for evaluating the ethics of a business and the ethics of the people who operate it. Remember, there is no one universally accepted theory or approach to ethics in general or business ethics in particular. Each firm can select a theory of ethics to follow in developing its own ethical approach to conducting its business. Before choosing a theory, the businessperson should also consider several other factors. These factors should include, but are not limited to, the short-term versus the long-term impact of any decisions, the constituent groups that will be affected by the decision being made (constituent groups are discussed later in the chapter), and the way in which the ethical decision fits within the legal environment.

One problem that many people face in making ethical decisions is recognizing that an ethical issue is present. Before you can use the "tools" in your ethics toolbox, you need to recognize that you are facing an ethical issue. When a business or economic issue is addressed, it is normally obvious, and the decision is made on business and/or economic bases. Sometimes a prudent economic decision must be balanced against ethical considerations. For example, while most people agree that slavery is wrong and that having slaves is unethical, slavery was allowed in the United States for decades and was often justified as being the natural order of things. In fact, slavery was economically beneficial for the slaveholders, and its existence was rationalized on economic grounds. In a similar manner, unequal pay for women has been rationalized to justify the economic benefits to the employer rather than being addressed as an ethical issue. Once an ethical issue is identified, it is logical to also apply your ethical tools to the decision in front of you.

Perhaps a business would be best advised to seek a synthesis of different ethical theories as it develops its approach to ethical issues. After

all, other people will judge the business, and they may view its decisions from a different ethical perspective. This approach would provide a structure for evaluating actions and options regardless of the ethical theory that most closely reflects the values of the business. One such synthesis is suggested by the work of Vincent Ruggiero.[30] Ruggiero suggests that there are three common concerns in ethical decision making: obligations, ideals, and effects. From this foundation we can develop a framework for ethical decision making. In making a decision, the following three factors should be considered:

1. The obligations that arise from organizational relationships
2. The ideals involved in any decisions that are made
3. The effects or consequences of alternative actions

Any actions that (1) honor obligations; (2) simultaneously advance ideals; and (3) have the effect of benefiting people can be presumed to be moral actions. Any actions that fall short in any respect become suspect.[31] This is not to say that these latter actions are necessarily unethical. However, since these actions have a negative impact on one or more of the areas of concern, the actions should be very carefully evaluated, and alternatives should be examined to see if a better choice has been overlooked.

With this in mind, the business should follow a two-step process to ensure that it is making ethical decisions. The first step is to identify the important considerations involved (obligations, ideals, and effects). The second step is to decide where the emphasis should lie among these considerations. This approach allows the firm to apply its ethical principles while also taking into account the relative positions of each of the constituent groups of the business.

INFORMAL APPROACHES

An individual, including a businessperson, may want to adopt a less formal approach to the individual's ethical decision making. There are several informal approaches that can be used. Some of the more popular and effective approaches are:

1. The "Golden Rule" Test—The decision maker should "do unto others as you would have others do unto you." This is a generally accepted principle in Judeo-Christian religions.

2. The "Front Page" Test—Would the decision maker be comfortable seeing this decision or course of action as the lead story on the front page of local and national newspapers?
3. The "Other Side of the Fence" Test—How would the decision maker feel if the decision maker was standing on the "other side of the fence" observing someone else making this decision?
4. The "What Would Your Mother Think" Test—Is this a decision that would make the decision maker's mother proud when she learns that her child made it?

While none of these possess the elegance of more formal ethical theories, each provides an evaluation method that forces the decision maker to consider the impact of the decision from an outsider's perspective and may help the person reach a decision in which the person can take pride and/or avoid embarrassment. Sometimes it is helpful for the individual to just stop and "think." For example, Amy Cooper falsely reported that a black bird watcher was threatening her in Central Park.[32] Would she have behaved in this manner if she had used one of the informal approaches to ethical decision making? Other individuals have had racist or sexist rants in public.[33] (Some of these individuals have lost both their jobs and their reputations over their behavior.) Most individuals today always carry a cell phone camera with them. What a person says or does in public can easily be documented and posted to social media. In effect, this *can* make a person's behavior "front page" news.

THE EVOLUTION OF BUSINESSES AS ETHICAL ENTITIES

Business as an Amoral Institution

Historically, many people viewed business as an amoral institution. Since any given business was inanimate, and since only animate objects could be expected to possess morality, it stood to reason that a business was not expected to possess morality. Because it could not be expected to be moral, it also could not be immoral. Morality and immorality were reserved for animate beings, and inanimate objects were *amoral*. This historical view did not present much of a problem when most businesses were relatively small and local in nature. The owners and operators of businesses were known in the community. Even though the business was viewed as amoral,

the owner or operator was held to community standards. Most businesses were operated in an ethical manner to satisfy the local customers.

As businesses grew larger and more complex, they lost this local flavor. Businesses no longer operated in a restricted geographic market and no longer had to adhere to community standards. Eventually, society began to demand some minimal ethical standards from businesses. Included among these standards were (1) the expectations of fair play and honesty; and (2) the expectation that a business would seek profits for its investors. If a business did not meet these demands voluntarily, society could seek intervention and help from the legislature. Sometimes the legislature would respond by setting minimum standards for business behavior. If the business obeyed these laws, it met the duty of fair play. If the managers did not blatantly lie to the customers, the business met the duty of honesty. And if the firm generated profits for its investors, it met its duty toward them.

Sometimes courts were asked to enforce the standards. The 1919 Michigan Supreme Court's opinion in *Dodge v. Ford Motor Company*[34] is an example. Ford Motor Company was an extremely successful enterprise at the time, and it was paying substantial dividends reflecting that success. Stockholders were receiving ordinary dividends of 5 percent *per month* and special dividends that had averaged more than *400 percent* per annum over the previous five years. Then Henry Ford and the board of directors announced a change. While Ford would continue to pay regular dividends of 5 percent per month, it would stop the special dividends. Instead, the board announced its intention to reduce the price of new cars *and* to make substantial investments in socially beneficial programs for the employees and the community. Two of the stockholders, the Dodge brothers, filed suit to prevent the implementation of the programs proposed by Ford. The Michigan Supreme Court ruled that the board of directors of a corporation may *not* place the interests of the public ahead of the interests of the stockholders and may *not* divert corporate funds to non-corporate purposes. The court instructed the board to continue to maximize profits and to leave any charitable or public benefit contributions to individuals who chose to make such contributions from their personal funds.

The *Dodge v. Ford Motor Company* case was viewed as a landmark opinion, providing guidance for boards of directors in closely held corporations. While this opinion deals directly with the conflict between the desire of the Ford board to provide for the workers and society and the

challenge by shareholders who want dividends, the basic thrust of the opinion is that the board has a legal duty to the shareholders to maximize the return on their investments. It is not supposed to look out for others.

Notice what the court said a corporation is expected to do. If a corporation followed this rule today, would it be considered ethical? If not, what has changed? Investors still want a return on their investments, and they expect to receive dividends from the corporations in which they invest. Businesses are still expected to earn a profit and to return at least a portion of that profit to the shareholders.

Game Theory of Business

As society and the courts began to recognize the existence of corporate duties, the concept of business as an amoral institution became indefensible. If a business had duties, it also had some ethical responsibilities. These responsibilities tended to be based on adherence to those rules. If a business obeyed the rules and stayed within the law, it was considered to be ethical. This approach to business ethics led to the development of *game theory* as a means of judging the ethical stance of the business.[35] Game theory equates the operation of a business with playing a game, and the rules of the game determine the ethics of the business. If a manager of a firm lied to the business's customers, the managerand consequently, the business had acted unethically. If the manager bluffed the firm's customers, the manager and the firm may have acted in an ethical manner, presuming that bluffing is an acceptable part of the game. Bluffing is an accepted part of several games, including poker. Of course, one person's bluffing may be another person's lying, but such problems were left for others to solve.

There is a basic flaw in the game theory of business ethics. Game theories and game rules are fair and equitable only if all the participants in the game are aware that a game is being played. If any of the participants do not realize a game is being played, they will not be aware of the rules and they will be at a disadvantage. To take advantage of people under such circumstances would not be ethical.

Under game theory, several rules were developed and followed. For example, *caveat emptor* (let the buyer beware) was a "rule" of the business game for a substantial period in U.S. history. Similarly, *laissez faire* economic regulation was a rule of business in the United States. Business and its customers were aware of these rules and played the business game

accordingly. Eventually, business began to industrialize and to gain an increasing ability to produce for larger markets. The game was no longer quite as fair. As the game became more one-sided in favor of business, the other "players" (the customers) began to seek new rules for the game. When business did not voluntarily change the rules, the customers asked the government to intervene. This led to government regulation of business and eventually an entirely new playing field for conducting the game of business. This new playing field is the one on which business must operate today.

Cyber Guardian 2.1 Sales/Manufacturing

IS BUSINESS A GAME?

Danica recognizes that there is a market for the venture's services and products, but she is afraid that creative criminals may devise ways to use the venture's software to commit crimes, such as identity theft. She is concerned that Cyber Guardian will be sued for their behavior. Asher insists that Cyber Guardian will not be held liable. It is up to its business customers to secure the software. Asher also points out, cheating is prohibited in most games, and yet some people still cheat. If it happens in a game, you must expect it to happen in business.

Danica is not satisfied with Asher's analogy, and she has asked for your advice. To what extent can/should a business be compared to a game? If business is to be compared to a game, what are the rules to be followed?

BUSINESS CONSIDERATIONS What business problems might arise for Cyber Guardian if its software is misused and the product is identified by name in news stories about the misuse? Should a business take steps to try to ensure that its product is not used in an inappropriate manner? Should warning labels be added to the user manual concerning the legal consequences of misuse?

ETHICAL CONSIDERATIONS Can the ethical theory followed by the firm help the principals in determining how to address issues such as

this? Should a business assume the worst of people and act accordingly? Explain your reasoning.

Social Contract Theory

Many business executives today argue that the U.S. government regulates business too much. These people want their businesses to be unfettered, set free from the "excessive" regulations imposed by the government and allowed to compete freely with foreign producers. Although this attitude can possibly be justified from a simplistic economic position, it fails to consider two factors: the spillover costs society must pay when a business fails to act in a responsible and ethical manner and the "social contract" between business and society. When businesses became too large for local control, the society sought legislative intervention to force compliance with social demands. This is the basis of the social contract theory. Business must comply with the demands of society if it wants to continue to exist and to operate within that society. The social contract defines the permissible scope of business conduct and goes beyond the purely economic issues. If society wants more from business than profits, business must accept this directive to survive in society. To do otherwise is to breach the social contract.

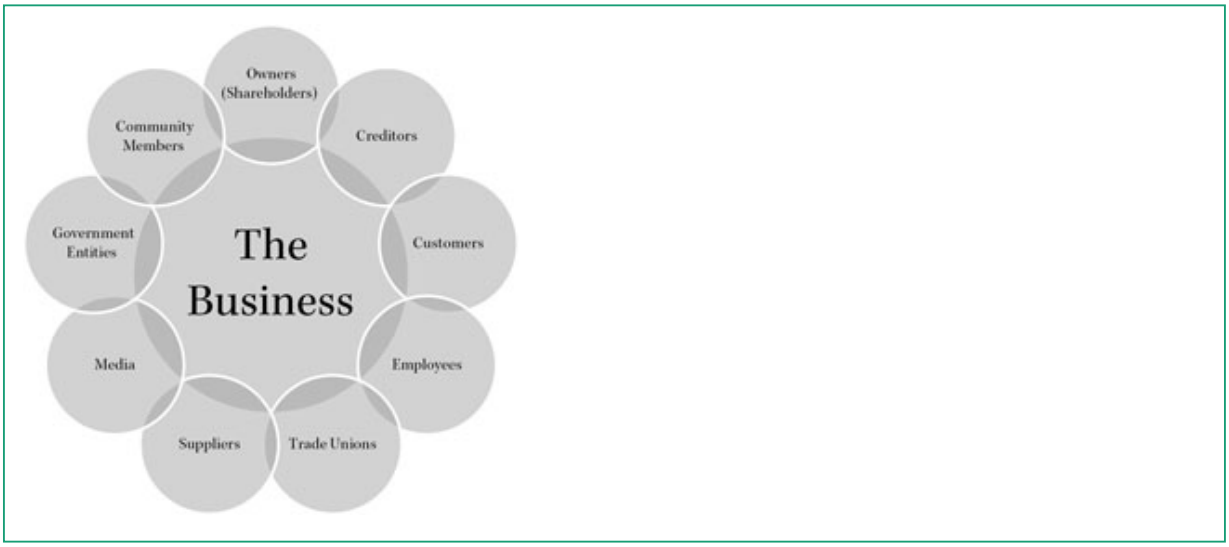
Social contract theory assumes that a business can exist only because society allows it to exist. Today, society expects (and demands) more from business than mere profits. Business must respond to many issues including consumer safety, environmental concerns, and quality of life. If these added demands cause costs to rise, so be it. If business will not meet these demands voluntarily, these demands will be enforced by regulation. In other words, society will change the rules of doing business. The Dodd-Frank Wall Street Reform and Consumer Protection Act is an example of society changing the rules. Note that the rules under Dodd-Frank changed again with the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act, which rolled back several sections of the Dodd-Frank Act.[36] Not only has the game theory of business been rejected by society, but the rules by which business is allowed to exist have also been changed by the social contract theory.

Under social contract theory, the United States has responded to recent business problems from Ponzi schemes to sales of defective mortgages. In dealing with the social contract theory and in evaluating the ethical stance

of any given business, it is important to recognize that each business has several constituent groups (or stakeholders). Each group of constituents will have different desires, needs, motivations, and wants. How the constituent groups are viewed, and how they are counted, is a matter of interpretation. More members or more groups could easily be used, if so desired.[37] The business manager must base decisions affecting the business, at least in part, on the impact these decisions will have on the various stakeholders. Some decisions will affect all of the constituent groups, although not equally. Others will only affect some of the groups. Some decisions will have a positive impact on some groups and a negative impact on others. Considering how each group will be affected, and how much weight to give to each group, is essential in reaching ethical decisions. Exhibit 2.4 shows *some* of the constituent groups a business must consider.

Exhibit 2.4

Stakeholders



Corporate Social Responsibility (CSR)

Social contract theory has influenced the development of corporate social responsibility (CSR). Although it is called "corporate" social responsibility, most individuals feel that it applies to all businesses and not just those organized in the corporate form. CSR is the concept that businesses can

and should act ethically and that they are responsible for their conduct. "While CSR does not have a universal definition, many see it as the private sector's way of integrating the economic, social, and environmental imperatives of their activities."[38] As CSR evolves, it has developed several competing theories about how a responsible business should make decisions and what a responsible business should do. Some of these developments are discussed below.

Critics complain that there is no consensus on which CSR theory to use. They also complain that CSR is only used to improve the corporate image; in other words, it is a public relations effort. CSR is also criticized for distracting businesses from their economic responsibility to be profitable. There is an active debate about whether social responsibility helps or hinders a firm's profitability. There is some evidence that a company's reputation for being socially responsible helps it to attract and retain workers.

Maximize Profits Approach The maximize profits approach is the traditional view of CSR. Under this theory, a business's duty is to maximize profits for its owners. For corporations, the owners would be the shareholders. The effect of a business's decisions on others is not important by itself. This approach is illustrated by the court's decision in *Dodge v. Ford Motor Company*.[39]

Moral Minimum Approach The moral minimum approach to CSR states that a business's duty is to make a profit and avoid causing harm to others. If it does cause harm to others, it has a duty to correct that harm or compensate those who are injured. Under this view, if a business pollutes a river, it has a duty to clean up the river or compensate those who are injured by the pollution. A business does not have an obligation to correct a problem when it did not contribute to the problem. Laws of the community may help establish what the moral minimum is.

Stakeholder Interest Approach Another view of CSR is that a business owes duties to other groups in addition to its owners (shareholders). The business should consider the impact of its decisions on various stakeholders. Businesses owe duties to the constituent groups, and the constituent groups are likely to owe duties to the businesses. Thus, there is a reciprocal set of duties and expectations, as illustrated in Exhibit 2.4.

Consider the following example of how these duties can affect a business in its decision making. A firm has developed a new production method that will lower costs, increase profits, and make safer products. Adopting this new method will primarily benefit two constituent groups, owners and customers. However, this new method will require relocating the plant, and it may produce several pollutants. Relocating the plant will cause harm to current employees who may be unable or unwilling to relocate and to the current community, which will suffer economic harm from reduced employment. The possible increase in pollutants will harm the community at the site of the new plant, although this harm will be offset to some extent by the increase in employment and the economic "ripple effect" a new plant will cause. Somehow the firm must undertake to balance these competing interests to reach a decision that reflects the best short-term and long-term interests of the firm. As this example also illustrates, one problem with the stakeholder approach is that of how to select which group's interests deserve the greater weight in any particular decision. The interests of the stakeholders often will conflict.

Corporate Citizenship Approach According to the corporate citizenship theory of CSR, businesses should be good citizens in the community by advancing society's goals. Businesses have a duty to "do good." A business should actively try to solve social problems, even social problems that it did not cause. For example, during the pandemic caused by COVID-19 (the respiratory disease caused by the novel coronavirus SARS-CoV-2), and the resulting shortage of medical equipment, many businesses assisted by converting their operations to produce face shields and ventilators. The corporate citizenship theory is based on the concept that businesses control much of the wealth and power; consequently, they have a responsibility to use the wealth and power in ways that benefit society. Under this view, a business would be evaluated based on (1) its contribution to social causes; and (2) its business operations, especially how it deals with issues such as human rights, employment discrimination, and the environment. Businesses have finite resources, and there will always be social problems, so one difficulty with this approach is deciding how the business should choose which causes to support. Should it limit itself to causes that are related to its business operations? Should it choose causes that are important to its stockholders or key personnel? How much should it contribute? If a business spends too much on social

problems, investors may be reluctant to invest in the business due to reduced profits and dividends.

There are risks to this approach. For example, the Walt Disney Company tried to dissuade the Florida legislature from enacting a state statute that limited school discussions about gay and transgender individuals. (Disney World is located in Florida.) When it was not successful working behind the scenes and Florida enacted the law, Disney representatives spoke out against it. This has created an open dispute between Disney and Florida officials. [40] The dispute appears to be harming the value of Disney stock and consequently, harming the shareholders.

Currently, most people seem to subscribe to either the stakeholder interest approach or the corporate citizenship approach.

Environmental, Social, and Governance Factors (ESG) ESG is closely related to CSR. ESG stands for a company's environmental, social, and governance factors (ESG). The factors are also sometimes stated as ethical, sustainability, and corporate government. (You should notice that this can also be abbreviated ESG.) Some members of society, including some investors, may be more interested in some ESG factors than others. For example, some may be more concerned about the quality of water and others may be more concerned about the impact on endangered species. Generally, society seems to desire more information about the corporation and its ESG factors. Increasingly managers need to provide information about ESG to comply with the social contract theory. It is important to note that some investors and politicians oppose using ESG factors. ESG is discussed in more detail in Chapter 22.

Problems with Business Ethics

Any business that seeks to act in an ethical manner faces a basic problem. There are no fixed guidelines to follow, no formal code of ethics to set the standards under which the business should operate. Numerous professional organizations have their own codes of ethics or conduct. For example, (1) the legal profession has the Code of Professional Responsibility; (2) the medical profession has its Hippocratic Oath; (3) the accounting profession has a code of ethics and it also has generally accepted auditing standards (GAAS) and generally accepted accounting principles (GAAP); (4) the real estate industry has a code of conduct; and (5) various other groups or organizations have similar codes. However,

"business" as a separate entity has no code of ethical conduct. The closest thing business has to an ethical guideline is the law. If a business is acting within the law, it is acting legally and is arguably meeting its minimum social requirements. However, this forces business into a reactive posture, always responding to legislative demands. It would seem that a proactive position in which business establishes its own path would be preferable.

Given this overriding problem, what can be done to provide a solution? At the present time, probably nothing can be done in the global, or even national, sense. But it may be possible for each industry to develop a code of ethics for that particular industry, in much the same manner that the real estate industry has developed a code for its members. If such an industry-wide approach does not prove feasible, each individual firm can develop its own personal code of ethics. Although such a micro-approach may not be ideal, it at least encourages a business to begin formalizing its ethical posture.

Cyber Guardian 2.2 Marketing/Manufacturing

SHOULD CYBER GUARDIAN ADOPT A CODE OF ETHICS?

Danica and Mai recently attended a business ethics webinar conducted by several prominent ethics professors. After the webinar they discussed several of the corporate scandals that were mentioned and how the businesses involved in the scandals were affected. Danica believes that Cyber Guardian should adopt a formal "Code of Ethics" for the firm to follow. She asserts that such a code will help the company not only to respond to ethical dilemmas as they arise, but also to avoid ethical problems in the future. She also states that such a code, if properly publicized, can help the firm improve its image. This could potentially increase profits. Mai disagrees with Danica. She points out that each of the three principals are ethical so that a code is not necessary. She also states that a code may in fact inhibit ethical behavior, since employees may think that only those actions proscribed in the code are considered inappropriate workplace behaviors. Consequently, any behaviors not covered in the code could be considered ethical. She believes a less

formal standard would better serve the business as it grows and develops.

Both want to operate the business with a strong ethics culture, but they are unsure as to how to achieve this goal. They have asked for your advice. What will you tell them?

BUSINESS CONSIDERATIONS Even if the firm is owned and operated by people who are already ethical, what would be the advantages of adopting a Code of Ethics now? By having a Code of Ethics, what message does it convey to the customers of Cyber Guardian?

ETHICAL CONSIDERATIONS Do you agree with Mai when she states that a code may in fact inhibit ethical behavior, since employees may think that only those actions proscribed in the code are considered inappropriate behaviors on the job? Why or why not? Following Danica's suggestion, if the firm is to adopt a Code of Ethics, what ethical theory do you believe should be selected as the foundation for the code? Explain your reasons. What should Cyber Guardian's Code of Ethics include?

The Legal Aspect

The U.S. legal system contains numerous ethical components. For example, a person is presumed to be innocent until proven guilty in criminal law. Each person is entitled to due process of the law and to equal protection under the law. Protections exist against compulsory self-incrimination and cruel and unusual punishment. The Constitution provides for free speech, free exercise of religion, and the right to counsel, among other rights and guarantees.

Business law also attempts to reflect the ethical standards of the society and to promote ethical conduct in the realm of business. The law of sales imposes a duty on each party to a sales contract to act in good faith. Bankruptcy is designed to give an honest debtor a fresh start. Agency law imposes the duties of loyalty and good faith on the agent.

The laws that regulate business have developed, to a significant extent, under social contract theory. In many cases, governmental regulations of business were enacted in response to a public demand for protection from

the abuses and excesses of big business. Antitrust laws were intended to control business and to protect the ideal of a free and competitive economy and the Federal Trade Commission was established to stop unfair and deceptive trade practices.

The government stepped in to deal with problems, ranging from unpaid wages and dangerous workplaces to coercive bill collection practices. In each of these areas, the application of social contract theory is apparent. Society perceived problems and demanded that corrective steps be taken to alleviate the problems. Business had an opportunity to take corrective steps in a manner devised by business but failedor refused to do so. When no satisfactory solutions were proposed by business, the government stepped in to resolve the problem in a rigid, statutory manner. By failing to respond in a proactive manner, which would have permitted a custom-tailored, micro-focused solution by the affected business or industry, the business community was presented with a reactive, macro-oriented solution that extends across industry lines and that is intended to control all aspects of the business community with one broad regulation. Government regulation often adds to the costs of doing business.

MULTINATIONAL ETHICS

Businesses involved in international transactions have additional complications. How should they deal with constituents in multiple countries? For example, assume that a U.S. business opens two factories in foreign countries. It plans to produce and sell its products abroad and import them into the United States. Whose ethics should the business apply? How should it treat its employees in these other countries? When a firm operates within only one society, the ethical stance of the firm is *more* likely to be consistent with the ethical values of that society. If the firm does not conform to socially acceptable standards, the social contract theory is used to change the permissible scope of the firm's conduct.

What happens when a company reassigns one of its agents to a foreign post within the company? This reassignment may have serious ethical implications. The social contract between the new location and its businesses may well be different from the social contract between the firm and its home country. This calls for a reassessment of what is acceptableor desirablebehavior. For instance, a firm may open a new plant in a nation with very lax environmental protection statutes. This same firm,

in its home country, has been an environmentally concerned business that has taken many steps to reduce its water pollution. If the firm tries to be pro-environment in its new location, it will be at a competitive disadvantage. If the company seeks to be economically competitive, it will be acting in a manner contrary to its stated policy of environmental concern and protection. What should the firm do?

Although there is no perfect solution, any firm that is considering expansion into another country needs to make every effort to learn about the cultural differences that exist between the two nations and to take steps to reduce any culture shock or conflict prior to the expansion. The firm may consider hiring citizens of the other nation, or it may consider requiring an educational program to prepare its employees for the move. The employees should be taught as much as possible about the new country, and they should also be urged to watch and learn. The firm and its employees should be aware that they are visitors, guests in another nation, and they should act as they would if they were personal guests at the home of a new friend. The firm and its employees should avoid being judgmental. New countries and new cultures may seem strange and exotic, or they may merely seem different, but the new country will provide the social values that drive the social contract under which the firm will now be conducting business. Assimilation and acceptance are essential!

A RECOMMENDATION FOR BUSINESS

U.S. businesses need to develop a model or a framework of ethical behavior. It is likely that no single model can be developed that will apply equally to every industry, but it is possible to suggest a general outline for business. This general outline can then be tailored by each industry to the needs and the demands of that specific industry. For example, business should probably lean toward the consequential ethical theories rather than the nonconsequential theories. Consequential theories are more readily understood and more easily accepted by the public than nonconsequential approaches. Additionally, consequential theories are more flexible and more responsive to social and technological changes.

Regardless of the overriding theory, business should adopt a "synthesis" approach for resolving ethical issues. The firm should first identify the important considerations involved (obligations, ideals, effects) and should then decide where the emphasis should lie among them. The business

should consider its impact on its constituents (owners, creditors, employees, customers, community, etc.). This approach (1) works well with any ethical principle; (2) takes into account the people to whom the firm must answer; and (3) provides a framework for decision making that is comparable to other types of business decisions regularly made by managers.

Business should also consider its public relations image in deciding how to proceed within the consequential area. A utilitarian approach that is concerned with the greatest good for the greatest number is more acceptable to society than an egoistic approach. Society already tends to view business as being too egoistic. Also, many people seem incapable of distinguishing between *egoistic* and *egotistic*. (As previously mentioned, *egoists* measure their conduct based on self-interest, choosing the course of conduct that will provide the greatest benefit to themselves. *Egotists* are self-centered, characterized by excessive references to themselves.)

Next, business should avoid rigid rules that force specific actions or reactions, especially with the rapid changes that occur with modern technology, such as AI. This does not mean business should not have rules and standards, but rather that the rules and standards should be flexible enough to change as society and the business environment change. Business should also emphasize that its agents will act within the law while keeping the best interests of the principal in mind.

Whenever possible, businesses and industries should try self-regulation. Business should also learn to work with the government in establishing regulations. By taking a proactive role in regulation, business can not only help to protect its own best interests but also can demonstrate its concern for society and its various constituents.

The development of a comprehensive business ethic will not be easy, nor will it be greeted with open arms by all businesses or business leaders. The alternative, however, is increasing regulation, public distrust, and a general malaise in the business community. Proactive steps can be taken to benefit *both* business and society.

Cyber Guardian 2.3 Marketing/Management

OPERATING CYBER GUARDIANETHICALLY

Asher, Danica, and Mai have each seen numerous examples of what they consider unethical conduct, both in the workplace and in society at large. Asher has several friends who are part-time salespeople, who believe that it is perfectly legitimate to say virtually anything short of an outright lie to close a sale with a customer. They frequently "push the envelope" to the edge, grossly exaggerating qualities of the product, often to the detriment of the purchasers of that product. Danica knows several people who would not hesitate to claim credit for the work of others, and she also knows a few who would even assert privileges based on their seniority to gain credit for the work of others. (Of course, both know even more people who do not act in this manner, but these others do not disturb them.) Mai knows people who have lied on their resumes or job applications, claiming accomplishments that were totally fictitious. Mai even knows one woman whose resume and cover letter were written by AI, and were not accurate. She has also seen situations in which a person was hired who did not meet the criteria set out in the job description. This usually happened because the applicant knew someone who was able to influence the hiring decision, an example of "it's who you know, not what you know." All three principals believe that such conduct is generally harmful to a business and its reputation. They also know they would like Cyber Guardian to operate ethically, and for their managers and employees to go through an ethics training program. They have asked you for your advice. What will you tell them?

BUSINESS CONSIDERATIONS Based on the various examples and areas of concern expressed by Asher, Danica, and Mai, what type of ethics training program would you put together for their managers and employees? What topics would the ethics training program include?

ETHICAL CONSIDERATIONS Should the principals adopt a formal ethics code or policy as they begin the company, or should they be less formal until they see what sorts of ethical issues arise in the operation of the firm? What advantages are there for having a formal written code for a firm? What advantages are there to taking an informal and flexible approach to ethics?

Contemporary Case

This Contemporary Case is a decision of the U.S. Supreme Court. The federal courts of appeal will be discussed in more detail in Chapter 3. However, the Supreme Court is more likely to agree to hear a case if the circuit courts of appeal disagree on an issue. Analyze this case from the perspective of business ethics. Based on the conduct of the parties involved, what were the ethics of the federal and state government agencies? Why? What were the ethics of Kousisis? Alpha? Markias? Why?

KOUSISIS v. UNITED STATES

605 U.S. 114 (2025)

FACTS Stamatios Kousisis managed an industrial-painting company, Alpha Painting and Construction Co. (Alpha). Alpha submitted bids for two government contracts for painting projects in Philadelphia, Pennsylvania. The federal government was going to provide a large portion of the funds for both projects through grants from the U.S. Department of Transportation (DOT). Consequently, both Pennsylvania, acting through the Pennsylvania Department of Transportation (PennDOT), and the federal government had a say in the project specifications. "DOT requires that grant recipients like PennDOT establish and 'actively implemen[t]' a disadvantaged-business program." A disadvantaged business enterprise is "a for-profit small business" that is majority owned and controlled by "one or more individuals who are both socially and economically disadvantaged." Both bids required the participation of a disadvantaged business by requiring that a specified percentage of the total contract go to a disadvantaged business. The disadvantaged business must perform a commercially useful role. DOT documents stated, a disadvantaged business "does not perform a commercially useful function if its role is limited to that of an extra participant in a transaction, contract, or project through which funds are passed to obtain the appearance" of disadvantaged-business "participation." Failing to comply with this requirement would be a material breach and could result in the termination of the contract.

Alpha stated in its bids to PennDOT that Alpha would purchase materials from a qualifying supplier. This was a false statement. Alpha created a scheme where Alpha would get its paint from its usual paint supplier. Kousisis negotiated directly with its normal suppliers. The bill for the paint would be sent to Markias, a qualifying disadvantaged business. Markias would tack on an additional fee and forward the inflated bill to Kousisis. Kousisis would issue two checks, one for the markup and one for the paint. Markias was merely a paper pusher, funneling checks and invoices. Alpha and Kousisis tried to cover up their scheme by submitting false certifications. Alpha's paint work was acceptable. However, it did not comply with the disadvantaged-business requirement. Once the scheme was detected, Alpha and Kousisis were indicted for the crimes of wire fraud and conspiracy to commit wire fraud.

ISSUE Did Alpha and Kousisis commit wire fraud under the federal statute?

HOLDING Yes. They did not materially involve a disadvantaged business, so they violated the terms of the bid. Causing a financial loss to the government is not a requirement for wire fraud.

REASONING Excerpts from the opinion of Justice Barrett:

. . . The circuits are divided over the validity of a federal fraud conviction when the defendant did not seek to cause the victim net pecuniary loss. Several circuits . . . hold that such convictions may stand. . . . Others disagree. . . . We granted certiorari to resolve the split. . . .

[W]e recently reiterated that the federal fraud statutes reach only "traditional property interests." . . . Schemes that target the exercise of the Government's regulatory power, for example, do not count. . . . Obtaining the victim's money or property must have been the "aim," not an "incidental byproduct," of the defendant's fraud. . . .

[We should start] with the statute. To be guilty of wire fraud, a defendant must (1) "devis[e]" or "inten[d] to devise" a scheme (2) to "obtai[n] money or property" (3) "by means of false or fraudulent pretenses, representations, or promises." . . . The prototypical fraudulent-inducement scheme plainly satisfies each of these statutory elements. Under the theory, a defendant

(1) "devise[s]" a "scheme" (2) to induce the victim into a contract to "obtai[n]" her "money or property" (3) "by means of false or fraudulent pretenses." . . . [T]he broad, generic language of . . . [the statute] leaves us struggling to see any basis for excluding a fraudulent-inducement scheme. . . .

Take the facts of this very case. By using Markias as a pass-through entity, petitioners "devised" a "scheme" to obtain contracts through feigned compliance with PennDOT's disadvantaged-business requirement. . . . Their goal? To "obtai[n] money" (tens of millions of dollars) from PennDOT. . . . And how? By making a number of "false or fraudulent . . . representations"—first about their plans to obtain paint supplies from Markias and later about having done exactly that. . . . Section 1343 [of the statute] requires nothing more. . . .

[T]he wire fraud statute is agnostic about economic loss. The statute does not so much as mention loss, let alone require it. Instead, a defendant violates . . . [the statute] by scheming to "obtain" the victim's "money or property," regardless of whether he seeks to leave the victim economically worse off. A conviction premised on a fraudulent inducement thus comports with . . . [the statute]. . . . Fraudulent inducement "has long been considered a species of actionable fraud." . . . Because the Third Circuit's judgment comports with . . . [the statute], we affirm it.

It is so ordered.

You Be the **Judge**

In January 2012, DeShawn Gervin pled guilty to attempted burglary in violation of Georgia law. The Georgia state court sentenced him to one year of incarceration and nine years of probation. The only condition of the probation was that Gervin could not return to the South Georgia Judicial Circuit (Mitchell, Baker, Calhoun, Decatur, and Grady Counties). The court did not include any general probation conditions, such as reporting to a probation officer or informing a probation officer of a change in residence. Those boxes were not checked on the sentencing form. Gervin was released from jail after his term. A sheriff's deputy escorted Gervin to the bus station. The deputy

watched him get on the bus headed to Missouri and watched the bus pull away. Gervin subsequently moved to North Carolina.

Pamela Florence, a probation officer, was assigned to supervise Gervin during his probation. In April 2012, Florence learned that Gervin had been released from a Georgia jail and was incarcerated in North Carolina. Florence applied for a warrant to arrest Gervin. Florence said that Gervin had "failed to report" and "absconded from probation supervision." She also falsely said "his whereabouts [were] unknown." Department policy required Florence to look at Gervin's sentence before asking for an arrest warrant. Florence later testified that she was sure she looked at Gervin's sentence before seeking a warrant. In addition, the trial judge who sentenced Gervin generally reads the sentence in open court, but Florence did not request the transcript of the trial. Based on the false information Florence provided, a county judge granted her request for the arrest warrant.

After serving his jail sentence in North Carolina, Gervin was released. Police arrested Gervin during a traffic stop on April 26, 2019, and extradited him to Georgia. Tandria Milton, a probation officer under Florence's supervision, petitioned to revoke Gervin's probation for failing to report. Milton also testified that she reviewed Gervin's sentence before asking to revoke Gervin's probation. "The Superior Court held Gervin's revocation hearing on August 7, 2019. In the meantime, Gervin spent 104 days in a Georgia jail waiting for that hearing." At the revocation hearing, Milton was asked to examine Gervin's sentence. Milton conceded that Gervin's probation included only one condition: to not return to the South Georgia Judicial Circuit during its term. The state court did not revoke Gervin's probation.

Then Gervin sued Florence and Milton, claiming violations of his Fourth, Eighth, and Fourteenth Amendments to be free from unreasonable seizures. Gervin alleges the probation officers' misconduct caused his arrest and prolonged confinement. Gervin claims he suffered "loss of liberty, humiliation, emotional distress, and physical pain and suffering" and he seeks damages. Assume that Gervin's suit against Florence and Milton has been filed in *your* court. How would *you* rule? Why? Analyze the ethical perspectives of the original sentencing judge, Florence, and Milton. [See *Gervin v. Florence*, 139 F.4th 1236 (11th Cir. 2025).]

Summary

- "Ethics" refers to either individual or group (including society) values, whereas "morals" refers to individuals' values and matters of conscience.
- There is no single ethical theory or model that is universally followed. There are a number of ethical theories, each with many adherents.
- Egoism and utilitarianism are consequential ethical theories, theories that measure the ethics of conduct by the consequences that follow the conduct.
- Nonconsequential ethical theories are more concerned with rules than results. In these theories, the emphasis is more on developing appropriate rules that the members of society will accept and follow.
- The social environment in which businesses operate has changed dramatically over the years. These changes in the social environment have led to changes in what society expects from businesses.
- Business was originally viewed as an amoral institution. When this perception changed, business followed the "game theory." When the game theory became unacceptable to society, the social contract theory developed. Today business operates under the social contract theory.
- The social contract theory requires a business to meet the demands of society to be allowed to continue to exist. If business does not follow the social contract, society can terminate its right to operate.
- It is sometimes difficult for business to act ethically because there is no universal "code of conduct" that exists to provide guidance. Each business must develop its own "moral compass" and devise its own code—keeping in mind the limitations imposed by the social contract.
- In developing a code of ethics, the business needs to remember both the human and the legal elements with which it must work.
- Developing a strong ethics culture in a business is a positive step toward reducing misconduct by employees, increasing employee satisfaction and loyalty, and being perceived as an ethical business.
- Businesses that operate in multiple countries need to be aware of the ethical standards and expectations of each nation in which they operate. Remember that what is acceptable in one culture may be taboo in another. Pay attention to local and national expectations.

Discussion Questions

1. Ask AI whether a business owner should speak up when the owner disagrees with a proposed government action. Also ask AI what the potential consequences may be of speaking up. What about the consequences of staying quiet? Do you agree with the answers from AI? Why or why not? Would you prefer a nonconsequential approach? Why?

2. There are some concerns about the use of AI in academic settings. Is it cheating to use AI, such as ChatGPT, to complete an assignment when the faculty member has not said anything about its use? Is it cheating if the faculty member has stated that students are not allowed to use AI? Analyze this from different ethical perspectives. What about using the spell checkers or grammar checkers in word processing programs? Is this the same or different? Why?

3. Some local police or sheriffs have been accused of picking up homeless people in their territory and dropping them off in another town. Assume that this is true. Analyze the ethical perspective of the law enforcement officers who do this.

4. Greenwashing occurs when a company makes misleading or false claims about the impact of its products or processes on the environment. Consumers, investors, and government agencies believe the company is acting as a steward for the environment, but its claims are not accurate. The claims may be technically true, for example, it may filter its wastewater as it claims. However, it is also dumping harmful chemicals on the land that will eventually seep into the ground water. What is the ethical perspective of these companies? Why? Should U.S. government agencies treat this as fraud? Why or why not?

5. In a just society, who should pay for research into new drugs and medical devices? Why? Is it just to charge residents of different countries different prices for a drug? Is it just to charge patients with insurance different prices than patients without insurance? Why?

Case Problems and Writing Assignments

1. David Hunter (75) and his wife, Janice Hunter (74), moved to the Republic of Cyprus when he retired. They were still British nationals. They

had bee n marr ied for 52 yea rs. Da vid admitted killing his wif e but denied that it was mur der. He was char ged with mur der, which carried an aut omatic lif e sentence if he was convicted.

Janice Hunter had a rar e type of blood cancer. She was in constant pain and allegedly ask ed her husband repeatedly to help her die. She complained to her doct ors about her sympt oms. Da vid testified that Janice was dying. She was quickly losing her sight. Janice also lost the ability to walk. Da vid said that she was miserable and in pain. Da vid suffocated her with his hands. He then tried to commit suicide with pills and alcohol. The paramedics arriv ed in time t o sa ve his lif e.

At the trial "M rs. Hunter 's doct or told the cour t she had a rar e blood cancer, but might not ha ve had terminal leukaemia [sic]." "Haemat ologist [sic] Dr. Ourania Seimeni said her patient [Janice Hunter] had my elodysplastic syndr ome (MDS), which was not nece ssarily terminal. Howe ver, she told the cour t 30 per cent of MDS cases do lead to leukaemia [sic]. Another doct or who ga ve evidence . . . put the figur e at about 45 per cent, which Dr. Seimeni attributed to diff er ent literatur e. . . . [Seimeni] told the cour t she could not say how long her patient had to liv e—wh ether it was tw o months, two years or mor e." Shor tly befor e her death Janice Hunter skipped a medical appointment to determine w hether she had leuk emia at that time. [41]

Assisted suicid e is not permi tted in the countr y of Cyprus. The society on Cyprus is socially conser vativ e. Euthanasia is outlawed. Prior to this case e ven discussing it publicly was taboo. [42]

At the end of the trial the cour t determined that Da vid's acts wer e not pr emeditated. The y wer e the impulsiv e acts of a man "in to rment" and the y wer e no t mur der. He was co nvicted of manslaughter. Da vid was released due to the time he had alr eady ser ved in prison. The lead judge in the case said, "T his is a crime that goes against human lif e, whic h is the highest vir tue. Taking it is a crime."[43] "Befor e us is a unique case of taking human lif e on the basis of feelings of lo ve, with the aim of relie ving the person of their suff ering that came due t o their illness."[44]

Some states in the United States ha ve passed statutes permitting assisted suicide. Other states ha ve not. Is assisted suicide ethical? Why or why not? Analyz e the questio n fr om the diff er ent ethical pe rspectiv es. [See BBC, "Cyprus Mur der Trial: Kil led Wif e 'Might Not Ha ve Been Terminally Ill'," *BBC*, Ma y 10, 2023, https:/ /www .bbc.com/news/uk-england-tyne-65536711 (last visited Ju n. 19, 2025); BBC, "Da vid Hunter: British Husband

Who Killed Wife in Cyprus Released," *BBC*, Jul. 31, 2023, https://www.bbc.com/news/uk-england-tyne-66322478 (last visited Jun. 19, 2025); Reporting by Michele Kambas; Editing by Kevin Liffey, "British Who Killed Terminally Ill Wife in Cyprus Freed After Sentencing," *Reuters*, Jul. 31, 2023, https://www.aol.com/british-killed-terminally-ill-wife-092020146.html (last visited Jun. 19, 2025); and Helena Smith, "How David Hunter's Trial Has Forced Cyprus to Confront Euthanasia," *The Guardian*, Jul. 31, 2023, https://www.theguardian.com/world/2023/jul/31/how-david-hunters-trial-has-forced-cyprus-to-confront-euthanasia (last visited Jun. 19, 2025).]

2. Sinister Manufacturing Co. is a Rosedale, California, company. One of its products is a kit that permits truck owners to avoid government mandated emissions standards on their vehicles. Sinister sold 39,792 defeat kits and at times earned one-fourth of its gross revenue from the kits. Diesel truck owners who installed the kits could increase horsepower and reduce maintenance costs. However, the kits also caused emissions to greatly increase. Sometimes Sinister's marketing materials said that the kits were for racing or off-road use. It is alleged that Sinister knew that most of its customers used the kits for regular trucks. Sinister gave customers advice on how to remove the kits for emissions tests and reinstall them after the tests.

"Sinister Diesel sold products that allowed drivers to strip the emissions controls from their trucks, causing a dramatic increase in the release of pollutants that worsen air quality and harm the quality of life," U.S. Attorney Talbert said. "Environmental laws that control diesel pollution are especially important to protect sensitive populations such as the young, the elderly, and people who suffer from respiratory conditions."[45] "EPA testing has shown that a vehicle altered with these parts can emit more than 100 times the amount of certain harmful air pollutants, compared to a vehicle with an intact emissions control system."[46] EPA's Air Enforcement Division released a report in November 2020. The report found that more than 500,000 diesel pickup trucks in the United States, approximately 15 percent of U.S. diesel trucks that originally had emissions controls, have had the controls illegally removed or bypassed.[47]

The federal Clean Air Act (CAA) prohibits the sale or manufacture of devices that bypass, defeat, or render inoperative emissions controls.

Sinister agreed to pay $1 million as part of its consent decree. This consent decree is still subject to the approval of the court. Sinister is also facing a criminal case for its actions. What is the ethical perspective of Sinister? Why? What is the ethical perspective of truck owners who purchased and installed the kits? Why? [See Sam Stanton, "California Company Pleads Guilty to Selling Thousands of Kits to Defeat Emission Controls," *The Sacrament o Bee*, republished by Yahoo!Life, Aug. 2, 2023, https://www.yahoo.com/news/california-company-pleads-guilty-selling-120000720.html (last visited Jun. 19, 2025); and U.S. Department of Justice, Office of Public Affairs, Press Release, "California Truck Parts Manufacturer Sinister Diesel Agrees to Pay $1 Million After Pleading Guilty to Conspiracy and for Manufacturing and Selling Illegal Defeat Devices," Aug. 1, 2023, https://www.publicnow.com/view/D289A2F6907B042D4B89DD8AB927D3934FB9E265 (last visited Jun. 19, 2025).]

3. Elizabeth Holmes claimed to have "revolutionized" blood testing by her invention. Holmes claimed that an array of diseases could be diagnosed with a single drop of blood from a patient. Innovative technology such as this would not only modernize medicine, but would create incredible cost savings and bypass the traditional practice of drawing multiple vials of blood from a patient. Millions of dollars were quickly invested into her company Theranos. Holmes became a billionaire. She was on the cover of many prestigious magazines. Many admired her for her entrepreneurial leadership. However, this all came crashing down when, in 2015, *The Wall Street Journal* exposed the truth about Theranos. There was nothing "new" about the technology Theranos was using; the company was simply using traditional machines for testing blood.

While Holmes claims that she never meant to mislead anyone, she was "charged by federal prosecutors with nine counts of wire fraud and two counts of conspiracy to commit wire fraud over allegations that she deceived investors and patients with her company's failed blood-testing technology. Each count carries a maximum sentence of 20 years in prison." She was found guilty on four of the criminal charges brought against her.

The doctrine of egoism involves those actions that best promote the long-term interests of the organization. While what Holmes did was legally wrong, could she have felt that she was acting in a manner that would maximize her long-term interests? Did she break a social contract with her investors, her employees, and/or society at large? Explain your answer.

With respect to the investors, is this a matter of *caveat emptor*? Should they have done a better job of vetting the claims made by Holmes? Explain and justify your answer. Holmes's partner, Billy Evans, has started a new biotech testing company named Haemanthus. Although Holmes has no formal role in the company she is advising Evans from her prison cell. What concerns should potential investors in Haemanthus have? Why? [See Christopher Weaver, Heather Somerville, and Sara Randazzo, "The Elizabeth Holmes Verdict: Theranos Founder Is Guilty on Four of 11 Charges in Fraud Trial," *The Wall Street Journal*, updated Jan. 3, 2022, https://www.wsj.com/health/healthcare/the-elizabeth-holmes-verdict-theranos-founder-is-guilty-on-four-of-11-charges-in-fraud-trial-11641255705 (last visited Jun. 20, 2025). See also Bobby Allyn, "Elizabeth Holmes' Partner Raises Millions for New Biotech Testing Startup," Heard on Morning Edition, *NPR*, May 10, 2025, https://www.npr.org/2025/05/10/nx-s1-5393950/elizabeth-holmes-theranos-billy-evans-blood-testing (last visited Jun. 20, 2025).]

Notes

1. History.com Editors, "18th and 21st Amendments," *A&E Television Networks*, updated Feb. 27, 2025, https://www.history.com/articles/18th-and-21st-amendments (last visited Jun. 19, 2025).
2. *Merriam Webster's Collegiate Dictionary* 398 (10th ed. 1993).
3. *Id.* at 756.
4. Moral relativism accepts the principles of cultural relativism, but it builds on the theory. It is a prescriptive theory that claims much more than cultural relativism. A discussion of moral relativism is outside the scope of this book.
5. William H. Shaw and Vincent Berry, *Moral Issues in Business*, 4th ed. (Belmont, CA: Wadsworth Publishing, 1989), at 51. By contrast, psychological egoism is a descriptive theory. It describes what people do.
6. Some of the early writers in this area were hedonistic egoists. This interpretation of "best interest" is not prevalent today.
7. Shaw and Berry, *supra* note 5, at 55.
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3

The U.S. Legal System and Court Jurisdiction

Learning Objectiv es

After completing this chapter , y ou should be able t o:

- Describe the power of the ex ecutiv e, judicial, and legislativ e branches of go v ernment Exp lain the role of standing in federal cour ts
- Recogniz e the major pr o visions in the U.S. Constitution
- Discuss the Bill of Rights
- Define subject matter jurisdiction
- Diff er entiate the type of cases that can be hear d in federal cour t and state cour t
- Identify how cour ts obtain jurisdiction o v er def endants
- Distinguish jurisdiction fr om v enue
- Interpr et the citation for a cour t case

Outline

- The F ederal Constitution
- The Cour ts and Jurisdiction
- How t o Find the Law

Agenda

Asher, Danica, and Mai are beginning to realize the importance of the U.S. legal system for owners and operators of a business. Now several questions have arisen. What do the Cyber Guardian entrepreneurs need to know about state and federal court systems and the different types of jurisdiction? Could they be sued in states other than their state of residence? How does a court obtain jurisdiction over business entities? What courts decide which types of cases? Asher, Danica, and Mai obtained a U.S. copyright on their software. However, they are not sure how well this copyright will protect Cyber Guardian's software. Will the government protect Cyber Guardian's copyright or does Cyber Guardian have to bring suit itself? Can Cyber Guardian test its copyright in court before there is a challenge to it? They also have discovered that they will have to distinguish the rules applicable to the federal government and those applicable to the states.

These and other questions will arise as you read this chapter. Be prepared! You never know when the firm or one of its members will seek your advice.

Classic Case

In this Classic Case, the U.S. Supreme Court considered whether the State of Washington had jurisdiction (or authority) over the International Shoe Company. Washington wanted the company to pay its state unemployment compensation tax. International Shoe had salespeople who lived in Washington and sold its shoes in that state. The company itself did not have facilities within the state.

INTERNATIONAL SHOE CO. v. STATE OF WASHINGTON

326 U.S. 310 (1945)

FACTS International Shoe manufactured and sold shoes. It was a Delaware corporation with its principal place of business in St. Louis, Missouri. It had places of business in several states, but not in Washington. Its merchandise was distributed through several branches located outside Washington. It had no office in Washington, made no contracts, and maintained no inventory there. During the years in question, International Shoe employed 11 to 13 salesmen under direct supervision and control of sales managers in St. Louis. These salesmen lived in Washington, their principal activities were confined to that state, and they were compensated by commissions based upon the amount of their sales. The commissions for each year totaled more than $31,000. The company supplied its salesmen with a line of samples that they displayed to prospective purchasers. Occasionally, they rented rooms to display samples. The cost of the rent was reimbursed by the company. The authority of the salesmen was limited to exhibiting their samples and soliciting orders at prices fixed by the company. The salesmen sent the orders to the company's principal office to be accepted or rejected. When the orders were accepted, the merchandise was shipped and invoiced from outside Washington. No salesman had authority to enter into contracts or to collect payment. Notice of the tax assessment was served on a salesman in the State of Washington. A copy was mailed by registered mail to International Shoe at its address in St. Louis, Missouri.

ISSUES Can the State of Washington require International Shoe to appear in its courts without violating the Due Process Clause of the Fourteenth Amendment? Can the state require International Shoe to pay the state unemployment compensation tax without violating the Due Process Clause?

HOLDINGS Yes, to both questions. The State of Washington's lawsuit and assessment of the unemployment contribution do not violate the Fourteenth Amendment.

REASONING Excerpts from the opinion of Chief Justice Stone:

. . . The statutes in question set up a comprehensive scheme of unemployment compensation, the costs of which are defrayed by contributions . . . by employers to a state unemployment compensation fund. The contributions are a specified percentage of the wages payable annually by each employer for his employees' services in the state. . . .

26 U.S.C. §1606 (a) provides that "No person required under a State law to make payments to an unemployment fund shall be relieved from compliance . . . on the ground that he is engaged in interstate . . . commerce, or that the State law does not distinguish between employees engaged in interstate . . . commerce and those engaged in intrastate commerce." It is no longer debatable that Congress . . . may authorize the states, in specified ways, to regulate interstate commerce or impose burdens upon it. . . .

Since the corporate personality is a fiction, . . . it is clear that unlike an individual, its "presence" . . . can be manifested only by activities carried on in its behalf by those who are authorized to act for it. . . . [T]he terms "present" or "presence" are used merely to symbolize those activities of the corporation's agent within the state which courts will deem to be sufficient to satisfy the demands of due process. . . . Those demands may be met by such contacts of the corporation with the state . . . as make it reasonable . . . to require the corporation to defend the particular suit which is brought there. An "estimate of the inconveniences" which would result to the corporation from a trial away from its "home" or principal place of business is relevant in this connection. . . .

"Presence" in the state . . . has never been doubted when the activities of the corporation . . . have not only been continuous and systematic, but also give rise to the liabilities sued on, even though no consent to be sued or authorization to an agent to accept service of process has been given. . . . Conversely it has been generally recogniz ed that the

casual presence of the corporate agent or even his conduct of single or isolated . . . activities in a state . . . are not enough to subject it to suit on causes of action unconnected with the activities there. . . . To require the corporation in such circumstances to defend the suit away from its home or other jurisdiction where it carries on more substantial activities has been thought . . . too great and unreasonable a burden on the corporation to . . . [comply] with due process. . . .

It is evident that the criteria by which we mark the boundary line between those activities which justify [subjecting] . . . a corporation to suit, and those which do not, cannot be simply mechanical or quantitative. . . . Whether due process is satisfied must depend . . . upon the quality and nature of the activity in relation to the fair and orderly administration of the laws. . . . [The Due Process Clause] does not contemplate that a state may make binding a judgment *in personam* against an individual or corporate defendant with which the state has no contacts, ties, or relations. . . .

But to the extent that a corporation exercises the privilege of conducting activities within a state, it enjoys the benefits and protection of the laws of that state. The exercise of that privilege may give rise to obligations. . . . [S]o far as those obligations arise out of or are connected with the activities within the state, a procedure which requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue. . . .

[T]he activities carried on in behalf of . . . [International Shoe] in the State of Washington were neither irregular nor casual. They were systematic and continuous throughout the years in question. They resulted in a large volume of interstate business, in the course of which appellant received the benefits and protection of the laws of the state. . . . The obligation which is . . . sued upon arose out of those very activities. It is evident that these operations establish sufficient contacts or ties with the state of the forum to make it reasonable and just, according to our traditional conception of fair play and

substantial justice, to permit the state to enforce the obligations which appellant has incurred there. . . . [W]e cannot say that the maintenance of the present suit in the State of Washington involves an unreasonable or undue procedure. . . .

[Washington] . . . imposes a tax on the privilege of employing appellant's salesmen within the state measured by a percentage of the wages. . . . The right to employ labor has been deemed an appropriate subject of taxation in this country. . . . [A] tax imposed upon the employer for unemployment benefits is within the constitutional power of the states. . . .

Affirmed.

THE FEDERAL CONSTITUTION

The Constitution of the United States is a unique document for two reasons: It is the oldest written national constitution, and it was the first to include a government based on the concept of a separation of powers. The Constitution was intended to prevent many of the problems the founders felt were present in Great Britain. The U.S. Constitution established a government structure that has three separate "divisions" and a series of checks and balances in which the power of one branch is offset, at least to some extent, by that of the others.

The Constitution places the power of the purse (fiscal and monetary control) in the legislative branch of government and the power of the sword (control over armed forces) in the executive branch. The power of the executive branch expands during times of emergencies. [1] The judicial branch does not have the formal, written power that exists in the other branches of government. It does possess what may be the most important power, at least from a constitutional perspective. The judicial branch has the power to decide where and how the other two branches may properly exercise their powers. This power was "created" by the court itself in the

landmark case, *Marbury v. Madison*,[2] and is called the power of judicial review. We will discuss judicial review in greater detail later in this chapter.

Allocation of Power

Legislative Power Article I of the Constitution creates a Congress consisting of two houses: the Senate and the House of Representatives. Congress has the power to levy and collect taxes, pay debts, and pass all laws with respect to certain enumerated powers, such as (1) providing for the common defense and general welfare; (2) regulating commerce; (3) borrowing and coining money; (4) establishing post offices and building highways; (5) promoting science and the arts; and (6) creating courts inferior to the U.S. Supreme Court.

Executive Power Article II creates the executive branch of government by establishing the offices of President and Vice President. The President is the Commander-in-Chief of the armed forces of the United States. In addition, the President has the power to make treaties and to nominate ambassadors, judges, and other officers of the United States. The Senate must ratify all treaties, or the treaties will not be effective. The Senate must also confirm all presidential appointments or the appointee cannot take office. The Vice President is the president of the Senate and also serves for the President when the President is unable to serve.

Administrative Agencies Administrative agencies also wield power, even though they are not discussed in the U.S. Constitution. These agencies are sometimes called a fourth branch of government. They are generally considered part of the executive branch. Agencies are created by Congress through the passage of a statute, often at the request of the executive branch. The statute that creates the agency is called the *enabling statute*, and it specifies the power and authority of the agency. Most federal agencies have the power, within their authority, to make rules and regulations that are similar to statutes.

They also decide controversies involving these rules and regulations. (These controversies are resolved in administrative hearings; they are not cases in the literal sense of the word.) The exact authority and the organization of the agencies vary greatly. Administrative agencies exist on the federal, state, and local levels. Administrative agencies will be discussed in more detail in Chapter 5.

Judicial Power Federal judicial power is placed in one Supreme Court and in such other inferior courts as Congress may create. The U.S. President nominates all Article III federal judges. When the judges are confirmed by a majority of the Senate, they are permitted to serve in office for the rest of their lives, as long as their behavior is "good."

The actual wording of Article III limits rather than expands judicial power. Under Section 2 of Article III, generally the federal courts may only hear and decide *cases or controversies* (claims brought before the court in regular proceedings to protect or enforce rights, or to prevent or punish wrongs). Legally, cases or controversies can be defined as matters that are appropriate for judicial determination. For a matter to be appropriate for judicial determination,

> [t]he controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests. It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts. [3]

Constitutional law has evolved through precedents so that, today, the following are *not* considered to be a case or a controversy:

- **Advisory opinions.** Opinions rendered by a court at the request of the government or of an interested party that indicate how the court would rule on a matter should such litigation develop. [4]

- **Moot cases.** Cases in which a determination is sought on a matter that, if decided, will not have any practical effect on the controversy; a question is moot when it presents no actual controversy or when the issues have ceased to exist. [5]
- **Cases where parties lack standing.** Standing means that the party has a sufficient interest in the outcome of a controversy to assert the parties' rights. [6]
- **Political questions.** Questions that the court refuses to decide, due to their purely political character or because their determination would encroach on powers of the other branches. [7]

The doctrine of the separation of powers requires that *federal* courts deal only with judicial matters. An *advisory opinion* is one in which the executive branch or an interested party refers a question to the judicial branch for a nonbinding opinion. However, that is not the purpose of the federal judicial system. Accordingly, whenever a member of the executive branch requires an advisory opinion, the question is referred to the justice department within the executive branch for an opinion from the attorney general. Under the U.S. federal system, the attorney general is the appropriate person to issue an advisory opinion. Contrary to the federal rule, some state courts are empowered to give advisory opinions. The International Court of Justice and the courts of several other nations also will issue advisory opinions.

The federal courts only hear cases that are appropriate for a judicial solution. *Moot cases* are those cases in which the matter has already been resolved or those cases in which any attempt at a resolution would have no practical effect. Sometimes the "resolution" occurs through the passage of time or a change in circumstances. In the case of *DeFunis v. Odegaard*,[8] the Supreme Court stated that the question of whether a student should be admitted to a law school was a moot case. While the case was moving through the court process the student had been admitted to the law school and was completing his degree. The law school informed the Supreme Court

that regardless of the outcome of the suit, the law school would award DeFunis a degree if he passed his final quarter of coursework. Accordingly, the court chose not to write an opinion on the merits of the suit.

Only persons who can demonstrate that they have actually been harmed or will be harmed have *standing* to sue. Courts will generally define standing as having a direct and immediate personal injury. For example, if you saw Taylor punch Kristen in the nose, you would not have standing to sue Taylor for *assault* (a threat to touch someone in an undesired manner) or *battery* (the unauthorized touching of another person without either legal justification or that person's consent); only Kristen would have standing to sue Taylor because she was the one who was injured. However, statutes may grant standing to sue in situations where it would not otherwise exist. For example, the Endangered Species Act (ESA) contains a citizen-suit provision that provides that in general, "any person may commence a civil suit" to enforce the ESA. [9]

Even though many political questions involve real controversies, U.S. courts will not hear political questions. While a political question may be considered a very real controversy, it is not considered to be a *judicial question* (a question that is proper for a court to decide). This rule is based on the concept of *judicial restraint*, a judicial policy of refusing to hear and decide certain types of cases. For example, if Darlene contends that a state is not based on a democratic form of government, she cannot argue that issue in a U.S. federal court because it is a political question. Similarly, if Luis thinks that a U.S. foreign policy is incorrect, he cannot debate that point in court because foreign policy is a political question. What constitutes a political question is not always clear. For instance, is *legislative apportionment* —the ratio of legislative representation to constituents —a political question? Historically courts have said yes. However, recently the courts have reviewed several legislative districting cases.

The Constitution contains four limits on judicial power but does not mention the one concept that has *expanded* judicial power. The specific power of judicial review is not mentioned in the Constitution.

The Supreme Court created this doctrine for federal courts in the landmark 1803 case of *Marbury v. Madison.* [10] This power is based on an interpretation of the Constitution, which states that U.S. courts may examine the actions of the legislative and executive branches to ascertain whether those actions conform to the Constitution. If they do not, the courts have the power to declare those actions unconstitutional and unenforceable. Under this doctrine, the Supreme Court can declare an act of Congress invalid if the congressional act does not conform to the Constitution. Similarly, the court can declare conduct by the President, or any other member of the executive branch, invalid if the conduct conflicts with the Constitution. This concept of judicial power does not exist in Great Britain, where the parliament is supreme. The U.S. judicial branch, which has neither the power of the purse nor the power of the sword, has significant power because it can determine what action by the other branches is legal.

Since 1803, the power of U.S. courts to judicially review all actions of the legislative and executive branches has gone unchallenged. It has become the cornerstone of the doctrine of the separation of powers. This power of the Supreme Court to invalidate legislation also extends to all state legislation because of the Supremacy Clause in the federal Constitution.

Cyber Guardian 3.1 Management

PRODUCT SAFETY LAWS

Asher read an article in a business publication that predicted which states would pass the strictest AI statutes in the next 12 months. The author thought Cyber Guardian's state would treat tech companies more harshly than other states. Asher, Danica, and Mai believe that their software is not likely to be affected by such statutes at this time. However, Asher is still concerned about the long-term effects on the company that the passage

of addit ional regulation could cause. He asks what you would advise the company t o do. What will y ou tell him?

BUSINESS CONSIDERATIONS What practical steps can a business tak e to avoid the impact of new state regulation? What le gal steps can a busin ess tak e to avoid new regulation? Can the firm a void the jurisdiction of the state 's cour ts? How?

ETHICAL CONSIDERATIONS Is it ethical for a busines s to attempt to avoid go vernment regulation? W ould it be ethical for a firm to attempt to discou rage state legislation that might harm the firm while helping cust omers?

Cyber Guardian 3.2 Management

HOW T O PRO TEC T CYBER GU ARDI AN'S COPYRIGH T

Mai is ver y concerned that another firm will "steal" the pr oprietar y so ftwar e behind Cyber Guar dian 's ser vices and under cut it on price. Although Cyber Guar dian holds a cop yright on its softwar e, Mai knows that cop yrights ar e not alwa ys upheld in cour t. Consequently , she would lik e to file a suit with the cour t to de termine if the cop yright will be upheld *befor e* a competit or duplicates it. She asks you how she should pr o ceed. What advice will y ou giv e her?

BUSINESS CONSIDERATIONS What can a business do to reduce the risk that its cop yright will be held inv alid? What technique or techniques would be most eff ectiv e? Ar e businesses mor e or less concerned about pr otecting their patents? How does uncer tain ty about a cop yright or a patent aff ect a business?

ETHICAL CONSIDERATIONS Analyz e the ethical perspectiv e of any busines s that would attempt to "steal" Cyber Guar dian 's

cop yright or patent. Is commer cial or industrial espionage an ethical method of doing business?

Role of Judges and Juries The role of a judge varies with the type of cour t over whi ch the judge presides. In a trial cour t the judge has se veral diff er ent r esponsibilities. If it is a jur y trial, the judge:

1. Pr esides o ver the trial
2. Determines the admissibility of any evidence either sid e wants t o pr esent
3. Rules on any motions or objections raised b y either side
4. Instructs the jur y about the applicable law in the case an d the standar ds that must be met in or der to decide for the plaintiff or the def endant in a civil suit, *or* to decide for the go vernment or the def endant in a criminal case
5. Awar ds remedies to the successful plaintiff in a civil suit or imposes a sentence on a criminal def endant who is foun d guilty of the crime

In a jur y trial the jur y decides which evidence is mor e belie vable and whether a par ty has pr oduced sufficient cr edible evidence to win. W e called this role the "decider of fact." If ther e is no jur y, the judge ser ves as the " decider of fact" in its place. The judge is the " decider of law ."

A ju dge or justice ser ving on an appellate cour t has a significantly diff er ent role. An appellate ju dge is expected to r eview th e recor d of the trial cour t or a lower cour t of appeals to ensur e that the law was applied corr ectly . Generally , new evidence is not pr esented in appellate cour ts. The appellate cour ts ar e examining potential err ors of law— mistak es in how the law was applied or interpr eted b y the lower cour t. When ther e ar e err ors, the appellate cour t justices must decide whether to r everse the lower cour t's opinion, remand the case for a new trial, or r ecommend other appr opriate r emedies.

Despite the role, the robes, and the titles, judges ar e people, too. As a result, the personalities of individual judges and justices ma y aff ect their rulings in any giv en case. The influence of the U.S. Supr eme Cour t Justices is par ticularly str ong. As of this writing, the

current Justices on the Supreme Court are Chief Justice John G. Roberts, Jr., and Associate Justices Samuel A. Alito, Jr., Amy Coney Barrett, Neil M. Gorsuch, Ketanji Brown Jackson, Elena Kagan, Brett M. Kavanaugh, Sonia Sotomayor, and Clarence Thomas.[11] When there is a vacancy on the Court, the remaining Justices continue to do the work of the Court. The personal and jurisprudential views of the judges impact the rulings in particular cases and the precedents being set for a jurisdiction. For example, there are numerous articles about how Justice Ruth Bader Ginsburg's work experiences and views affected her decisions when she was on the Court.[12] The same is true of other judges and justices. Justice Clarence Thomas made some pointed observations from the bench during a case involving cross burning that reportedly changed the tone of the proceedings.[13]

Judges who favor judicial restraint believe that the judge's role is to make sure that a law is legal and constitutional. These judges believe that if there is something wrong with the legal system, judges should not correct it. Corrections should be left to the legislature. For example, in addressing asbestos litigation, Justice Souter wrote, "[T]his litigation defies customary judicial administration and calls for national legislation."[14] Judges who are activists believe that their role is to encourage social change: These judges often believe it is not necessary to wait for the legislature to address the issue. This is often called "making law." Sometimes judges claim to be of one view, and then author opinions that actually are contrary to that view. For example, a judge may claim to favor judicial restraint and then make decisions that are very activist in nature. Those who believe that judges should not be activists often complain when they feel that judges are "making law."[15]

Federal judges and the judges in most states have a code of ethics.[16] In 2023, the U.S. Supreme Court members agreed to a code of conduct to govern their behavior.[17] In the preamble of the document, the Justices state that they have had a "common law" code of ethics. However, the lack of a written code prior to 2023 has caused some observers to believe that they did not have a code.

Some members of Congress have called for a more stringent code of ethics and enforcement procedures for the Supreme Court.[18]

Original Constitution

The original Constitution, signed on September 17, 1787, contained several rights pertaining to individuals. We will discuss some of the most significant rights. Among these rights is the right of habeas corpus. *Habeas corpus* is the name given to a variety of writs issued to bring a party before a court or judge (a *writ* is a writing issued by a court in the form of a letter ordering some designated activity). In Latin, *habeas corpus* means "You have the body."[19] Habeas corpus may be used by all persons who have been deprived of their liberty. There are special forms of the writ; however, when the words "writ of habeas corpus" are used alone, the writ is addressed to the person who detains an individual. The writ commands the recipient to produce the individual in court and to comply with any order by the court issuing the writ. This is probably the most common form of the writ.[20] Note that habeas corpus is a way to have the issue heard in court; it does not assure that the person will be released.

Another right established by the Constitution is that Congress may pass no bills of attainder. A *bill of attainder* is a "legislative trial," whereby a person is judged a felon or worse by act of the legislature and not by a court of law.

Congress also may not enact ex post facto laws. An *ex post facto* law is a law passed after an occurrence or act that retroactively changes the legal consequences of such act. Assume that Iron Fortress Defense, Inc. legally purchased some equipment in January. In March, Congress enacted a statute making the purchase of such equipment illegal. Iron Fortress Defense could not be prosecuted for making the purchase since it did so before the statute was enacted. Of course, Congress *can* declare illegal similar transactions in the future. The constitutional prohibition on ex post facto laws applies only to criminal law. This prohibition includes laws that (1) make an act a crime; (2) make a crime into a more serious crime; (3) change the punishment for a crime; or (4) alter the legal rules of evidence for

proving a crime.[21] The constitutional basis for regulating businesses is discussed in greater detail in Chapter 5.

Selected Amendments to the Constitution

Four years after the U.S. Constitution was signed, the first ten amendments were passed. These amendments, known as the Bill of Rights, spell out individuals' rights when dealing with the federal government. In all, 27 amendments to the Constitution have been passed. The amendments to the Constitution reflect the citizens' concerns about particular topics and reflect changes in the society. The Constitution itself serves as the supreme law of the land for U.S. society. All of the amendments are important because they affect the rights of the citizens and/or limit the power of the government. Not all of the amendments have a significant impact on the rights of businesses. In this section, we will briefly discuss the amendments that are most likely to impact business.

First Amendment The First Amendment provides that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." The First Amendment provides the basis for the separation of church and state. This amendment also provides for freedom of speech, freedom to assemble, and freedom of the press. For example, California passed a statute that prohibited the sale or rental of "violent video games" to minors. Members of the software and video game industries challenged the statute on the grounds that it interfered with their free speech. The U.S. Supreme Court decided that the statute violated the businesses' rights under the First Amendment.[22] More recently, a 2023 Texas law required pornography websites to verify that their visitors are 18 or older. A group representing the pornography industry brought an action against Texas. The group argued that the statute violated the First Amendment. In Texas, minors are not permitted to access obscene materials even though adults can. The U.S. Supreme Court ruled that requiring proof of age is an ordinary and appropriate means of restricting access to adults.[23]

Fifth Amendment The Fifth Amendment protects individuals from self-incrimination and double jeopardy. These protections are important in criminal matters. This amendment also provides that a person cannot be deprived of life, liberty, or property without due process of law. This provision applies to individuals and corporations. Sometimes courts expand their definition of "life, liberty, or property" and at other times they narrow their definition.

There are two types of due process—procedural due process and substantive due process. Procedural due process deals with the government's procedures when it deprives a person of life, liberty, or property. Procedural due process gives a person a right to a proper notice and hearing. The specifics of what will satisfy due process depend on the type of case. Generally, the more serious the case the more rights the person has. For example, if Avi is charged with murder, she will be entitled to a jury trial. If Matthew is charged with speeding, he will not be entitled to a jury trial in traffic court.[24]

Substantive due process refers to the basic fairness of the laws that may deprive an individual of life, liberty, or property. Privacy rights are often protected under substantive due process. If the government passes a law that limits a person's liberty or limits how the person uses the person's property, the government must have a proper purpose.[25] This will be discussed in more detail in Chapter 5.

Sixth Amendment The Sixth Amendment includes the right to a speedy and public trial. It is limited to criminal cases. One of the purposes for requiring a speedy trial is that some suspects have to remain in prison until their trial dates. We do not want them to remain in prison for a long time when they may actually be acquitted at their trial. During the 2020 novel coronavirus (COVID-19) pandemic, many courts were closed due to shelter-in-place orders. Officials responsible for administering the courts struggled with how to provide speedy and public trials while containing the spread of COVID-19. Many courts experimented with online hearings and trials.[26]

Four teenth Amendment The original Bill of Rights applied to the federal go vernment. Ov er time and numer ous decisions, the Supr eme Cour t has decided that under the Four teenth Amendment most of the guarantees in the Bill of Rights also apply to actions by state and local go vernments. Under this amendment, the states cannot depriv e individuals of lif e, liber ty, or pr oper ty without due pr oces s. In many states, a driv er's license is consider ed to be a pr oper ty right, so the state ca nnot te rminate a person 's driv er's license without giving the driv er an oppor tunity to be hear d. A business license wou ld also be consider ed a pr oper ty right.

In one case, Jeff Quon work ed for the City of Ontario Police Depar tment (O PD). He was a ser geant and member of the Special W eapons and Tactics (SW AT) Team. The city pr ovided Quon and a number of other officers with alphanumeric pagers. The bills fr om the ser vice pr ovide r indicated high usage, and for a while the city ask ed the officers to pa y for their o verages. Then the city decided to audit the usa ge for some of the offi cers who wer e ex ceeding the number of characters allo wed under the basic plan. The city ask ed the ser vice pr ovider to transcribe the officers' messages. The city then read the messages and determined wh ich ones wer e personal and which ones wer e work related. Quon "sen t or receiv ed 456 messages d uring work hours in the m onth of A ugust 2002, of which no mor e than 57 wer e work related. "[27] S ome of the messages wer e sexually explicit. Quon ar gued that the city violated the ban on "unr easonable sear ches and seizur es" under the F our th Amendment and made applicable to the states under the F our teenth Amendment. The Supr eme Cour t found that the sear ch was reasonable because it was "motiv ated by a legitimate work-r elated purpose, and because it was not ex cessiv e in scope. "[28]

THE COUR TS AND JURISDIC TION

Jurisdiction is the power of a cour t to affect legal relationships. W e will examine four aspects of jurisdiction:

1. *Subject matter jurisdiction*, which is the power of a court to hear certain kinds of legal questions
2. Jurisdiction over the persons or property
3. Concurrent versus exclusive jurisdiction
4. Venue

Subject Matter Jurisdiction

Subject matter jurisdiction refers to the power of the court to hear and decide particular types of cases. Article III of the Constitution defines the Supreme Court's subject matter jurisdiction as including all cases in law and equity arising under the Constitution, the statutes of the United States, and treaties. The subject matter jurisdiction granted to the Supreme Court is extensive. A state juvenile court, on the other hand, is limited solely to hearing matters concerning children that arise within that state and under its laws. If an adult were brought before a juvenile court, the court would lack subject matter jurisdiction. Likewise, a federal bankruptcy court may not decide a criminal matter because its jurisdiction is limited to bankruptcy matters. Subject matter jurisdiction deals with which court is the "right" court to hear a particular type of case or controversy.

Jurisdiction over the Persons or Property

In addition to the appropriate subject matter jurisdiction, a court must also have jurisdiction over the persons or property whose rights, duties, or obligations the court will decide. The defendant may not want to have the case decided where the plaintiff filed the suit. Jurisdiction may be a particular problem for businesses that enter contracts with people outside their state or country. It may also be an issue for businesses that sell their products in many states and countries. Such a business may be subject to suits in many different locations, each of which may be able to assert jurisdiction over the business. A purchaser of the company's product may prefer to litigate any disputes in the consumer's "home court" rather than the home

court of the business. This may be due to convenience, cost, or an implicit bias. For example, some people believe that Apple had this type of "home court" advantage in one of its U.S. patent infringement suits with Samsung because the dispute was litigated close to Apple's corporate headquarters. [29]

Three bases exist for obtaining jurisdiction over persons or property— *in personam, in rem*, and *quasi in rem.*

***In Personam* Jurisdiction** *In personam* jurisdiction refers to the court's authority over the defendant. It is also called personal jurisdiction. We will use both terms. Questions do not arise about the court's jurisdiction over the plaintiff. The plaintiff chooses to file the suit in a particular court and so implicitly consents to the court's jurisdiction. It is inconsistent to allow the plaintiff to file the suit in a court and then complain that the same court lacks jurisdiction over the plaintiff.

The defendant does not choose the court. Often, if the defendant were given a choice, the defendant would choose to avoid a trial altogether. If a trial must take place, the defendant might well prefer to have it held somewhere else. The question, then, is how to get *in personam jurisdiction* of the defendant. When can the court legally compel the defendant to attend or face a *default judgment* if the defendant refuses to attend the trial? (A *default judgment* is a civil judgment against a defendant who does not appear in court. It is only valid when the court has jurisdiction over the court case and the defendant.)

Consent The defendant may simply consent to the court's jurisdiction. Consent can occur either by express consent or by failure to raise the issue of jurisdiction and, instead, responding to the legal questions in the lawsuit. Consent can also be given prior to the lawsuit. This is commonly accomplished by a contract clause or by appointment of an agent to accept service of process. (*Service of process* is the delivery of a legal notice to inform the defendant of the nature of the legal dispute.) Generally, a corporation is considered to have given consent when it registers with a state as a *foreign*

corporation (a corporation that had its articles of incorporation approved in another state) and asks permission to conduct business in a state. This depends on the specific language of the relevant statutes and court interpretation of it.[30] Some courts have concluded that a corporation has given implied consent when it engages in business as a foreign corporation without the required registration.

Physical Presence A court will also have *in personam* jurisdiction over a defendant who is physically present in the state when the defendant is served with process. This would include a person who is on a trip to the state or even merely passing through the state on the way to another destination. Courts will usually decide that there is no jurisdiction over a defendant who is tricked into entering the state by the plaintiff. A corporation is physically present in a state in which it is *doing business.* (Doing business is also used as the basis of implied consent by some states.) The courts have decided numerous cases about what constitutes doing business and have devised various tests for recognizing doing business. Two of these tests are (1) whether the corporation's activities were single, isolated transactions or continuous and substantial activities; or (2) whether the corporation's agents were only soliciting offers in the state or were engaged in additional activities.

In the Classic Case of *International Shoe Co. v. State of Washington*,[31] the U.S. Supreme Court concluded that before a defendant is required to appear in a state court, the defendant must have certain *minimum contacts* with the state. Otherwise, the suit would offend traditional concepts of fair play and substantial justice. This decision created a constitutional test for *in personam* jurisdiction. The defendant in this case was a corporation, but the ruling now applies to other business entities and individuals as well.

Domicile In personam jurisdiction also exists in the defendant's state of domicile. Domicile is a complicated legal doctrine (and most of its complexity is outside the scope of this text). Human beings have one and only one domicile. A person may choose a domicile or the law may assign it. *Domicile* is usually the place where a person is

physically present and the person considers as home; it is the person's permanent home. When the person leaves for a while, the person intends to return to this place. Domicile does *not* require that a person live in a state for a certain minimum time. Consequently, domicile contrasts with residency statutes that require, for example, a person to live in a state for a set period of time before voting in the state or being eligible for in-state tuition at its colleges and universities.

Suppose that both the plaintiff and the defendant are domiciliaries of Alaska; Alaska has jurisdiction over them. If the plaintiff is a domiciliary of Oregon and the defendant is a domiciliary of Alaska, Alaska would once again have *in personam* jurisdiction. The defendant's domicile would create jurisdiction in the Alaskan court. On the other hand, if the plaintiff is a domiciliary of Alaska but the defendant is a domiciliary of Oregon, Alaska may not have proper jurisdiction over the defendant. If the plaintiff wants to sue the defendant in a state court, the plaintiff might need to go to Oregon and sue the defendant there, since a defendant's domicile is almost always an appropriate forum. (*Forum* is the court that is or will be conducting the trial.) Potential jurisdiction in a federal court is discussed later in this chapter.

A corporation may be sued where it is domiciled. A corporation is domiciled in the state in which it is incorporated. It is also considered to be domiciled in the state where it has its corporate headquarters, if this is a different state. A corporation is also subject to *in personam* jurisdiction in all states in which the corporation does business because it is physically present in these states.

There are different rules for other types of business entities. A general partnership is domiciled in every state where a partner is domiciled. Similarly, a limited liability company will be domiciled in every state where a member is domiciled. (*Members* are the owners of limited liability companies.) A state has general *in personam* jurisdiction over a defendant domiciled within it, meaning that the defendant can be sued on any issue in that state.

Long-arm Statutes Most states have laws called *long-arm statutes.* The purpose of these statutes is to permit the state to exercise *in personam* jurisdiction when ordinarily this would not be possible. A common long-arm statute permits a state to exercise authority over a person who drives on its roads. This type of long-arm statute is also called a *nonresident motorist statute* .[32] (Note that despite the use of the term "resident" in many statutes, the legislatures probably mean "domiciliary.") Suppose that Cara, a domiciliary of Ohio, drives a car on the roads of Kansas and injures Colin, a domiciliary of Kansas. In this situation, the courts of Kansas would have *in personam* jurisdiction over Cara, because Kansas feels that it would be unfair to force Colin to go to Ohio to sue. Some states have enacted much broader long-arm statutes. For example, Illinois enacted a statute that listed certain acts that would confer jurisdiction if the acts were completed in the state. California, Iowa, Kansas, Nebraska, [33] and Pennsylvania, [34] on the other hand, enacted long-arm statutes that provide for *in personam* jurisdiction whenever it complies with the federal and state constitutions. [35] As with other matters under the control of the states, there is great variation among long-arm statutes.

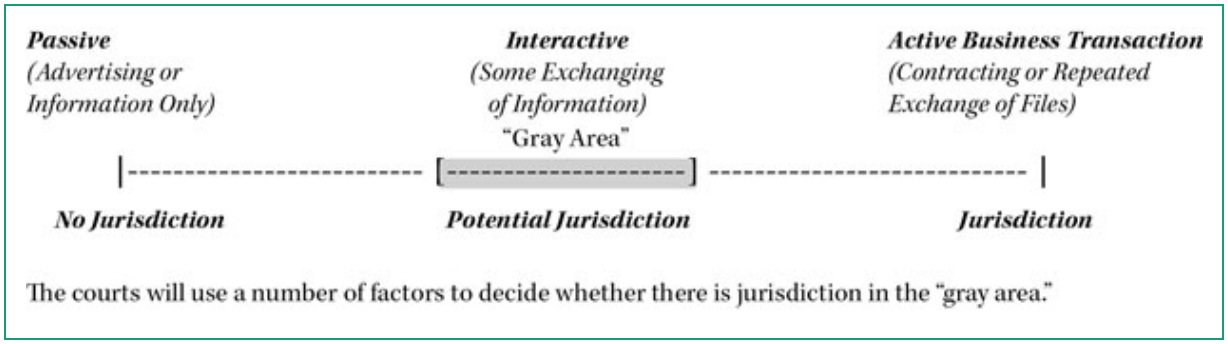
Web-based Businesses E-commerce has created new challenges in applying *in personam* jurisdiction. U.S. courts rely on the precedent established by *International Shoe* and try to apply it to internet cases. If a defendant simply posts information on a passive internet website in another jurisdiction, [36] there are not sufficient contacts with any "foreign" jurisdictions to permit the exercise of personal jurisdiction over the defendant posting the information. Such passive websites do no more than make information available. At the other extreme are websites that actively engage in selling products and services in the forum state. Between these two extremes lies the troublesome area. In this area, a defendant might host an interactive website that allows for the exchange of information between the user and the host computer . The plaintiff may have interacted with this website. In these situations, personal jurisdiction will depend on the level of interaction and , also, on whether the exchange of information is

commercial in nature.[37] In reaching a decision, courts look at the extent to which the defendant actually and purposefully conducted commercial or other transactions with residents in the forum state through its website. Courts also consider whether the website specifically targets residents in the forum state or knowingly receives substantial revenue from forum residents.[38] Websites can be categorized as three types for purposes of *in personam* jurisdiction: (1) a passive website which only advertises on the internet: personal jurisdiction is inappropriate; (2) a website that permits a user to exchange information with a host computer: jurisdiction is determined by the degree of interactivity and whether the exchange of information is commercial in nature; and (3) a website that clearly engages in business over the internet through repeatedly entering into contracts: personal jurisdiction is proper.[39] For a graphic representation of the rules, see Exhibit 3.1 .

There is still a lot of uncertainty in this area. One solution for some e-commerce businesses is to specify in their contracts where they should be sued. X (formerly known as Twitter®) is one business that took this approach.[40]

Exhibit 3.1

General *In Personam* Jurisdiction Over Web-based Businesses



General and Specific In Personam Jurisdiction Courts have developed two types of *in personam* jurisdiction—specific and general. Specific personal jurisdiction (case-linked jurisdiction) is

jurisdiction over cases related to the defendant's actions within the forum state. It depends on a connection between the state and the underlying controversy, i.e., something took place in the state, like a tort, and it is subject to the state's regulation. In specific jurisdiction the case must relate to the defendant's activities within the forum. The court will examine the interrelationship among the defendant, the forum, and the litigation. On the other hand, general personal jurisdiction (all-purpose jurisdiction) is the state's power to decide any cause of action involving the defendant, regardless of where the cause of action arose. It allows jurisdiction over a defendant based on the defendant's connection to the forum unrelated to the underlying suit. An example is domicile. The court can hear the claim even if all the activity occurred in another state.

***In Rem* Jurisdiction** If a state cannot obtain *in personam* jurisdiction on any of these grounds, it may be able to use *in rem* jurisdiction. *In rem* jurisdiction exists when the court has authority over property or status of something that is located within the control of the court. *In rem* jurisdiction allows the state to exercise its authority over something such as land, a marriage, or a partnership within its boundaries. The court's judgment will affect everyone's rights in that "thing." It cannot be used to impose a personal obligation on the defendant. For example, if an individual or a corporation has real property in one state but is domiciled in another, the state where the property is located can exercise *in rem* jurisdiction in a dispute over ownership of the property. However, *in rem* jurisdiction cannot be used to force a party to pay damages or publish an apology.

***Quasi in Rem* Jurisdiction** In this type of jurisdiction, the court determines the rights of particular persons to specific property. (It is distinct from *in rem* jurisdiction because a court with *in rem* jurisdiction will determine the rights of all persons in the thing. It differs from *in personam* jurisdiction because there is no authority over the person of the defendant.) *Quasi in rem* jurisdiction is authority obtained through property under the control of the court. Depending on the state, the court obtains control of the property

through one of two methods. In one, the property is within the jurisdiction of the court, and the plaintiff wishes to resolve issues of ownership, possession, or use of the property—for example, to foreclose a mortgage. In the second method, the dispute does not concern the property, but is personal to the plaintiff, such as a breach of contract or the commission of a tort. Jurisdiction will exist if the plaintiff can locate the defendant's property within the state and bring it before the court by *attachment* (seizure of the defendant's property) or *garnishment* (procedure to obtain possession of the defendant's property when it is in the custody of another person). The state will have limits on when attachment or garnishment is allowed. When the plaintiff 's suit is successful, the recovery is limited to the value of the property. Exhibit 3.2 summarizes the techniques for obtaining jurisdiction over the defendant.

Service of Process Regardless of the type of jurisdiction, the plaintiff must properly serve the defendant with process to inform the defendant of the suit. One type of service is *actual notice*, where the defendant is personally served by an officer of the court or is mailed service by registered mail. If the plaintiff cannot arrange actual notice after reasonable attempts to do so, the plaintiff may serve notice publicly by posting on the property or in a newspaper. This is called *constructive service* or *constructive notice*. For a business entity, constructive notice may also include service at the office of the state 's secretary of state. For example, when an out-of-state corporation registers in Virginia, the state may specify that process may be served on Virginia 's secretary of state.

The person who serves process is considered an officer of the court because the person is performing an important judicial function. In most states, you do not have to be a court employee to be a process server. In many states, any adult can serve process on the defendant. Some states even permit the plaintiff to serve the process. Even where it is permitted, you should not serve the defendant yourself. This could possibly lead to an exchange of heated words or even the commission of a battery. It is better to pay

someone else, such as a sheriff, to hand the legal papers to the def endant.

Concurr ent v ersus Ex clusiv e Jurisdiction

Exhibit 3.2

Methods to Obtain Jurisdiction o ver the Defendant

Type of Jurisdiction	**Type of Judgment**	**Differences Between Individual and Corporate Defendants**	
		Individual	*Corporation* [a]
In personam			
A uthority o ver a specific person or corporation within the contr ol of the state. A uthority ma y deriv e fr om consent, domicile, physical pr esence, or long-arm statutes.	Aff ects the person.	**Consent** Def endant consents t o personal jurisdiction; consent can occur befor e or after a suit has begun. **Domicile** Def endant has a residence, usually a home, at which the def endant	**Consent** A corporation generally consents when it registers as a for eign corporation with the state. [b] **Domicile** A corporation is incorporated (has filed its ar ticles of incorporation with the

Type of Jurisdiction	Type of Judgment	Differences Between Individual and Corporate Defendants	
		is/has been physically pr esent and intends t o remain for the time being; individuals ha ve only one domicile. [c] **Physical Presence** Def endant is ser ved b y hand while within the geographic boundaries of the state. [d]	state) and/or has its corporate headquar ters in the state. **Physical Presence** A corporation is r ecogniz ed as " doing business" in the state.
In r em			
A uthority o ver pr oper ty or status of something within the contr ol of the state. Settles ownership	Aff ects the pr oper ty or status.	The rules for individuals and corporations ar e basically the same.	

Type of Jurisdiction	Type of Judgment	Differences Between Individual and Corporate Defendants
inter ests in pr oper ty or status for all persons. *Quasi in r em* A uthority obtained thr ough pr oper ty under the contr ol of the state. Settles issues of ownership, possession, or use of pr oper ty; or settles personal disputes unr elated t o the pr oper ty.	Aff ects the rights of specific people t o the pr oper ty.[e]	The rules for individuals and corporations ar e basically the same.

[a] This column ap plies to corporations. Other business entities ha ve diff er ent rules. For examp le, a limited liabi lity company is domiciled in the states wher e any of its members ar e domiciled.

[b] If th e co rporation fails to register , the cour t ma y imply consent fr om the act of doing bu siness in the state. Ge nerally , implied consent is limited to cases arising fr om the actual doing of business in the state.

[c] Some people are not capable of selecting domiciles for themselves; they have domiciles determined for them by legal rules (for example, minors).

[d] Most states will refuse to exercise jurisdiction if the defendant is brought into the state by force or enticed into the state by fraud.

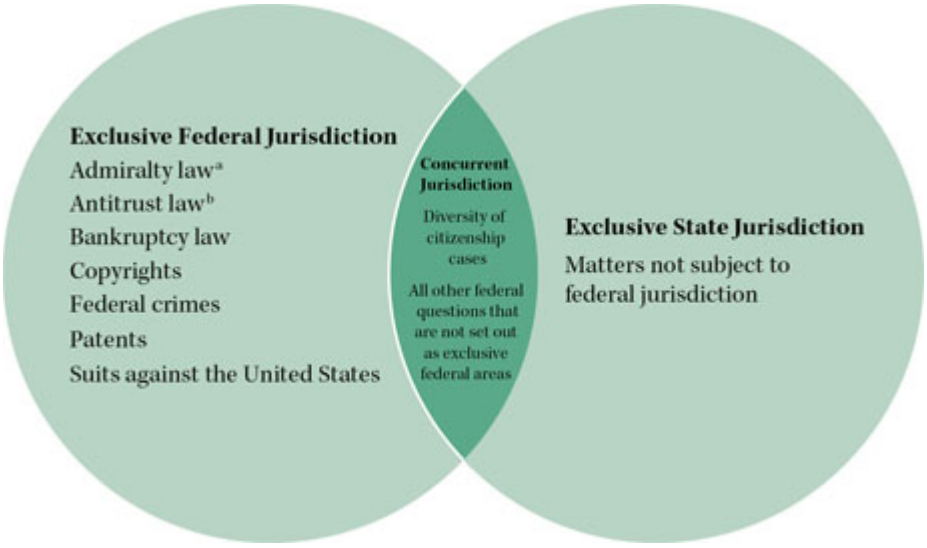
[e] A successful plaintiff is limited to the value of the property.

In certain cases, more than one court may have jurisdiction. This is called *concurrent jurisdiction.* On the other hand, some subjects can be heard only by a specific court to the exclusion of other courts, which is called *exclusive jurisdiction.* Examples of exclusive jurisdiction in the federal courts are suits in which the United States is a party or suits that involve bankruptcy, copyrights, federal crimes, and patents. Most federal statutes set out whether jurisdiction under the statute is exclusive to the federal courts or concurrent with federal and state courts. Employment discrimination is an example of concurrent jurisdiction. An employee who sues based on allegations of discrimination can sue in either federal or state court. Generally, the employee can combine federal claims and state claims. Exhibit 3.3 illustrates the jurisdictional domains of federal and state courts.

Concurrent jurisdiction in multiple courts is common. When there is concurrent jurisdiction, the plaintiff and the plaintiff's attorney must choose where to file the suit. This is commonly called *forum shopping*. The plaintiff considers several things in making the decision. For example, the plaintiff may be more likely to be successful in one court compared to other courts. The parties may have to wait longer for a trial date in some forums than other courts. If the parties want a jury trial, the probable makeup of the jury is also important. The parties, attorneys, and witnesses will also be required to travel to the court, so the relative cost and convenience of traveling to the forum is also a factor. The plaintiff's attorney will only be licensed to try cases in certain courts. If the case is tried somewhere else, the plaintiff will have to hire additional lawyers, or the plaintiff's attorney will have to obtain the court's permission to appear before it. Different remedies may be available depending on the courts.

Exhibit 3.3

A Comparison of Federal and State Court Jurisdiction



[a] States have concurrent jurisdiction over some aspects of admiralty law under federal statutes.

[b] Some states have state antitrust laws.

Venue

Once a court establishes that it has proper jurisdiction over the subject matter and the defendant, it must decide whether it is the proper venue. *Venue* literally means "neighborhood." In a legal sense, however, it means the proper geographical area or district where a suit can be brought. In federal courts, the question of venue is which federal judicial district is the appropriate one. In state courts, it is usually a question of which county is appropriate. If both the plaintiff and the defendant are domiciled in the same state, *in personam* jurisdiction exists in that state's courts. But which of the state courts is best situated to hear the case? For example, venue could be proper in the county where an incident, such as an automobile accident, occurred. The court may consider the domicile of the defendant in

determining the proper venue. More than one court may have proper venue. The laws of most states explain in great detail which courts would have venue.

Choice of Laws

Choice of laws is the selection of which jurisdiction's laws should be applied to a particular incident, that is, what laws should govern the subject before the court. Although it is also called "conflict of laws," choice of laws is the more descriptive title. The forum court will use choice of laws rules to determine the *substantive laws* (the laws that create, define, and regulate rights) that should be applied to the dispute; however, the forum will use its own procedural laws. (*Procedural laws* are the methods for enforcing rights or obtaining redress for the violation of rights.) Choice of law rules can be very complex. Since state laws can vary greatly, the forum's choice of which law to apply can often determine the outcome of the dispute. To reduce some of the uncertainty, parties to a contract often specify what law should govern the transaction, i.e., a clause that says "this contract is governed by the laws of South Carolina." Courts will usually enforce the clause if the state specified has some connection with the agreement. In addition, the parties can also select a court for any litigation; for example, "any disputes will be decided in Arizona state court."

Federal Jurisdiction

Two specific grounds exist for federal jurisdiction: (1) federal question; and (2) diversity of citizenship *plus* amount in controversy. Most federal questions do not require a particular amount to be in controversy.

Federal Question Jurisdiction Federal question jurisdiction comes directly from Article III of the Constitution. *Federal questions* are questions that pertain to the federal Constitution, statutes of the United States, regulations of federal administrative agencies, and treaties signed by the United States. For example, if Rachelle's

Flowers, Inc. wants to file for bankruptcy protection, that will raise a federal question under the federal bankruptcy code. If Aspen Publishing brings an action asserting that another publishing company has infringed its copyright, Aspen Publishing raises a federal question because copyright is both a federal constitutional and statutory question. States do not have the authority to issue copyrights, and state courts do not have subject matter jurisdiction to decide copyright cases.

Generally, state courts are presumed to have concurrent jurisdiction over civil cases under federal statutes unless Congress clearly intended for the federal courts to have exclusive jurisdiction.[41] Litigation can occur over whether the jurisdiction is concurrent or exclusive when the statute is not clear. For example, in 2012 the U.S. Supreme Court resolved the issue of whether individual private suits filed under the Telephone Consumer Protection Act (TCPA) could be tried only in state courts or whether federal courts had concurrent jurisdiction. It decided that jurisdiction under the act was concurrent.[42] Some other examples of concurrent jurisdiction between the federal courts and state courts are in the areas of civil rights[43] and trademark cases.[44] There is also concurrent jurisdiction over some areas of admiralty law.[45] Federal courts have exclusive jurisdiction over antitrust under federal statutes,[46] bankruptcy,[47] copyright,[48] federal crimes,[49] and patents.[50] Even when there is exclusive jurisdiction in the federal courts, state courts can try related cases. For example, a state court can hear a suit for breach of contract when the contract involves the sale of a copyright or patent.

Diversity of Citizenship Jurisdiction Federal question jurisdiction is not necessary when diversity of citizenship is present. *Diversity of citizenship* exists when the plaintiff is a citizen of one state and the defendant is a citizen of another; it also exists when one party is a foreign country and the other is a citizen of a state. The primary reason underlying diversity jurisdiction is possible bias. Suppose that a citizen of Hawaii must file suit in Iowa to obtain jurisdiction over a citizen of Iowa. The Hawaiian plaintiff could worry that the Iowa court

might favor its own citizen. If the plaintiff is worried about such potential favoritism, the plaintiff can file suit in federal court.

When federal jurisdiction is based on diversity of citizenship, a further requirement exists: a *minimum amount* in question. Federal law requires that the amount in question must exceed $75,000 in diversity cases.[51] The purpose behind the amount is to prevent federal courts from dealing with trifles and to reduce the caseload in federal courts. Many cases are highly complex, and the dollar amount is often unknown when the lawsuit is filed. Accordingly, the courts look to the amount the plaintiff, acting in good faith, claims to be in dispute. This is called the *plaintiff viewpoint rule.* In contrast, cases in which the federal courts have federal question jurisdiction generally do not require a minimum amount in controversy.

Another aspect of diversity jurisdiction is called complete diversity. *Complete diversity* requires that no plaintiff be a citizen of the same state as any of the defendants. This rule poses complex problems when there are multiple plaintiffs and/or defendants. Complete diversity also prohibits having an alien plaintiff and an alien defendant in the same suit, even when the aliens are from different countries. (An *alien* is a person or corporation that is a citizen of another country.) Courts do not permit people to create diversity by assignment of rights, the creation of trusts, or similar techniques.[52] (An *assignment* is a transfer of rights. A *trust* is a legal arrangement where a trustee manages property for other people's benefit. People can put assets in a trust for their own benefit or the benefit of others.)

Exhibit 3.4 depicts the two grounds for federal jurisdiction.

Exhibit 3.4

The Two Grounds for Federal Jurisdiction

For Federal Jurisdiction the Case Must Involve	
Either	***Or***

For Federal Jurisdiction the Case Must Involve

Federal Question

The controlling law involves a federal statute, rule, or regulation; an issue of U.S. constitutional law; or a treaty.
The case involves a consul or ambassador as a party.
The case involves maritime or admiralty law.
The United States is a party to the action.
The case is between two or more states.

Diversity of Citizenship *

Parties on one side of the controversy are citizens of a different state than the parties on the other side.
and
A Minimum Amount in Controversy
(Excluding Costs and Interest)
The plaintiff must sue for more than $75,000.

* There are special rules for cases filed under the federal Class Action Fairness Act (CAFA).

Cyber Guardian 3.3 Management/Marketing

LAWSUIT AGAINST A COMPETITOR

Cyber Guardian recently learned that Always Alert, a California firm located in Silicon Valley, is providing a service very similar to that of Cyber Guardian. Always Alert is leasing its service for several dollars less than Cyber Guardian. Customers are leaving Cyber Guardian for the lower cost alternative. Asher, Danica, and Mai believe that Always Alert has infringed their copyright and patent, and they would like to sue. However, they are concerned about the short-and long-term effects on the company's finances and reputation. They ask you what the company should do. What will you tell them? What should they consider in making their decision?

BUSINESS CONSIDERATIONS Can Cyber Guardian sue Always Alert? In what court(s) could the suit be filed? What additional information will be necessary and why? Would filing the suit improve or harm Cyber Guardian's reputation? Why?

ETHICAL CONSIDERATIONS What should Cyber Guardian do to protect its reputation? Are there any ethical restrictions on what Cyber Guardian does to protect its reputation?

The Federal Court System

Congress has, from time to time, created courts of *limited* jurisdiction. The U.S. Court of Appeals for Veterans Claims, U.S. Court of International Trade, and the U.S. Tax Court are examples of courts with limited jurisdiction. Congress has created *federal district courts* (general trial courts in the federal court system) in every state. Each state has at least one; some states have many. Rhode Island, for example, has one district court, and Texas has four. Most federal judges are nominated by the President, confirmed by a majority of the Senate, and entitled to serve for life during good behavior.[53]

All of the district courts are grouped into 13 circuits. Each circuit has a court of appeals, which hears appeals from the trial courts. Courts of appeals do not retry the case; instead, they review the record to determine whether the trial court made errors of law. Generally, a panel of three judges from the circuit hears appeals. Decisions of the court of appeals establish precedents for all district courts in the circuit. For the most part, the decisions of these *circuit courts of appeals* are final. In a very few cases, the parties can appeal to the U.S. Supreme Court.

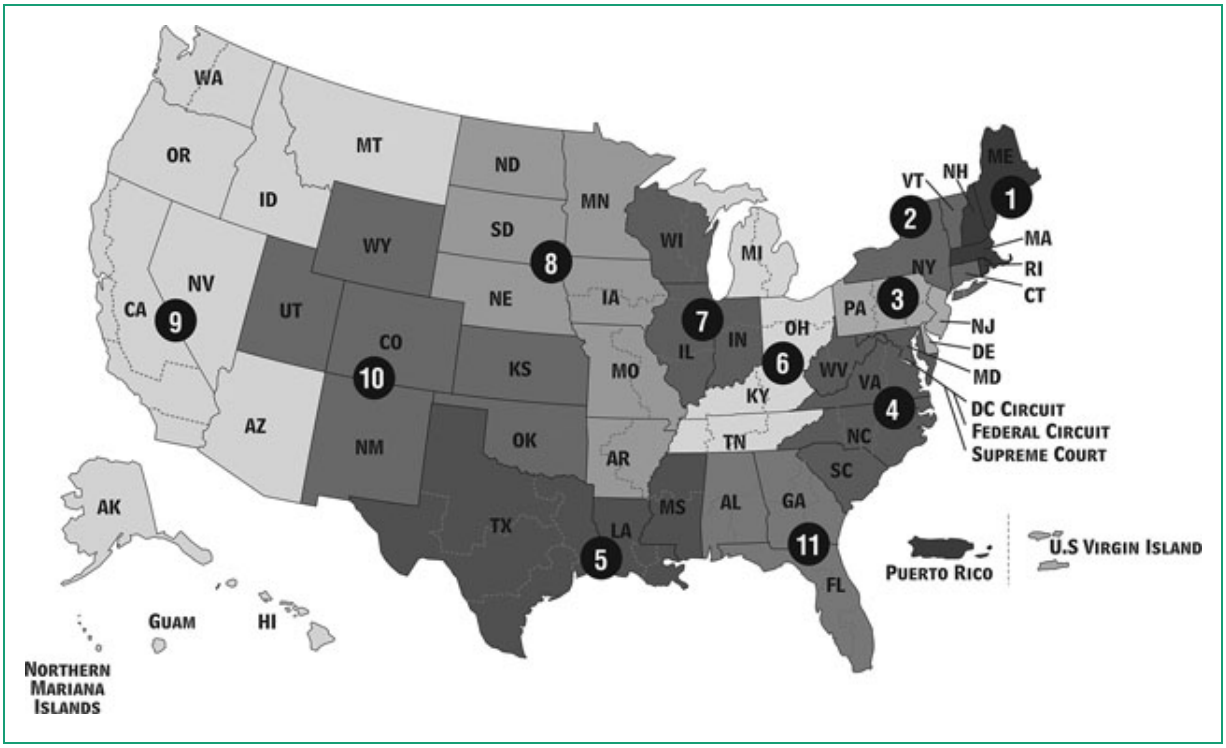
The 13 federal judicial circuits and their seats are: First: Boston, Massachusetts; Second: New York, New York; Third: Philadelphia, Pennsylvania; Fourth: Richmond, Virginia; Fifth: New Orleans, Louisiana; Sixth: Cincinnati, Ohio; Seventh: Chicago, Illinois; Eighth: St. Louis, Missouri; Ninth: San Francisco, California; Tenth: Denver, Colorado; Eleventh: Atlanta, Georgia; Twelfth: District of Columbia,

Washington, D.C.; and Thirteenth: Federal Circuit, Washington, D.C. For details on the 13 federal judicial circuits, see Exhibit 3.5.

Exhibit 3.6 describes how the federal courts are related to each other. There are three basic levels, the U.S. district courts (the trial courts in the federal system), the U.S. court of appeals, and the U.S. Supreme Court. Federal agencies are not courts; however, they often perform court-like functions, also called *quasi-judicial* functions. They are shown in Exhibit 3.6 to illustrate the appeal "path" from the agency to the court system.

Exhibit 3.5

The Thirteen Federal Judicial Circuits



Source: United States Courts, "Geographic Boundaries of United States Courts of Appeals and United States District Courts," https://www.uscourts.gov/sites/default/files/u.s._federal_courts_circuit_map_1.pdf (last visited Jun. 16, 2025).

The Supr eme Cour t

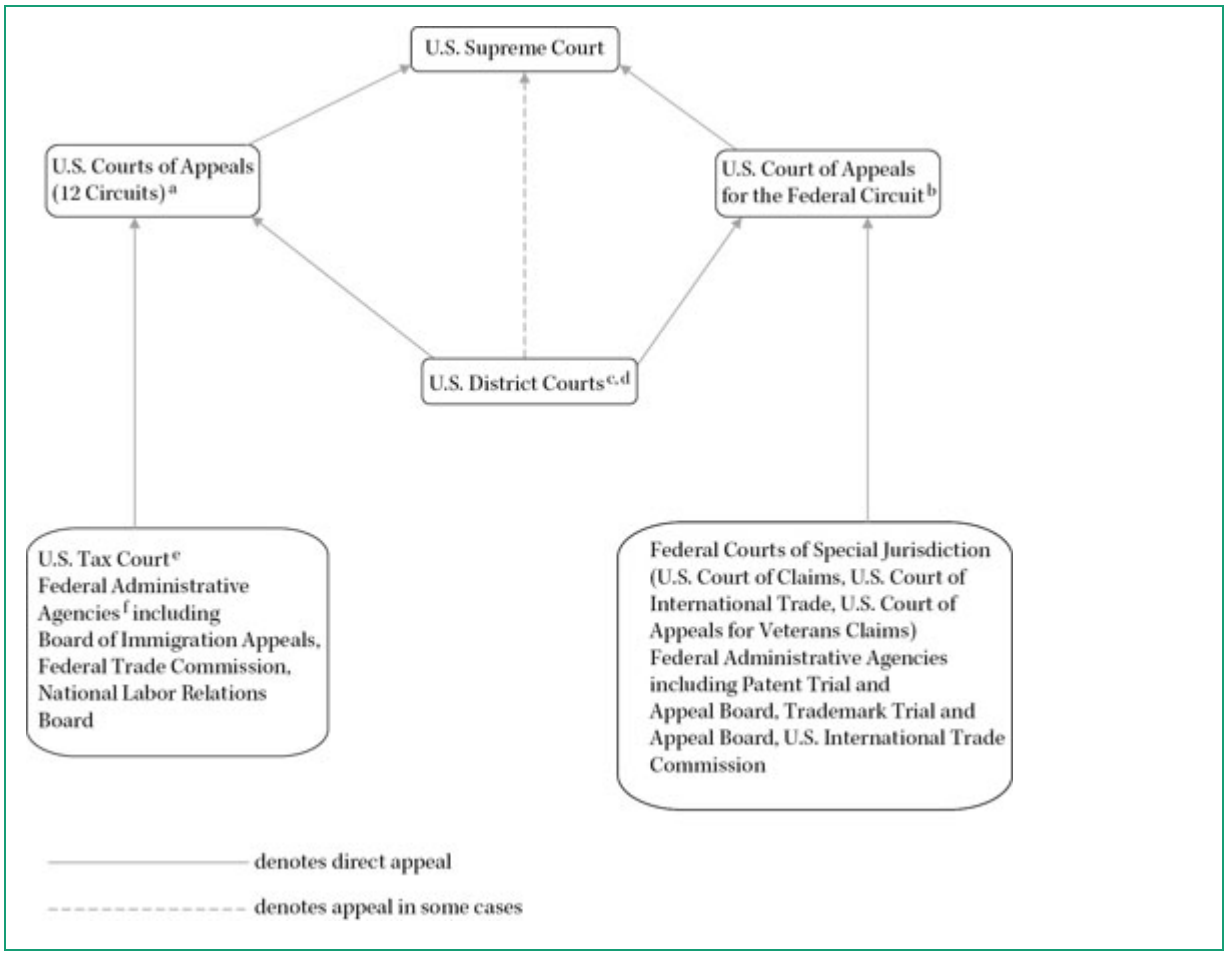
The Sup reme Cour t sits at the top of the U.S. judicial system. It is the only co ur t cr eated by the Constitution. The Constitution does not specify the number of judges, called Justices, on the Supr eme Cour t. The Supr eme Cour t is led by the Chief Justice, and it has eight Associate Justices by statute. [54] The Justices, including the Chief Justice, ar e nominated by the Pr esident and confirmed by a majority of the Senate, and the y ar e entitled to ser ve for life du ring good beha vior .[55]

As pr eviously m entioned, cer tain cases ma y be appealed to the Supr eme Cour t. Howe ver, the Cour t ma y affirm a cas e routinely without permitting oral ar guments or formally considering the case. The Co ur t is mor e lik ely to h ear a case under one of the following conditions:

- Whene ver the highest state cour t declar es a federal law inv alid
- Whene ver the highest state cour t v alidates a state law that is challenged based on a f ederal law

Exhibit 3.6

The F ederal Judicial System



[a] Includes District of Columbia Cir cuit.

[b] T ak es appeals fr om some specializ ed cour ts.

[c] Bankruptcy cour ts exist as units of the district cour ts.

[d] Appeals fr om some f ederal agencies go t o the U.S. district cour ts.

[e] In some cases, ther e is Supr eme Cour t r eview .

[f] Administrativ e agencies per form cour t-lik e functions; howe ver, the y ar e not cour ts.

- Whene ver a federal cour t declar es a federal statute unconstitutional and the go vernment was a par ty to the suit
- Whene ver a federal appellate cour t declar es a state statute inv alid on the gr ounds that it violates f ederal law

- Whenever a federal three-judge court decides a civil case involving an equitable remedy

Certiorari Even when there is no right of appeal, the Supreme Court can hear cases under certiorari. *Certiorari* means "to be more fully informed." When the Supreme Court decides to grant *certiorari*, it issues a writ that orders the lower court to certify a record of the proceedings and send it to the Supreme Court. A minimum of four Justices must agree to hear the case on *certiorari.* Other than that requirement there are no hard and fast rules. However, there are certain situations in which the Supreme Court is more likely to grant *certiorari*:

- Whenever two or more circuit courts of appeals disagree with respect to the same legal issue
- Whenever the highest state court has made a decision that conflicts with prior decisions of the U.S. Supreme Court
- Whenever the highest state court has decided a question that has not yet been determined by the U.S. Supreme Court
- Whenever a circuit court of appeals has decided a state law question that appears to be in conflict with established state law
- Whenever a circuit court of appeals has decided a federal question that has not yet been decided by the U.S. Supreme Court

Original Jurisdiction The Supreme Court also has original jurisdiction in several types of cases or controversies. When the Supreme Court exercises its *original jurisdiction*, it serves as a trial court. Article III, Section 2 of the Constitution declares that the Supreme Court shall have original jurisdiction "[i]n all cases affecting ambassadors, other public ministers and consuls, and those in which a state shall be a party."

State Courts

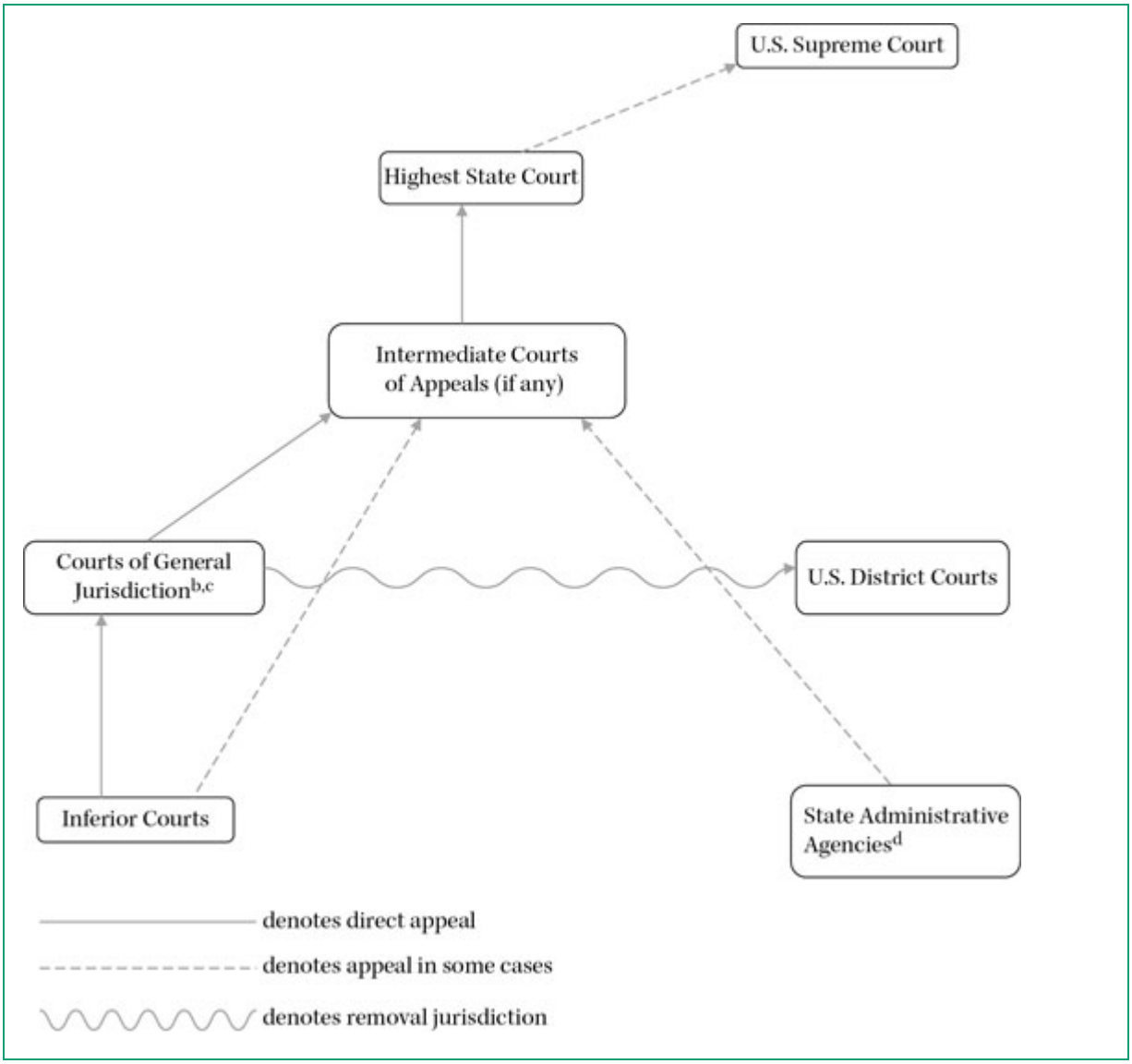
Like the federal system, most states have three basic levels: trial courts, courts of appeals, and a supreme court. The names of the courts vary from state to state. States also have *inferior trial courts*. These may include municipal courts, juvenile courts, domestic relations courts, traffic courts, small claims courts, probate courts, and justice courts presided over by justices of the peace. (Historically, justices of the peace were not required to be lawyers. Many states have changed their rules and now require new justices of the peace to be lawyers.) For the most part, inferior trial courts are not *courts of record*—that is, they make no record or transcript of the trial. In cases of appeals from their decisions, there is a *trial de novo*, a new trial, in a regular trial court.

Usually, the more significant cases involving matters of state law begin in *courts of general jurisdiction* (courts having unlimited or almost unlimited trial jurisdiction in civil and criminal cases). In some jurisdictions, two courts exist at this level. One court is charged with resolving all questions of law and the other with resolving all matters of equity. An example of a question of law is a suit seeking money damages. Most business law cases fall into this category. Equity suits, on the other hand, are those in which the plaintiff is seeking a special remedy, such as an *injunction* (a writ issued by the court of equity ordering a person to do or not do a specified act), because monetary damages will not make the plaintiff "whole."

Each state has at least one court of appeals. The highest court of appeals is usually called the supreme court. There are exceptions. In New York State, for example, the Court of Appeals is the highest court in the state. New York also labeled some of its trial courts as Supreme Courts and labeled some of its appeals courts as Appellate Terms of the Supreme Court.[56] Sometimes intermediate courts of appeals also exist, as in the federal system. These appellate courts review the trial court record to determine whether the lower court made any errors of law. Appellate courts do not usually review decisions of facts made by the lower court. Some appellate courts hold trials *de novo*, which are exceptions to this general rule.

Exhibit 3.7

The T ypical State Judicial Systema



[a] Ther e is gr eat variation among the states. The titles of the cour ts var y fr om state t o state.

[b] The state trial cour ts ma y be divided int o divisions—for examp le, the civil division, the criminal division, and family cour t.

[c] Removal jurisdiction generally is exercised when the defendant asks that a case filed in one court be moved to another court.

[d] Administrative agencies perform some court-like functions; however, they are not courts.

An example of a case history is *Bennis v. Michigan.*[57] It was originally decided by the Wayne County Circuit Court, then appealed (in this order) to the Michigan Court of Appeals, the Michigan Supreme Court, and then the U.S. Supreme Court.

Exhibit 3.7 describes a typical state system and its interrelationship with the federal system. State agencies, like federal agencies, are not courts; a person can appeal an unfavorable agency decision to the intermediate court of appeals in most states.

HOW TO FIND THE LAW

We have already referred to some legal cases in this and previous chapters. Other cases will be cited in later chapters. If you want to go to the library and read these or other cases in their entirety, you will need to know how to find the law.

Federal Court Cases

If you are looking for the Classic Case of *International Shoe Co. v. State of Washington*, 326 U.S. 310, 90 L. Ed. 95, 66 S. Ct. 154 (1945), for example, you will find it in any one of three sources. The case citation tells you where to look. The first number is the volume, the letters designate the reporter, and the second number is the page on which the opinion begins. The first citation tells you that the opinion is found in volume 326 of the *United States Reports* (published by the U.S. Government Printing Office) on page 310. The case can also be found on page 95 of volume 90 of *Lawyers Edition*, published by the Lawyers Cooperative Publishing Company, or in volume 66 of the *Supreme Court Reporter*, which is published by West Publishing Company, at page 154.

Reported cases decided by the circuit courts of appeals are found in the *Federal Reporter*, abbreviated "F." U.S. District Court cases are

found in the *Federal Supplement Series*, abbreviated "F. Supp." Both use the same format of volume, abbreviation for the books, and page number. If the name of the book is followed by "4th," that means that it is in the fourth series. The title of the court and the year of the decision generally follow in parentheses.

State Court Cases

State court decisions are reported using the same format. States generally also have their own system for publishing cases. In addition, West Publishing Company publishes reporters for some states, and they publish reporters for different regions.

Computerized Legal Research

There are three digital databases for legal research—LexisNexis, Loislaw Libraries on Fastcase, and Westlaw. The search techniques are similar, although the particular computer commands vary. These systems allow you to indicate what material you wish to search and to enter keywords for search terms. If your search terms are not appropriate or are too broad, you may not locate the desired material. Some historical cases may not have been added to the database. Increasingly courts are publishing their own decisions online. There are also several sites on the internet that contain articles on the law, court cases, and government activity. You should be careful since websites are not generally subject to review, so their information may be incorrect or out of date.

Contemporary Case

In this Contemporary Case, the Court of Appeals is deciding whether the creation of the trust and the appointment of Nicholas Fugedi, a citizen of Michigan, as its trustee was a sham to create diversity of citizenship jurisdiction in the federal courts. The underlying dispute is

about the ownership of real property in Texas. The defendants and the beneficiaries of the trust are residents of Texas.

FUGEDI v. INITRAM, INCORPORATED

150 F. 4th 690 (5th Cir. 2025)

FACTS Nicholas Fugedi, as trustee for the Carb Pura Vida Trust, sued to quiet title to the property in Texas. (A *quiet title action* asks the court to declare the plaintiff the owner of the property against other claimants.) In this part of the litigation, the district court decided that Fugedi had been appointed as a sham trustee in order to manufacture diversity jurisdiction in contravention of 28 U.S.C. §1359. The case is now before the federal court of appeals.

ISSUE Can a party create diversity of citizenship by creating a sham trust and appointing an out-of-state trustee?

HOLDING No. Parties cannot use sham transactions to create diversity.

REASONING Excerpts from the opinion of Judge Duncan:

We again consider this "contentious" and "convoluted" dispute over real property located . . . in Houston, Texas. . . . The main issue this time around is whether a trust can be used as a device to improperly manufacture diversity jurisdiction in violation of 28 U.S.C. §1359. . . . We review a dismissal for lack of subject matter jurisdiction *de novo*. . . . To the extent the ruling depends on the district court's resolution of disputed jurisdictional facts, we review those findings for clear error. . . .

Fugedi argues the district court erred because 28 U.S.C. §1359 does not apply to a trust. We disagree.

Section 1359 provides:

> A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court.

"The purpose of [§1359 is] to prevent agreements whose primary aim [is] to vest the court with a jurisdiction it had not formerly enjoyed." . . . ("If federal jurisdiction could be created by assignments of [a collusive] kind . . . , then a vast quantity of ordinary contract and tort litigation could be channeled into the federal courts at the will of one of the parties. Such 'manufacture of Federal jurisdiction' was the very thing which Congress intended to prevent when it enacted §1359 and its predecessors." . . . [T]he language of §1359 does not support Fugedi's argument. It forbids manufacturing diversity jurisdiction "by assignment or otherwise." Nothing in those words excludes the use of a trust. Fugedi counters that a trust does not involve an "assignment." But, even assuming that's true, it doesn't matter. The provision says "assignment *or otherwise.*"

Nor does the nature of a trust suggest it couldn't serve as a vehicle for collusively creating diversity jurisdiction. When a trustee sues, only his citizenship matters for diversity purposes. . . . So, if someone wanted to concoct diversity in a property dispute, one way would be to create a trust to manage the property and choose a trustee with citizenship different from everyone on the other side of the *v.* That's the kind of skulldugger y §1359 is designed to prevent. . . . As the district court pointed out: "The Supreme Court has expressly contemplated that an 'allegation of sham or collusion' warrants looking beyond the trustee's citizenship." . . . Two circuit courts have done the same. . . . "[W]hile [§1359] does not ban the appointment of nonresident fiduciaries, the artificial selection of a straw representative who has no duty or function except to offer the use of his citizenship to create diversity in contemplated litigation is a violation of its provisions."

Accordingly, we reject Fugedi's argument that 28 U.S.C. §1359 cannot apply to a trust.

Fugedi also argues that even if §1359 applies to a trust, the district court erred in finding the trust was improperly or collusively made to invoke federal jurisdiction. We disagree. The court made numerous findings supporting its conclusion that Fugedi was improperly appointed as a sham trustee to create diversity jurisdiction that would otherwise have been lacking. For instance, the court found that: Fugedi had met Elberger (the trust's beneficiary) less than two months before being appointed trustee; Fugedi does only what his attorneys tell him to do such that he seemingly does not control the trust; Fugedi has no special experience to qualify him as trustee; . . . there is no credible non-collusive reason to select an out-of-state trustee; and the suit is wholly local in nature. . . . On appeal, Fugedi makes no serious attempt to show the district court erred, clearly or otherwise, in making any of these findings.

The district court's judgment is AFFIRMED.

You Be the **Judge**

James Ethridge is a Texas resident (domiciliary). He purchased a Samsung 18650 lithium-ion battery from a Wyoming-based seller on Amazon. The record does not describe how the seller obtained the battery or delivered it to Ethridge.

Ethridge was injured when the lithium-ion battery in his e-cigarette exploded and caught fire in his pants pocket. Ethridge was in Texas when the device exploded and injured him. Ethridge sued several defendants, including the manufacturer of the battery, in Texas state court. Subsequently, the case was removed to federal court based on diversity jurisdiction. Ethridge claimed product liability, breach of warranty, and gross negligence. Samsung moved to have the case against it dismissed due to lack of personal jurisdiction over it.

Samsung SDI (Samsung) is not incorporated in Texas. It is a South Korean corporation. Its principal place of business is South

Korea. It does not have a physical presence in the United States. It has subsidiaries and distribution companies which is uses to serve its U.S. customers. Samsung sells 18650 batteries directly to Texas companies (like Dell, HP, and Black & Decker). Samsung also sells 18650 batteries to qualified businesses in Texas; these businesses generally use them in battery packs. Samsung does not sell directly to Texas consumers.

The Texas long-arm statute says the state has jurisdiction as long as jurisdiction is constitutional. Assume that this case has been filed in *your* court of appeals. How would *you* decide this case? Be certain that you explain and justify your answer. Does the State of Texas have personal jurisdiction over Samsung? Why or why not? Would the exercise of personal jurisdiction comply with the Fourteenth Amendment's conceptions of fair play and substantial justice? Why or why not? Does Texas have general personal jurisdiction or specific personal jurisdiction? [See *Ethridge v. Samsung SDI Company, Limited*, 137 F.4th 309 (5th Cir. 2025).]

Summary

- The U.S. government is divided into three distinct branches: legislative, executive, and judicial.
- Administrative agencies also play an important role.
- Federal courts cannot issue advisory opinions, decide moot cases, or decide political questions.
- Plaintiffs must have standing to sue in court.
- The doctrine of judicial review allows the federal courts to determine whether a statute passed by Congress or the action of the executive branch is constitutional.
- Courts must have subject matter jurisdiction and jurisdiction over the persons or property.
- There are three techniques to obtain jurisdiction over persons or property— *in personam, in rem*, and *quasi in rem.*
- Courts can have exclusive or concurrent jurisdiction based on whether there is only one potential forum or multiple forums.

- A federal district court's jurisdiction can be based on either (1) a federal question or (2) diversity of citizenship, plus a minimum amount in controversy.

Discussion Questions

1. There have been several recent cases where legislators, judges, and their families have been assaulted or killed.[58] Ask AI how the United States could protect its government officials. Analyze the results from the AI. Do you think AI's suggestions would provide additional protection to these individuals? Why or why not? What are the limitations to the AI's proposals?

2. Should AI be regulated at the federal level, state level, or both? Why? Do we have any U.S. laws that inform us who is entitled to regulate AI? If so, what are they?[59]

3. Does Congress have the authority to impose a Code of Conduct on the U.S. Supreme Court Justices? Why or why not? If you were creating a Code of Conduct for the Justices (either as a member of the Senate or a member of the Court), what would you include in it? Why? What conduct by the Justices or their family members might concern the public? Why? What type of gifts might be a concern? Why?

4. Assume that you are a congressional aide. Your Senator has asked you to find out the purpose of a specific federal agency. Where would you go to discover this information? Why would that be a good source of information?

5. Courts have acknowledged that specific personal jurisdiction is not the clearest legal doctrine.[60] Do clear legal doctrines benefit businesses? Why or why not?

Case Problems and Writing Assignments

1. Louisiana passed a statute, H.B. 71, that required public schools to permanently display a specific protestant version of the Ten Commandments [61] in every classroom in the state. Louisiana requires students to attend school. H.B. 71 was scheduled to go into effect January 1, 2025, requiring "that the Ten Commandments be displayed (1) in every public school classroom in the state (2) on a poster subject to comparable minimum size requirements (3) with context statements purporting to describe the historical basis for each display. . . ."[62] The statute did not integrate the Ten Commandments into the curriculum. There is a "minimum requirement that the Ten Commandments shall be displayed on a poster or framed document that is at least eleven inches by fourteen inches. The text of the Ten Commandments shall be the central focus of the poster or framed document and shall be printed in a large, easily readable font."[63] The posters can be financed by private donations.

"Parts of the Ten Commandments include basic principles regarding criminal conduct that are part of a civilized society, such as the prohibition against murder. However, they come from religious texts and include commandments that have clear religious import, such as requiring worship of one God and keeping the Sabbath holy. Their display in public school classrooms . . . qualifies as a religious display."[64]

"Courts are 'normally deferential to a [legislative] articulation of a secular purpose.' . . . But an alleged secular purpose 'must be sincere,' and not 'merely a sham.' . . . When "undertaking a 'sham' inquiry, . . . [the courts] consider whether the challenged action furthers the particular purposes articulated by the legislature or whether the challenged action contravenes those avowed purposes."[65] H.B. 71's legislative purpose states:

> It is the Legislature's intent to apply the decision set forth by the Supreme Court of the United States in . . . [precedents], to continue the rich tradition [of including the Ten Commandments in the education of our children] and ensure that the students in

> our public schools may understand and appreciate the foundational documents of our state and national government. [66]

However, statements made during the legislative debate support a religious objective.[67] "It is also unclear how H.B. 71 ensures that students in Louisiana public schools 'understand and appreciate the foundational documents of [its] state and national government' when it makes displaying those 'foundational' documents optional, and does not require that they also be printed in a large, easily readable font."[68]

A group of multi-faith and non-religious Louisiana parents and students filed a lawsuit requesting an injunction. They want to stop Louisiana from implementing H.B. 71. Is this dispute ripe for a decision? A case is not ripe when it is abstract or hypothetical. Do the plaintiffs have standing to file this suit? Does H.B. 71 violate the Establishment Clause and Free Exercise Clause of the First Amendment? [See *Roake v. Brumley,* 141 F. 4th 614 (5th Cir. 2025). The court of appeals has vacated its decision, and all the eligible members of the court are going to rehear it in the future. *Roake v. Brumley,* 154 F. 4th 329 (5th Cir. 2025).]

2. The California State Legislature concluded that lesbian, gay, bisexual, transgender, queer, and questioning youth confront various forms of discrimination. Consequently, the Legislature passed Assembly Bill 1955. One of the provisions in the bill prohibits California public schools from revealing to any third party (including parents), when a child goes by a different name or gender pronoun in school without that child's permission. Plaintiffs are a group of parents and school entities that want to challenge this provision of Assembly Bill 1955. In this Case Problem, we are concerned with the Parent Plaintiffs. Parent Plaintiffs have children enrolled in California public schools. They are "devout Christians and believe that God created man and woman as distinct, immutable genders."[69] They argue that the Assembly Bill violates their First Amendment rights, because it unduly restricts parents' ability to find out about their children's gender identity or gender expression at school. The policy

has not actually been applied to the children of Parent Plaintiffs. There is no indication that their children will fall in the group protected by this statute.

"Standing under Article III of the U.S. Constitution has three basic elements: the Plaintiff must have suffered: (1) an "injury in fact"; (2) which is fairly traceable to or caused by the defendant's offensive conduct; and (3) which is likely to be redressed by a favorable decision. "[70] Do the Parent Plaintiffs have standing under Article III so that their lawsuits can be heard in federal court? Why or why not? Be sure to explain and justify your answer. [See *Chino Valley Unified School District v. Newsom*, 2:24-cv-01941-DJC-JDP, Slip Copy, 2025 WL 1151004 (E.D. CA Apr. 17, 2025).]

3. In 2025 President Trump signed Executive Order No. 14160 (the Citizenship Order).[71] Its language limits the situations in which a person born in the United States is a U.S. citizen. The plaintiffs are individuals, organizations, and States which filed three separate lawsuits in U.S. district courts to enjoin the implementation and enforcement of the executive order. The plaintiffs claim that the executive order violates the Fourteenth Amendment's Citizenship Clause §1 and §201 of the Nationality Act of 1940. Each district court concluded the executive order is probably unlawful. Each district court granted a preliminary injunction stopping various federal officials from applying the policy to *anyone* in the country. (A *preliminary injunction* is a temporary order that bars people from taking action until the merits of the dispute can be resolved. It is granted by a court after holding a hearing. It is granted to parties who will suffer irreparable injury and who are likely to win on the underlying arguments (merits).) This is called a universal preliminary injunction (also a nationwide or national preliminary injunction), because it applies to everyone in the United States. One district court justified its universal preliminary injunction this way:

> Only a nationwide injunction will provide complete relief to the plaintiffs. ASAP [one of the groups before the court] has "over 680,000 members . . . who reside in all 50 U.S. states and several

> U.S. territories." . . . ASAP expects that "[h]undreds or even thousands of ASAP members will give birth to children in the United States over the coming weeks and months." . . . Because ASAP's members reside in every state and hundreds of them expect to give birth soon, a nationwide injunction is the only way "to provide complete relief" to them. [72]

In each case, the executive branch appealed to the appropriate court of appeals asking those courts of appeals to stop the universal preliminary injunctions. The courts of appeals denied the executive branch's requests agreeing that the Executive Order is probably unconstitutional. [73] Then the executive branch filed three emergency applications to the Supreme Court, one for each lawsuit. The executive branch claimed that the federal courts did not have authority to prevent the executive branch officials from enforcing the President's executive order in this manner. The government asks for a partial stay of the injunctions limiting the injunctions to the parties before the District Courts. The executive branch does not raise the question of whether the executive order violates the Citizenship Clause or Nationality Act. Assume that you are sitting on the Supreme Court and you are called upon to decide this case. What is the authority of the district courts? What should be their authority? What would you decide and why? Be sure to explain your reasons. [See *Trump v. CASA, Inc.*, 606 U.S. 831 (2025). [74]]

Notes

1. Cornell Law School, Legal Information Institute, "Emergency Powers," updated Nov. 2022, https://www.law.cornell.edu/wex/emergency_powers (last visited Jun. 23, 2025). The authority of state governors also can expand during emergencies. For example, see National Conference of State Legislatures, "Legislative Oversight of Emergency Executive Powers," Sep. 22, 2023, https://www.ncsl.org/about-state-legislatures/legislative-oversight-of-emergency-executive-powers (last visited Jun. 23, 2025).
2. *Marbury v. Madison*, 5 U.S. 137 (1803). *Marbury v. Madison* is also the Classic Case in Chapter 5.
3. Citations deleted. *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-241 (1937).
4. *Black's Law Dictionary* 54 (6th ed. 1990).
5. *Id.* at 1008.

6. *Id.* at 1045.
7. *Id.* at 1158.
8. *DeFunis v. Odegaard*, 416 U.S. 312 (1974).
9. Endangered Species Act of 1973 (ESA), 16 U.S.C. §1540(g); and *Bennett v. Spear*, 520 U.S. 154 (1997).
10. *Marbury v. Madison*, *supra* Note 2.
11. Supreme Court of the United States, "Current Members," https://www.supremecourt.gov/about/biographies.aspx (last visited Jun. 21, 2025).
12. Sheila M. Smith, "Comment: Justice Ruth Bader Ginsburg and Sexual Harassment Law: Will the Second Female Supreme Court Justice Become the Court's Women's Right Champion?," 63 U. Cin. L. Rev. 1893 (1995).
13. Lawrence Hammack, "Supreme Court Takes Closer Look at Virginia Ban on Cross Burning," *Roanoke Times*, Dec. 12, 2002.
14. *Ortiz v. Fibreboard Corporation*, 527 U.S. 815 (1999).
15. There is a lot of commentary and opinion about the proper role of judges. "Dean John Henry Wigmore . . . noted in 1917 that common-law judges were constantly making law, and 'our own Supreme Courts have long been drawing copiously and consciously from this unbounded field of public policy.' " Carol Nackenoff, "Privacy, Police Power, and the Growth of Public Power in the Early Twentieth Century: A Not So Unlikely Coexistence," 75 Md. L. Rev. 312, 322, 323 (2015). See also Richard Lavoie, "Issues Facing the Judiciary: Activist or Automaton: The Institutional Need to Reach a Middle Ground in American Jurisprudence," 68 Alb. L. Rev. 611 (2005).
16. For example, see Code of Conduct for United States Judges, Mar. 12, 2019, https://www.uscourts.gov/file/25752/download (last visited Jun. 24, 2025) and Rules of the Chief Administrative Judge, Part 100: Judicial Conduct, NYCourts.gov, https://ww2.nycourts.gov/rules/chiefadmin/100.shtml (last visited Jun. 24, 2025).
17. Supreme Court of the United States, Statement of the Court, Regarding the Code of Conduct, Nov. 13, 2023, https://www.supremecourt.gov/about/Code-of-Conduct-for-Justices_November_13_2023.pdf (last visited Jun. 24, 2025).
18. Senators reintroduced the Supreme Court Ethics, Recusal, and Transparency (SCERT) Act in the belief that the Supreme Court's Code was not adequate. Tim Kaine's Website, "Kaine, Colleagues Introduce Bill to Require Supreme Court to Adopt Binding and Enforceable Code of Ethics," May 30, 2025, https://www.kaine.senate.gov/press-releases/kaine-colleagues-introduce-bill-to-require-supreme-court-to-adopt-binding-and-enforceable-code-of-ethics (last visited Jun. 24, 2025).
19. *Black's Law Dictionary* 601 (7th ed. 1999).
20. Habeas corpus can be used in immigration detention cases. See Trina Realmuto and Kristin Macleod-Ball, "Nuts and Bolts of Habeas Corpus Petitions, Challenging Immigration Detention," Practice Advisory, Copyright ©2021, National Immigration Litigation (NILA) and Children's Immigration Law Academy of the American Bar Association (CILA), Jul. 31, 2021, https://www.immigrationlitigation.org/wp-content/uploads/2021/08/Practice-Advisory-Nuts-and-Bolts-Imm-Detention-Habeas.pdf (last visited Jun. 24, 2025).
21. *Supra* note 19.
22. *Brown v. Entertainment Merchants Association*, 564 U.S. 786 (2011).
23. *Free Speech Coalition, Inc. v. Paxton*, 606 U.S. 461 (2025). The Court used the intermediate scrutiny test which will be discussed in Chapter 5.

24. The constitutional requirements for a jury trial under the Seventh and Fourteenth Amendments are outside the scope of this text. See *Securities and Exchange Commission v. Jarkesy*, 603 U.S. 109 (2024).
25. It is possible to explain the difference between procedure and substance. However, the Court has acknowledged that the demarcation is difficult. Recently the Supreme Court, quoting precedents, has said, "The line between procedural and substantive law is hazy." . . . Many rules "are rationally capable of classification as either." *Moore v. Harper*, 600 U.S. 1, 23-24 (2023).
26. For example, see Brandon Marc Draper, "And Justice for None: How COVID-19 Is Crippling the Criminal Jury Right," 62 B.C. L. Rev. E-Supplement I.-1 (Aug. 28, 2020); and National Association of Criminal Defense Lawyers (NACDL), "Criminal Court Reopening and Public Health in the COVID-19 Era," 44-MAY *Champion* 46 (May, 2020).
27. *City of Ontario, California v. Quon*, 560 U.S. 746, 753 (2010).
28. *Id.*
29. Choe Sang-Hun, "Mixed Emotions over Deft Imitator," *The International Herald Tribune*, Sep. 3, 2012; and Kim Tae-Jong, "Wharton Director Says Apple Claims Unreasonable," *Korea Times*, Sep. 7, 2012.
30. 36 Am. Jur. 2d Foreign Corporations §418 and 36 Am. Jur. 2d Foreign Corporations §419.
31. *International Shoe Co. v. State of Washington*, 326 U.S. 310 (1945).
32. Some states have similar statutes for nonresidents who operate aircraft in the state.
33. See *Wheelbarger v. Detroit Diesel ECM, LLC*, 978 N.W.2d 334 (Neb. Ct. App. 2022).
34. See *Skidmore v. Led Zeppelin*, 106 F. Supp. 3d 581 (E.D. Pa. 2015).
35. 62B Am. Jur. 2d *Process* §160.
36. When the courts write about passive and interactive websites, it is a legal term. It has nothing to do with how the website functions internally. 15B Am. Jur. 2d Computers and the Internet §171.
37. *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997). The sliding scale in *Zippo* has created several inconsistencies. It has been argued that the sliding scale does not provide effective notice to the public and consequently violates due process. "Without consistency in common law how can an internet user 'structure [his or her] primary conduct with some minimum assurance as to where that conduct will and will not render [him or her] liable to a suit[?]' " (citations deleted). Emily Ekland, "Comment: Scaling Back *Zippo*: The Downside to the *Zippo* Sliding Scale and Proposed Alternatives to Its Uses," 5 Alb. Gov't L. Rev. 380, 381-382 (2012). This continues to be an issue. For some recent discussions of the problem, see Justin Angotti, Comment, "Everywhere and Nowhere: Reframing Personal Jurisdiction to Meet the Realities of an Increasingly Boundaryless Society," 28 Geo. Mason L. Rev. 1513 (Summer 2021); Jenny Bagger, Note, "Dropping the Other Shoe: Personal Jurisdiction and Remote Technology in the Post-Pandemic World," 73 Hastings L.J. 861 (Apr. 2022); and Celia Kaechele, "Traditional Notions of Fair Play and Substantial Justice in the Age of Internet Interconnectivity: How Masking an IP Address Could Constitute Purposeful Availment," 21 Yale J.L. & Tech. 59 (2019).
38. 15B Am. Jur. 2d Computers and the Internet §170.
39. 15B Am. Jur. 2d Computers and the Internet §171.
40. See *Doshier v. Twitter, Inc.*, 417 F. Supp. 3d 1171 (E.D. Ark. 2019).
41. 32A Am. Jur. 2d Federal Courts §912.
42. *Mims v. Arrow Financial Services, LLC*, 565 U.S. 368 (2012).
43. 32A Am. Jur. 2d Federal Courts §912.

44. 74 Am. Jur. 2d Trademarks and Tradenames §142.
45. 32A Am. Jur. 2d Federal Courts §912.
46. States have authority to enact and enforce their own antitrust legislation when the antitrust behavior has significant local consequences. The contract, conspiracy, or monopoly may actually occur outside the state. When a combination affects interstate *and* intrastate commerce, federal control over the interstate part does not prevent state control over the intrastate aspects. See Am. Jur. 2d Monopolies, Restraints of Trade, Unfair Trade Practices §793.
47. *Id.*
48. *Id.*
49. *Id.*
50. State courts do not have jurisdiction over any cases brought under federal patent law. 60 Am. Jur. 2d Patents §816.
51. 28 U.S.C. §1332(a).
52. *Fugedi v. Initram, Incorporated,* 150 F. 4th 690 (5th Cir. 2025).
53. This applies to federal judges serving on the Supreme Court, the federal courts of appeals, the federal district courts, the U.S. Court of Claims, and the U.S. Court of International Claims. These judges are called Article III judges. Article III judges serve "during good behavior." They cannot have their salaries reduced. Federal Judicial Center, "Part 2: How the Federal Courts Are Organized," https://fjc.adobeconnect.com/p2xcfge0oq8z/ (last visited Jun. 23, 2025); Federal Judicial Center, "The U.S. Legal System: A Short Description [English Original]," Federal Judicial Center, Aug. 4, 2014, https://www.fjc.gov/content/us-legal-system-short-description-english-original (last visited Jun. 23, 2025); United States Courts, "About Federal Judges," https://www.uscourts.gov/about-federal-courts/types-federal-judges (last visited Jun. 23, 2025); and United States Courts, "FAQs: Federal Judges," https://www.uscourts.gov/about-federal-courts/about-federal-judges/types-federal-judges/faqs-federal-judges (last visited Jun. 23, 2025).
54. The number of Associate Justices is established in 28 U.S.C. §1. Cornell Law School, Legal Information Institute, "28 U.S. Code §1. Number of Justices; Quorum," https://www.law.cornell.edu/uscode/text/28/1 (last visited Jun. 23, 2025).
55. Supreme Court, "FAQs-General Questions," https://www.supremecourt.gov/about/faq_general.aspx (last visited Jun. 23, 2025).
56. New York uses "Supreme" in the labels of several of its courts. See NYCOURTS.GOV, The Courts—General Information, Structure of the Courts, updated Aug. 3, 2023, https://www.nycourts.gov/courts/structure.shtml (last visited Nov. 9, 2025).
57. *Bennis v. Michigan*, 516 U.S. 442 (1996).
58. Meg Anderson, Rachel Treisman, and Russell Lewis, "The Suspect in the Shooting of 2 Minnesota Lawmakers Had a 'Hit List' of 45 Officials," *NPR*, updated Jun. 16, 2025, https://www.npr.org/2025/06/16/nx-s1-5433748/minnesota-shooting-suspect-vance-boelter-arrested-melissa-hortman-john-hoffman (last visited Jun. 23, 2025) and Ben Kesslen, "The Attack on Judge Salas' Family Highlights Concerns Over Judicial Safety," *NBC News*, Jul. 21, 2020, https://www.nbcnews.com/news/us-news/attack-judge-salas-family-highlights-concerns-over-judicial-safety-n1234476 (last visited Jun. 23, 2025).
59. Andrew R. Lee, Jason M. Loring, and Graham H. Ryan, "US House of Representatives Advance Unprecedented 10-Year Moratorium on State AI Laws," The National Law Review, May 28, 2025, https://natlawreview.com/article/us-house-representatives-advance-unprecedented-10-year-moratorium-state-ai-laws (last visited Jun. 29, 2025) and U.S.

Senate Committee on Commerce, Science & Transportation, Press Releases, "State Attorneys General Tell Congress: AI Moratorium Will Leave Consumers, Citizens Vulnerable to AI Fraud, Theft & Other Harms," Jun. 18, 2025, https://www.commerce.senate.gov/2025/6/state-attorneys-general-tell-congress-ai-moratorium-will-leave-consumers-citizens-vulnerable-to-ai-fraud-theft-other-harms (last visited Jun. 29, 2025).

60. *Ethridge v. Samsung SDI Company, Limited*, 137 F.4th 309, 319 (5th Cir. 2025).
61. According to the Louisiana statute H.B. 71, the text must read:

> "The Ten Commandments
> I AM the LORD thy God.
> Thou shalt have no other gods before me.
> Thou shalt not make to thyself any graven images.
> Thou shalt not take the Name of the Lord thy God in vain.
> Remember the Sabbath day, to keep it holy.
> Honor thy father and thy mother, that thy days may be long upon the land which the Lord thy God giveth thee.
> Thou shalt not kill.
> Thou shalt not commit adultery.
> Thou shalt not steal.
> Thou shalt not bear false witness against thy neighbor.
> Thou shalt not covet thy neighbor's house.
> Thou shalt not covet thy neighbor's wife, nor his manservant, nor his maidservant, nor his cattle, nor anything that is thy neighbor's." *Roake v. Brumley,* 141 F. 4th 614, 626-627 (5th Cir. 2025).

62. *Id*. at 626.
63. *Id*.
64. *Id*. at 632.
65. *Id*. at 643.
66. *Id*. at 644.
67. Some of the discussion about the bill includes:

- H.B. 71's primary author and sponsor stated during a legislative debate: "It is so important that our children learn what God says is right, and what he says is wrong, and to allow [the Ten Commandments] to be displayed in our classrooms as a visual aid, I believe, especially in this day and time is so important."
- In support of the bill, a co-author of the bill stated, "I really believe that we are lacking in direction. A lot of people, their children, are not attending churches. . . . We need to do something in the schools to bring people back to where they need to be." . . .
- H.B. 71's primary author also stated, "You know, not all children . . . are taught right from wrong. . . . But I believe when I went to school, I learned . . . to know there was a God by reciting the Ten Commandments. . . . I knew what God said was right, and what he said was wrong, . . . not all of us were taught that." . . .
- When asked how a Buddhist or Muslim student would interpret one of the Commandments, the bill's author responded, "Well I'm not Buddhist or Muslim so I'm not really worried about defining it for them. . . . [The Ten Commandments] [are] a model for what's God—it's God's law, and it's universal law." . . .

- Another co-author and co-sponsor of H.B. 71 expressed his support for the law during debate by claiming that those who oppose it are waging an "attack on Christianity" and suggesting that it would provide a religious counterbalance to students' secular education: "My wife is a Christian and if she was a teacher she would be asked to teach evolution which is in complete contradiction with the theory of creation that we believe out of the Bible. . . . I am a parent and am asking for this [bill]." *Id.* at 644.

68. Id. at 645.
69. *Chino Valley Unified School District v. Newsom*, 2:24-cv-01941-DJC-JDP, Slip Copy, 2025 WL 1151004 (E.D. CA Apr. 17, 2025) at *2.
70. *Id.*
71. See Protecting the Meaning and Value of American Citizenship, 90 Fed. Reg. 8449 (2025).
72. ASAP is the Asylum Seeker Advocacy Project. *CASA, Inc. v. Trump*, 763 F. Supp. 3d 723, 746 (D. Md. Feb. 5, 2025).
73. *CASA, Inc. v. Trump,* No. 25-1153, 2025 WL 654902 (4th Cir., Feb. 28, 2025); *Washington v. Trump,* No. 25-807, 2025 WL 553485 (9th Cir., Feb. 19, 2025); and *New Jersey v. Trump,* 131 F.4th 27 (1st Cir. 2025).
74. In this opinion, Justice Sotomayor wrote a dissenting opinion. Justice Kagan and Justice Jackson joined in her dissent.

4

Civil Dispute Resolution

Learning Objectives

After completing this chapter, you should be able to:

- List the stages in a typical civil lawsuit
- Identify the different types of fee arrangements clients can have with their lawyers
- Contrast the types of discovery
- Describe the role of small claims courts
- Recognize the advantages and disadvantages of using alternate dispute resolution
- Compare the different types of alternate dispute resolution

Outline

- Litigation
- Small Claims Courts
- Alternate Dispute Resolution (ADR)

Agenda

Lynn M. Forsythe • Jacquelin J. Curry

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I want to dedicate this book to Daniel Davidson, who has been my co-author on the last four editions of this book. With this edition, I welcome Jacquelin Curry to the author team. I also want to dedicate this book to our students, past, present, and future. I want to thank my family for their encouragement, support, and love, especially Jim and Mike Poptanich and Aileen Zollweg.

—Lynn M. Forsythe

I would like to dedicate this book to Lynn Forsythe. She is an exceptional mentor and writing partner. I am very thankful for her guidance. I also want to dedicate this book to our students who often amaze me with their creativity and resilience. I am thankful to my family for believing in me and encouraging me to pursue my love of writing.

—Jacquelin J. Curry

We dedicate this Fifth Edition to Daniel V. Davidson, who co-authored the first four editions. Dan was a pleasure to work with because of his positive approach to writing. He always stayed true to the mission of the text—to provide a comprehensive business law text that is accessible and engaging for undergraduate students. Dan made many creative contributions to the development and design of the book. He played a significant role in the development of our thread case and You Be the Judge boxes. We are pleased to continue the traditions he started with this edition.

—Lynn M. Forsythe
—Jacquelin J. Curry

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Preface

A BUSINESS-ORIENTED TEXT

The fifth edition of *Business Law: Principles and Cases in the Legal Environment* provides students with a business-oriented introduction to the legal and ethical topics that affect business. This perspective may seem obvious. However, not all business law textbooks focus on the *practice* of business. Some fail to show students how the law will affect their future careers as businesspeople. Our goal as business law and legal environment instructors is not to teach lawyers, but to teach future businesspeople. The book is not organized along the lines of law school classes—for example, administrative law, agency, and remedies. Instead, it is organized along the lines of how businesspeople should think about the law. For example, torts material may be in the agency chapters and remedies material may be in the contracts chapters.

Businesspeople need to be able to anticipate and avoid legal problems. If legal problems occur, businesspeople need to know how to recognize the nature of these problems and how to work with lawyers to achieve solutions. Legal problems, including lawsuits, are business problems that can and should be strategically managed.

Our goals in this text are:

- To present in a student-friendly fashion a current and comprehensive introduction to the legal topics relevant to business;
- To demonstrate how these topics apply to business enterprises and transactions;
- To offer legal strategies for business leaders;

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- To provide approaches for analyzing legal topics encountered in the practice of business; and
- To develop critical thinking skills and habits.

We also support the students and instructors using this text. Aspen offers a wide variety of supplementary materials for students and instructors.

Cyber Guardian Business Cases

We have included an integrated, continuous business case or scenario. The Cyber Guardian case is threaded throughout the text. The individual threads profile the experiences of a hypothetical business, Cyber Guardian, owned and operated by a "local" group of student entrepreneurs. The entrepreneurs and their artificial intelligence (AI)–based business are introduced before Chapter 1. Each chapter begins with an Agenda that highlights some major legal issues from the chapter that are likely to be relevant to Cyber Guardian (and many real businesses). Within each chapter there are at least three Cyber Guardian application boxes that address particular legal issues and call for students to offer guidance to the firm. Each application box is categorized by the relevant functional area of business—accounting, finance, international business, management, manufacturing, marketing, personal law, and sales. Application boxes pose questions including Business Considerations and Ethical Considerations. These questions ask students to go beyond the text and apply the concepts to a business entity. Many of the questions ask students to make strategic business decisions informed by their knowledge of the law.

Students in business schools often focus on one subject at a time. When they are in accounting class they think about accounting problems, and when they are in business law they focus on business law. Operationally, problems in a business generally overlap more than one functional area. A problem can be both a business law problem and a marketing problem. The problems are interdependent, not separate. In addition, business problems do not arise with labels

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attached. Busin esspeople need to be able to identify the su bjects that ar e inv olv ed. W orking with the Cyber Guar dian thr ead case helps students recog niz e the inter dependent natur e of business pr oblems and bus iness decision making. Students ma y not be able to pr o vide a full answer to some of the q uestions posed. Some quest ions might requir e additional information or r esear ch t o fully r espond.

Cyber Guar dian thr ead cases ar e not intended to encourage business stude nts to practice law without a license. (It is illegal to practice law without a license, and we ar e not adv ocating that students br eak this or any other law .) Howe ver, application is an impor tant aspe ct of mastering material. K nowledge of th e law is of little us e if students do not know how or when to apply the knowledge. Co llege students should ask themselv es: "How can I use this information?" The Cyber Guar dian case pr o vides an oppor tunity for stud ents to practice applying their knowledge of the la w. Lik e our Cyber Guar dian entr epr eneurs, businesspeople do not call their att orne ys to discuss e ver y decision that ma y ha ve legal ramifications. The y often rely on their own knowledge and the information the y gain fr om th eir colleagues, friends, and the internet. (As we kn ow , not all colleagues, friends, or interne t sites ar e well informed, and the y do not alwa ys pr o vide up-t o-date and/or accurate information.)

Exhibits

Ther e ar e num er ous exhibi ts in the text. These exhi bits assist students in compr ehending th e material, but the y ar e not intended to replace the text. The y pr o vide a visual aid to compr ehension and learning.

TOPICAL CO VERAGE

Our first goal is to pr esent a curr ent and compr ehensiv e intr oduction to the legal top ics rele vant to business in a readable, accessible style. To achie ve this goal, the book is divided int o se ven par ts based on the typical t opical co verage of under graduate business law courses.

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Part I: Foundations of Law and the U.S. Legal System Part I presents an overview of law and the legal system. Chapter 1 discusses different ways to look at the law. It includes a discussion of theories of jurisprudence and how the law is viewed in different countries. Chapter 2 focuses on how businesspeople might apply ethical theories in making business decisions. Chapter 3 examines the U.S. court system and how courts obtain jurisdiction over cases. Chapter 4 introduces a civil trial through a hypothetical accident involving our Cyber Guardian entrepreneurs. It also discusses alternatives to the court system that businesspeople can use. Chapter 5 discusses the constitutional bases for government regulation of business. Chapter 6 examines potential liability for torts. Chapter 7 addresses business crimes including computer crimes, espionage, and the Racketeer Influenced and Corrupt Organizations Act (RICO). Chapter 8 deals with international business and various topics of international law.

Part II: Contracts Part II examines contract law and its importance in business transactions. The material includes an in-depth discussion of the common law of contracts and information about how contract law is changing in response to the increase in e-commerce. Chapter 9 is an introduction to the law of contracts. Chapter 10 covers offer, acceptance, and consideration. Chapter 11 deals with capacity to contract, the reality of consent, and illegal contracts. Chapter 12 addresses contract writings, including techniques courts use to interpret contracts. Chapter 13 discusses the rights and obligations of third parties. Part II concludes with Chapter 14 discussing discharge, breach, and available remedies.

Part III: Debtor–Creditor Relations Chapter 15 examines debtor–creditor relations by looking at secured transactions under Article 9 of the UCC with its significant revisions. Next is Chapter 16 dealing with other credit transactions. This discussion includes payday loans, credit businesses may extend to their customers, and credit businesses may use to purchase assets or inventory. Chapter 17 addresses the federal protections available for honest debtors under

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the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The discussion compares Chapters 7, 11, and 13 of the Bankruptcy Act.

Part IV: Agency Part IV explains the agency relationship and its importance in operating a business. Chapter 18 includes a discussion of the distinction between employees and independent contractors and why it is critical to correctly categorize workers. This is an important issue that is evolving as the gig economy grows and the political pressures to treat gig workers as employees increase. Chapter 19 emphasizes the liability of the principal and agent for contracts entered into by the agent. Chapter 20 focuses on the liability of employers and employees for torts and crimes committed by employees. Policies underlying the rules are also addressed. The discussion includes how to protect the business's confidential information and when the employer can use covenants not to compete.

Part V: Business Organizations Part V treats the various types of business organizations in a unique manner. Rather than have separate chapters dealing with each business form, the text treats the types of organizations in a compare-and-contrast fashion within the chapters. Chapter 21 deals with forming the business enterprise. Chapter 22 discusses how the enterprise operates, and Chapter 23 explains how the business terminates or merges with other enterprises. The focus is on the strategic advantages and disadvantages of the different structures for the operation of a business. The coverage includes the more traditional business forms, such as sole proprietorships, partnerships, and corporations. It also includes the newer business forms such as limited liability companies, limited partnerships, limited liability partnerships, and limited liability limited partnerships. Part V also includes a discussion of securities regulation in Chapter 24 and antitrust law in Chapter 25.

Part VI: Government Regulation of Business Part VI addresses the regulatory issues commonly faced by businesses. Chapter 26

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explains how the law regulates products and protects consumers. Chapter 27 is devoted to consumer credit and stresses concepts that relate back to Chapter 16. Chapter 28 addresses many of the major environmental statutes. Chapter 29 examines the rights and responsibilities of businesses to their employees. It includes laws dealing with operation of unions. It also discusses laws prohibiting discrimination in employment.

Part VII: Property Protection Chapter 30 addresses the types of property and the rights that property owners have. It also discusses government regulation of real property. It includes a discussion of the forms of joint ownership and transfer on death ownership. It also explains bailments of personal property. Chapter 31 focuses on types of intellectual property, including copyrights, patents, trade marks, and trade secrets.

APPLICATIONS

Our second goal is to demonstrate how the legal topics presented in the text apply to the practice of business. In addition to the thread case, *Business Law* includes the following features:

Court Cases

Each chapter contains two court cases. After the learning objectives, chapter outline, and Cyber Guardian Agenda, the chapter begins with a Classic Case. This is an older court case, often a landmark legal decision. Each chapter then ends with a Contemporary Case, a more recent decision showing how courts today are applying legal concepts to current disputes.

All the court cases show how the courts apply chapter concepts to actual disputes between litigants. Many of them are also illustrative on how the parties could have avoided the dispute in the first place, such as avoiding ambiguities in drafting a contract or a deed. Court cases are organized into the following parts:

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- Facts—the facts of the case
- Issue(s)—the question(s) that the court is deciding
- Holding(s)—the court's answer(s) to the issue(s)
- Reasoning—the reasoning the court used in analyzing the question(s), reaching a decision, and explaining the decision to the public

The reasoning is excerpted from the language of the court. We have summarized the other three parts of the case.

You Be the Judge

After the Contemporary Case, each chapter has a You Be the Judge box. Many of the You Be the Judge boxes take their materials directly from current events, focusing on cases that encourage students to think critically about a variety of topics. Examples include (1) when a transportation network company, like Uber, should be held vicariously liable for its drivers (Chapter 20), and (2) whether a planned condominium community must allow an emotional support animal that does not comply with its pet policy (Chapter 30). The boxes ask students to prepare an opinion that applies the law to the facts presented in the box. Students have the opportunity to play the roles of trial judges, appellate justices, and legislators offering them different vantage points to view the issues. By doing so, students will gain a greater appreciation for the difficulties involved in considering the alternatives and drafting an opinion or statute.

Discussion Questions and Case Problems and Writing Assignments

Each chapter concludes with five Discussion Questions that ask students to test their knowledge of chapter material. The first Discussion Question aids students in improving their skills in critically using artificial intelligence. The Discussion Questions are followed by three Case Problems and Writing Assignments. These questions ask students to apply ethical and legal concepts to actual situations. All

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the end-of-chapter materials can be used as study tools in reviewing the material, as class or small-group discussion material, or as writing assignments.

SUPPLEMENTAL RESOURCES

Instructor resources for this text include a comprehensive Instructor's Manual, Test Bank, and PowerPoint slides. Please visit the product page that accompanies this book at *aspenpublishing.com* for additional resources, including additional cases, You Be the Judge boxes, and end-of-chapter questions.

AACSB CURRICULAR STANDARDS

In 2020, the AACSB implemented new accreditation standards with the adoption of the AACSB 2020 Guiding Principles and Standards for Business Accreditation, effective July 28, 2020. The AACSB Guiding Principles and Interpretative Guidance were updated February 28, 2025. The Curriculum Standard says, "The school delivers content that is current, relevant, forward-looking, globally-oriented, aligned with program competency goals, and consistent with its mission, strategies, and expected outcomes. The curriculum content cultivates agility with current and emerging technologies." (Curriculum Standard 4.1, at 40.) We believe *Business Law: Principles and Cases in the Legal Environment, Fifth Edition*, uniquely satisfies these standards in a readable yet rigorous format that aligns well with the goals of most business schools.

Under the standards, one important guiding principle for accredited schools is to nurture a Global Mindset. According to the standards, "The curriculum imbues the understanding of other cultures and values, and learners are educated on the global nature of business and the importance of understanding global trends. The school fosters sensitivity toward a greater understanding and acceptance of cultural differences and global perspectives." (*Id.*, at 17.)

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Global issues are treated in several areas, beginning with Chapter 1 and its introduction to different legal systems, including those based on various religions, and international examples. Chapter 4 covers international alternate dispute resolution. Global issues continue in Chapter 8, International Business Law. Chapter 31 addresses international dimensions of intellectual property. Chapter 2, Business Ethics, addresses the ethical theories and how they can be applied in business. It stresses the importance of recognizing that individuals have varying ethical perspectives. Ethics questions follow each of the thread cases.

We engage students with emerging technologies with the AI question at the end of each chapter. We also discuss the legal aspects of using AI in several chapters.

We have created a text that we hope is intuitive, engaging, and oriented toward providing the legal skills students will need in the business world. The pedagogical features are intentionally designed to support this approach.

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Acknowledgments

Writing a textbook is a rewarding endeavor. However, it is also a significant undertaking. It would not have been possible without the help and support of several people along the way. We have enjoyed working together on this project. We each prepared about half of the chapters and commented on the drafts prepared by our co-author. We hope this team effort has been successful and that you enjoy using this book as much as we have enjoyed writing it.

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A sincere thank you to our adopters, who trust us enough to use our text, and to the students who are using it. We approach our work based on our experiences in the classroom, to provide a text that

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contains the essential material and is user friendly, readable, and enjoyable.

We also appreciate the encouragement and support of our students and colleagues.

January 2026

Lynn M. Forsythe
Jacquelin J. Curry

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Lynn M. Forsythe received her B.A. from The Pennsylvania State University and her J.D. from the University of Pittsburgh School of Law. She passed the bar examinations in the states of California and Pennsylvania. She is emerita professor of business law at the Craig School of Business at California State University, Fresno. She teaches Business and the Legal Environment and Law for Entrepreneurs.

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Professor Forsythe is the author or co-author of numerous articles on business law and business law pedagogy. She served as a part of the author team on four textbooks. She has held the positions of editor-in-chief, staff editor, and reviewer for *The Journal of Legal Studies Education*. She received numerous best paper and best presentation awards from the Western Academy of Legal Studies in Business. Professor Forsythe is active in the Academy of Legal Studies in Business. She has served on the Executive Committee, the House of Delegates, and as the chair and vice-chair of the Business Ethics Section of the Academy. She has served in the officer ranks of the Western Academy of Legal Studies in Business first from 1983-1987 and again from 2006-2009. Professor Forsythe is a member of Beta Gamma Sigma and a Life Member of Alpha Kappa Psi.

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Part I

Foundations of Law and the U.S. Legal System

"Ignorance of the law is no excuse." The basic truth of this old adage seems simple and obvious. However, it can be difficult to understand the law. Each citizen—and resident—of this country has "constructive notice" of the law. This means that each person is expected to be aware of, and to abide by, *all* the laws of the land. The enormous scope of "the law" makes this expectation virtually impossible. No one person can realistically be expected to know *all* that the law entails, yet every person is expected to obey *every* aspect of the law—or to face possible sanctions for failing to do so.

Part I of this book will first help you to understand what law is, how it operates, and how it affects business. To prevent legal problems and successfully handle the legal problems that do arise, a businessperson needs to understand how the U.S. legal system operates. This part describes the powers and limitations of the federal government outlined in the U.S. Constitution and the constitutional bases for government regulation of business. It

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describes the court system and how cases progress in the courts through the anatomy of a hypothetical civil suit involving Cyber Guardian and its owners. Part I also discusses alternatives to using the courts to resolve disputes and why businesses may want to use these alternatives. It examines the differences between private wrongs, such as torts, and public wrongs, called crimes.

Each part of this text will offer insights into various aspects of the law, especially the area of business law. A thorough knowledge of the law takes years of specialized study. However, this text will help you begin to understand the law, and it will provide references to other sources for you to explore. While you may not intend to become a lawyer, we hope this text will help you understand how the law operates and how it affects the business that you own or that employs you.

Overview

Cyber Guardian Needs Your Help!

What Is Cyber Guardian? Many people dream of owning their own business, of being their own boss, and of becoming successful entrepreneurs. Three close friends in college share this dream. Danica Evanko, Asher Katz, and Mai Vang are students at the local college. Their business concept started one day after their information systems class when they were discussing the need for improved security for internet-based businesses. The professor had mentioned that artificial intelligence (AI) can be used to efficiently scan computer systems for vulnerabilities and cyberattacks. Danica mentioned a recent cyberattack of her dentist's office. Patient records were stolen, and she is concerned about potential identity theft. Asher revealed that his father's accountant also suffered an attack. The three of them knew that a business needs to secure customer and client records, trade secrets, and business plans. They thought they had the skill set to create a proprietary AI program

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and provide monitoring services to other businesses. Consequently, Asher, Danica, and Mai decided to start their own business. Asher's expertise is in entrepreneurship and computer engineering, Danica's is in information systems, and Mai's is in marketing.

Their business model is to be primarily a business-to-business enterprise. They plan to provide security for online and cloud-based businesses through their software and active monitoring. Their proprietary AI platform and software will provide much of the security. In most situations, they plan to lease their software to their customers, rather than sell it. In other words, it will be software as a service (SaaS). The firm's first software, Cyber Defense Suite, is now on the market. In rare cases, they may sell customized software to their clients. The nascent entrepreneurs plan to expand their offerings to provide secure virtual private networks (VPNs) to businesses and consumers. They are also developing an integrated system that includes their software with a modem that will connect clients to the internet. Their slogan is "On Guard 24 Hours a Day." Part of their marketing plan is to build their brand identity. They are, of course, hoping for financial success. They are implementing their business plan, but they know that they will need help and advice along the way.

Asher, Danica, and Mai's exit strategy is to grow the business and eventually be acquired by a large corporation. Of course, Cyber Guardian will need skill, luck, and legal advice to be successful.

The People Behind Cyber Guardian Danica Evanko is majoring in business information systems with a minor in artificial intelligence. She is currently a sophomore at their college.

George Evanko is Danica's brother and a good friend of Asher and Mai. He is not a part of the Cyber Guardian team, but he is interested in becoming an entrepreneur and he has offered to provide free advice to Cyber Guardian.

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Asher Katz is a junior majoring in entrepreneurship. He is concurrently working on a minor in computer engineering.

Mai Vang is currently a junior majoring in marketing. She recently completed an internship in social media marketing at a local public relations firm.

What Is Your Role in Cyber Guardian? Asher, Danica, and Mai are just starting their business. While they will have an attorney to whom they can turn on various legal issues, they do not want to call their attorney every time a question arises. They realize that they will be billed for each consultation with their lawyer, and money will be tight as they begin their business. Instead, they would like to ask *you* to be their consultant, since you are learning about business law. When a problem with business law implications arises, the friends would like to consult with you, asking you for advice and suggestions. Obviously, they do not want you to "practice law" (which would be illegal), but they would appreciate your help in determining whether an issue might have serious legal implications, how they might avoid legal problems, and when they should consult with their attorney.

Cyber Guardian is, of course, a fictional company created and operated by fictional people. But the use of this fictional business will illustrate how the legal concepts discussed in each chapter might apply in the business environment. Each chapter will begin with an "Agenda," which highlights some of the major business law issues that are discussed in that chapter. Within each chapter there are several different scenarios, each addressing a particular issue that might arise in a business setting. For each, you are asked to provide guidance and advice to the firm about the legal implications involved in that scenario, and to assess the business and ethical issues involved. You will become a more educated consultant as you progress through the text. The problems you confront will involve many different functional areas of business besides law—accounting, finance, international business, management, marketing, and sales—and even a few personal issues. Although the scenarios are not labeled as entrepreneurship, most of them also relate to that discipline. This

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appr oach is intended to help you recogniz e the interr elationships between the various busine ss subjects. This recognit ion is impor tant to a business' s success. Business courses should be viewed not in isolation but as integrated resour ces that, when pr operly combined, can help a business to maximiz e its chances for success.

You ar e the co nsultant who will pr o vide advice and guidan ce on potential issues that the business encounters during its de v elopment. Despite the dedication and exper tise of the thr ee entr epr eneurs, Cyber Guar dian is less lik ely to succeed without your help, so be pr epar ed!

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1

Introduction to the Law and Its Role in Business

Learning Objectives

After completing this chapter, you should be able to:

- Identify why it is important for businesspeople to understand the law
- Contrast substantive law and procedural law
- Restate the functions of the law
- Discuss the different theories of jurisprudence
- Explain the role of precedents in U.S. law
- Describe the sources of U.S. law
- Compare law and equity
- Recognize that legal systems and processes can vary in other countries

Outline

- Business and the Law
- Legal Systems
- Jurisprudence
- Sources of Law
- Classifications of Law

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Agenda

Asher , Danica, and Mai need to understand what types of law will affect Cyber Guardian. Will Cyber Guardian be subject to federal regulation? To state regulation? How will these regulations impact Cyber Guardian and its success? Most of the legal issues in business law involve civil law. Should the members of the firm also be concerned with criminal law? How does criminal law influence business?

What happens when a party to a lawsuit asks the court for a particular action as the remedy? Why are U.S. lawyers and courts so interested in prior court decisions?

These and other questions will arise as you read this chapter. Be prepared! You never know when the firm or one of its members will seek your advice.

Classic Case

In this Classic Case, the U.S. Supreme Court dealt with an alleged criminal libel. It also addressed the old adage that ignorance of the law is no excuse. The case involves a sugar exporter, Barlow , who claimed on the export register that he was exporting refined sugar. If this was true, Barlow was entitled to have the duties reduced, which was called a drawback. If this was not true, Barlow would have committed a criminal libel(an untrue statement treated as a crime) and he would forfeit the sugar. Barlow claimed that he could not be found guilty since he was unaware (ignorant) of the law: He thought that the sugar he was exporting met the legal definition to be classified as refined sugar.

BARLOW v. UNITED STATES

32 U.S. 404 (1833)

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FACTS Joseph Barlow allegedly made a false denomination (entry) of sugar in the office of the duty collector, with the intent to defraud the government of its revenue. Barlow admitted that he made the entry to obtain a drawback on the export duties, but he denied that the entry was made by a false denomination. Barlow claimed that the sugars are truly refined sugars as he listed them. Under the statute, goods are subject to forfeiture to the federal government if a false entry is made. Barlow argued that the federal statutes did not apply. He claimed that the sugar was refined sugar, as he understood the term, and that under the statute he was entitled to the refined sugar drawback.

ISSUE Is Barlow excused because he was ignorant of the law?

HOLDING No, ignorance of the law is no excuse. Barlow cannot avoid the forfeiture of the sugar.

REASONING Excerpts from the opinion of Justice Story:

. . . The . . . question is whether the sugars were . . . entered by a false [label.] . . . They were entered by the name of "refined sugars." They were, in fact, sugars known by the appellation of "bastard," or "bastarded" sugards [sic], which are a species of sugars of a very inferior quality, of less value than the raw material; they are the residuum or refuse of clayed sugars, left in the process of refining, after taking away the loaf and lump sugar. . . . The question is, whether this species of sugar is, in the sense of the acts of Congress, "refined sugar." These acts allow a drawback "on sugar refined within the United States."

It has been contended . . . that all sugars which have undergone the full process of refining, after they have arrived at the point of granulation, are properly to be deemed refined sugars. . . . In a certain sense, they may certainly be . . . deemed to be refined; that is, in the sense of being . . . clarified and freed from their feculence. But the question is, whether this is the sense in which the words are used in the acts of Congress.

The acts of Congress on this subject, are regulations of commerce and revenue; and there is no attempt in any of them to define the

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distinguishing qualities of any of the commodities which are mentioned therein. Congress must be presumed to use the words in their known and habitual commercial sense; not indeed in that of foreign countries, if it should differ from our own, but in that known in our own trade, foreign and domestic. . . . [I]f among buyers and sellers generally in the course of trade and business, the appellation "refined sugars," is exclusively limited to . . . lump and loaf sugar, and never includes bastard sugar, the acts of Congress ought to be construed in this restrictive sense. . . . [W]e think that there is a decisive and unequivocal preponderance of evidence to establish, that bastard sugar is not deemed . . . "refined sugar." The appellation is exclusively limited to . . . white refined loaf or lump sugars. This is established, not merely by the testimony of merchants and grocers, and persons in the custom house, but by the testimony of sugar refiners. . . . [A delivery of bastard sugars would not satisfy a contract for the sale of refined sugars. This] puts an end to the question, whether the sugars in controversy were entered by a false denomination. . . .

There was no accident in the case. . . . [Barlow] knew what the article was when he entered it. The only mistake, if there has been any, is a mistake of law. The party in the present case has acted . . . with his eyes open. . . . He has not been misled; and his conduct . . . is not . . . free from . . . suspicion. . . . He has made every effort in his power to obtain the drawback, by passing off, as refined sugars, what he well knew were not admitted to be such by the . . . government officers.

. . . [This case] presents the broader question, whether a mistake of law will excuse a forfeiture in cases of this description. We think it will not. . . . It is a common maxim, familiar to all minds, that ignorance of the law will not excuse any person, either civilly or criminally; and it results from . . . the extreme danger of allowing such excuses to be set up for illegal acts to the detriment of the public. There is scarcely any law which does not admit of some ingenious doubt; and there would be perpetual temptations to violations of the laws, if men were not put upon extreme vigilance to avoid them. There is . . . [no] reason to suppose that the legislature . . . had any intention to supersede the common principle. The safety of the revenue, so vital to the

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government, is essentially dependent upon upholding it. . . . [I]t is the opinion of the court that the judgment of the circuit court ought to be affirmed. . . .

BUSINESS AND THE LAW

Business

This book is about the legal environment of business. An organized society is established, to a significant extent, on duties. Members of the society have certain duties imposed on them, while they voluntarily assume other duties. Businesses are a part of the society in which they operate, and the businesses also must honor their duties as members of the society.

U.S. society relies on businesses to satisfy many of its needs and desires. Most people in the United States are not self-sufficient. They purchase electricity, food, gas, and water. They rent apartments and vehicles. Most of the things they acquire, they purchase or rent from businesses. Residents in the United States provide the labor and skills needed by businesses so they are also the employees of businesses. Employees earn wages so that they can purchase goods from businesses. Even nonprofit organizations operate like businesses and are subject to many of the same laws. Statutes and regulations define the obligations of each party to others. The emphasis throughout the book is to provide an understanding of the legal environment from the perspective of businesspeople.

Law

Before we begin our study, we must answer a basic question: What is *law*? Many definitions exist, ranging from the philosophical to the practical. Plato (427-347? B.C.), a Greek philosopher who studied and wrote in the area of philosophical idealism, said law was *social control*. Sir William Blackstone (1723-1780), an English judge and legal commentator, said law is the set of rules specifying what is right and what is wrong. For our purposes, we shall define law as "rules that

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must be obeyed." People who disobey these rules are subject to sanctions such as paying a fine or going to jail.

U.S. society has many kinds of rules, but not all rules can be considered "law." For example, rules in games or sports are not laws. What differentiates a law from other types of rules? A person who violates a "mere" rule does not face sanctions from the government. The person may be subject to peer pressure, ridicule, even "shunning," but the person does not face legal penalties. People who break laws can be held accountable for their actions through court-imposed sanctions, such as fines, imprisonment, or forfeitures. Laws are enforced by the government through the legal system. Mere rules are not enforced this way.

Many different types of legal rules exist. One type defines a specific way to create a legal document, for example, a contract or a will. A second type forbids certain kinds of conduct; criminal law is an excellent example of this kind of legal rule. (*Criminal law* is the body of law dealing with public wrongs called crimes.) A third type of legal rule was created to compensate people who have been injured because someone else breached a duty by committing a tort. (*Tort law* is the body of law dealing with civil wrongs for which the victim is entitled to remedies.) For example, when an automobile manufacturer negligently builds a car, and the manufacturer's negligence is the direct cause of an injury, the manufacturer may have to pay the injured person monetary damages. (*Negligence* is the failure to do something a reasonable and prudent person would do or doing something that a reasonable and prudent person would not do.)

Rules that describe binding contracts, define crimes, and specify legal duties are generally rules about substantive law. *Substantive law* is that part of law that creates and defines legal rights. It is distinct from *procedural law*, which is the law specifying the methods used to enforce legal rights or obtain compensation for the violation of these rights. U.S. courts establish rules to take care of their everyday business. For example, all states have a rule concerning the maximum number of days defendants have to answer a civil lawsuit; this is an example of a procedural law. The distinction between substantive law and procedural law is important.

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Exhibit 1.1

A Comparison of Tort Law, Criminal Law, and Contract Law

Question	Tort Law	Criminal Law	Contract Law
How is the obligation created?	Tort law imposes duties on all people to respect the rights of others	Criminal law imposes duties on all people to respect the social order; prohibits or requires certain conduct of all people	Individuals agree on a contract and voluntarily assume duties under the agreement
Who enforces the obligation?	Suit by an injured plaintiff	Prosecution by a government entity	Suit by a party to the contract
What is the burden of proof in court?	Preponderance of the evidence	Beyond a reasonable doubt	Preponderance of the evidence

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Question	Tort Law	Criminal Law	Contract Law
What happens if the defendant loses?	Defendant can be required to pay for the injury caused	Defendant can be imprisoned, sentenced to probation, and/or fined	Defendant can be ordered to perform the contract or pay for the injury caused
Who can appeal the decision?	Either party can appeal	Generally, only the defendant can appeal	Either party can appeal

Source: Courtesy of Lynn M. Forsythe, © 2026.

Exhibit 1.1 compares some of the major areas of law discussed in this book. A *plaintiff* is the one who files a civil lawsuit. The *defendant* is the one who responds to the suit.

We will view the law as a body of rules that establish a certain level of social conduct, or of *duties*, that members of society must honor. One way to view these duties is shown in Exhibit 1.2. The party or parties who are injured can seek enforcement against the wrongdoer. The wrongdoer may be forced to (1) pay money as damages or as a fine; (2) perform an act or refrain from performing an act (one type of equitable relief); or (3) go to jail or prison.

Exhibit 1.2

Duties in a Society

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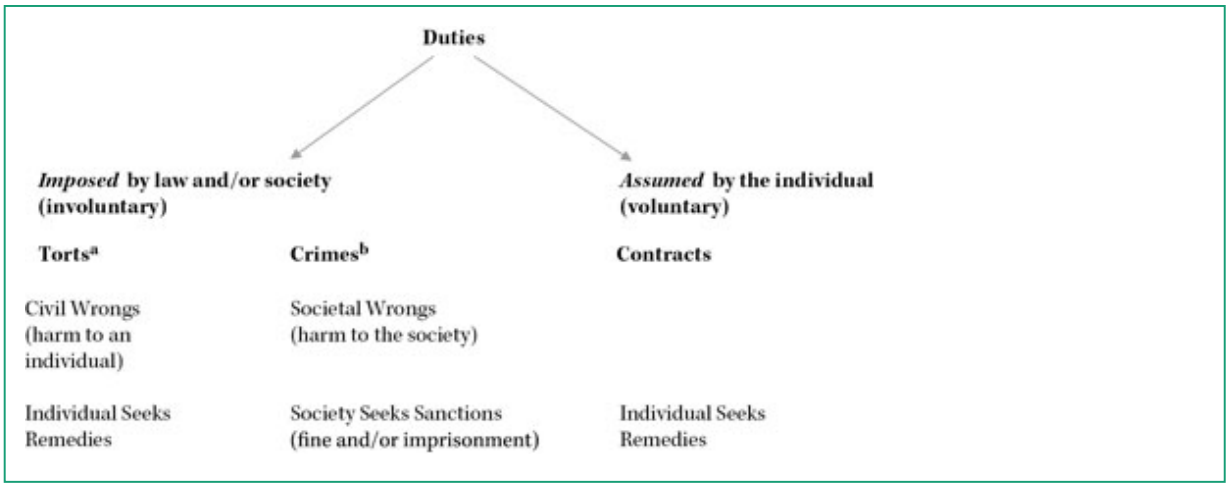

[a] Some torts may also be crimes. The victim of the crime can seek civil remedies while the government will seek criminal sanctions. Criminal sanctions can include restitution.

[b] Most crimes not only harm society but also harm one or more individuals. The individuals who are harmed can seek civil remedies under tort law.

Most of the U.S. legal system is based on voluntary compliance. People are assumed to know the law, as in the Classic Case of *Barlow v. United States.* [1] In the United States, we also expect people to comply with the law. For example, drivers generally stop at stop signs and red lights. We expect other drivers to stop. When a driver stops at a red light and then drives through it, we are surprised because most drivers obey the rules of the road. Similarly, U.S. tax law is based on voluntary compliance. This does not mean that you can choose whether to pay income tax. What it means is the taxpayer is supposed to fill out an accurate tax return and submit it to the government. (Some countries do not expect accurate tax returns. The tax form is merely the starting point for negotiations between the taxpayer and the government.)

Why Study the Law of Business?

Law is crucial to the way we conduct business in the United States. Businesspeople need to be aware of the legal implications of their actions. They need to know when they can sue and when they may be sued. They need to realize the potential for recovery if they file suit and the possible liability if they are sued. An understanding of the law

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allows businesspeople to know (or learn) the limits society imposes on their actions. Some specific examples include:

- **Contracts.** The law provides that valid contracts will be enforced. A business can establish a plan for the future, secure in the knowledge that its contracts with customers and suppliers will usually be performed. This means that both parties will do what they agreed to do in the contract. If a party does not do what it agreed to do, the other party can sue for its losses. A business will also be liable for its contracts with others if it does not perform, so it should live up to its contractual obligations. Some form of contract law is essential if a business is to operate in an efficient manner.

  Imagine a society where people could choose whether or not to perform their contracts. Would this be hard on businesses? Why?

- **Employment law.** The law provides rules and regulations regarding employment. These rules and regulations provide standards to ensure some protections for employees. For example, there are minimum wage laws, maximum hour laws, workplace safety rules, and employment discrimination rules. Businesses that do not comply may be subject to lawsuits and/or fines.

  Imagine a society where businesses are not obligated to provide safe workplaces. Would businesses be likely to invest funds to protect their workers? What would happen to the workforce? Would this be hard on workers? How would it affect business?

- **Intellectual property (IP) law.** IP law provides protection to a business that has acquired intellectual property. For instance, a business can apply to the government for a patent for its invention. If the patent is granted, the business receives a government-sanctioned monopoly for the length of the patent. Once the patent is issued, the business can prevent others from using its invention in the United States

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without permission. Businesses can then license the invention to others who pay for the right to use the invention.

Imagine a society where inventions cannot be protected by patents. Would businesses be less likely to invest their resources in research and development? Why? Would the society have fewer advances and less technology? How would this affect the economy?

- **Government regulations.** The social contract theory states that businesses exist because society allows them to exist. It also holds that society can change "the rules of the game" at any time, forcing businesses to adapt to the new rules or face sanctions. These sanctions may include losing the right to continue in existence. Many of the government regulations affecting business are an outgrowth of the social contract theory. For example, antitrust laws, consumer protection laws, environmental laws, and securities laws all originated to some extent from public pressure on government to address these issues.

  Imagine the United States without these laws. Would businesses voluntarily engage in practices that protect consumers or the environment? How would that behavior affect public goods like clean air or water? In some cases, you can examine history before the laws were enacted to see how society would be different.

Think about the role of law in business decision making. Law plays a significant part in the success or failure of many business enterprises.

You need to understand the legal implications of your actions as a businessperson, a business owner, and a consumer. Otherwise, your actions may have unexpected legal consequences. If you can apply your legal knowledge to specific business situations, you may also save yourself great expense. It is helpful to understand the legal environment in which a business operates. If businesspeople "scan" the legal environment, they can often identify trends. Sometimes a business or industry may impact the direction of a change. When a business takes direct action, it is called being proactive. (*Proactive*

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means to identify potential problem areas and actively participate in resolving them.) For example, industries may decide to self-regulate in an attempt to avoid government regulation. The video game industry created a rating system for games at least in part to avoid potential legislation.

When a business is *reactive*, it waits to see what develops and *then* reacts. It does not initiate change. It changes only when it is forced to do so. A business or industry may be proactive on some subjects and reactive on others. As you will learn, the law of business is a practical subject.

Another reason to study the law of business is because it will help you develop valuable decision-making skills. This book will introduce you to the legal style of analysis, which can be used in business decision making. This study will also alert you to particular situations in which you may need the assistance of a lawyer. Legal counsel can be helpful in preventing problems and in seeking remedies. For example, in the sale of commercial real estate the buyer or seller needs the assistance of a lawyer *before*, rather than after, a contract is signed.

We will focus on prevention, including (1) how to recognize potential legal problems; (2) how to avoid legal problems if possible; and (3) how to resolve them as quickly as possible if they do arise. *Preventive law* is law designed to prevent harm or wrongdoing before it occurs. Many statutes are intended to prevent certain conduct by providing for sanctions against people who violate the statutory provisions. *Remedial law* is designed to deal with problems that do arise.

Legal Language The study of law requires learning legal terminology. Your text defines many of the terms for you. Remember to read in context and to be aware of legal meanings. These three rules will help improve your mastery of this material:

1. Legal terms may appear to be synonyms with everyday words, but often they are not.
2. Legal terms may have more than one legal meaning.
3. Some legal terms have no relation to everyday language.

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You will see examples of these rules in later chapters as you encounter more legal language.

Cyber Guardian 1.1 Management

HEALTH INSURANCE FOR CYBER GUARDIAN EMPLOYEES

When Asher, Danica, and Mai began Cyber Guardian, they did not consider providing health insurance benefits for its employees. The young entrepreneurs purchased their health insurance through their college. The firm has grown and expanded. Several of the employees have asked Asher about a benefits package that would include health insurance coverage. Asher is also concerned about changes that will make it more difficult for individuals to obtain health insurance on their own. Asher has asked you whether the firm should provide health insurance for the employees. What are the consequences of this decision? What advice will you give him about providing health insurance?

BUSINESS CONSIDERATIONS Should Cyber Guardian provide health insurance as a benefit for its employees? What are the business implications if such coverage is provided? What are the business and legal implications if such coverage is not provided?

ETHICAL CONSIDERATIONS Would it be ethical for Cyber Guardian to provide coverage for Asher, Danica, and Mai but not for other employees? What are the ethical implications of denying health insurance to the firm's employees to increase profits?

Role of the Attorney Legal issues can be serious in all businesses. Whether the business is facing litigation or practicing preventive law and attempting to avoid legal problems, attorneys can be important allies in running a business. One of the primary purposes of this text is to assist you in working with your attorney and to enable you to more fully understand what the attorney says. There may be situations when

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you are able to represent yourself in legal matters, such as negotiating a lease for a residence. When you represent yourself in court, it is called appearing *pro persona*, or *pro per* for short. It can also be called *pro se*. There are many situations, when it is unwise to represent yourself and you should hire a competent attorney.

LEGAL SYSTEMS

When people refer to "the law" they are really referring to a legal *system*, which consists of some combination of law, order, and justice. Each legal system involves a variety of people, rules, and processes. Every culture and every society is built around its own system, including its own rules, expectations, and provisions for enforcement. Each legal system provides a structure for enforcing the rules in order to meet the expectations of that specific society.

Traits of a Legal System

Order Order has different meanings in different contexts, and "an order" is significantly different from "order." The law usually considers *an order* as a legal command issued by a judge, while *order* is the absence of chaos. We are using *order* in this second sense. *Chaos* is confusion and total disorganization, producing a disorderly society. If the laws of a society were always followed and never broken, there would be perfect order. No crime would exist, and everyone would be safe. No society with perfect order has ever existed.

The words *law* and *order* are often linked together. It is natural to link them because, when the law is followed, there is order. However, because the law is not followed all the time by all the people, perfect order does not exist. Society is always *somewhat* chaotic and disorganized. One of the reasons people do not always obey the law is that they may not be aware of what the law is in a particular situation. However, the U.S. legal system *presumes* that everyone *is* aware of the law and what it requires. If society did not presume that everyone knows the law, individuals accused of breaking the law would have an excellent defense: They could argue that they did not know they were breaking the law, and the society would then have to prove the person's

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knowledge of the law before imposing sanctions. The presumption that everyone knows the law also creates an incentive for citizens to study the law. The educational system also plays an important role in helping us to learn the law.

Justice Justice is a difficult term to define. Different theories of justice exist, and individuals have varying beliefs about justice. When we speak of *justice*, we normally mean "fairness." Although perfect justice *is* fair, there is more to the concept of justice than merely being fair. Justice, as used in the Anglo-American legal system, refers to both the *process* followed and the *results* obtained in the process. Courts try to administer justice in conformity with the laws. From a social perspective, justice may be affected as much—or even more—by appearances than by results. This means judges and lawyers are required to avoid the *appearance* of impropriety in their dealings. If the public perceives that the system is not just, they are less likely to accept the results the system provides. This perception can lead to the destruction of the order developed in society through its laws and their enforcement.

The goal of any legal system should be attaining justice by continually searching for fairness and equity. Fairness is less abstract than justice and is easier to address on a practical level. Most people have a basic concept of "fairness" that can be applied to any given situation. For example, when you see a bully pick on a victim, you probably believe that this conduct is not fair. In this type of situation, the conduct is clearly unfair *and* unjust. In most situations, it is difficult to determine what a fair-and-just result would be. For example, suppose that a wealthy individual is accused of committing a crime. That wealthy individual hires the best attorneys the person can find, and is found not guilty by the jury in a very public trial. Many people might question whether this result is *fair*. While there may be doubts about the fairness of the result, the process followed in the legal system tries to assure that the result of the trial is *just*.

The Needs of a Legal System

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The Need to Be Reasonable A legal system needs to be reasonable. It should rely on reasonable conclusions based on facts. Laws prohibiting texting while driving are reasonable because we can prove that texting while driving increases the number of accidents. Similarly, laws requiring the use of face masks during a pandemic are reasonable when we can prove that the use of masks reduces the spread of the illness.

In addition to being reasonable, laws need to be applied in a reasonable manner. A law stating that Juana, a car buyer on credit, will have the car taken away from her if she does not pay for the vehicle is certainly reasonable. It would be an unreasonable law if Juana's children were taken away from her if she stopped making payments on the car. In the second situation, there is no reasonable connection between the conduct and the penalty.

The Need to Be Definite The law needs to be definite, not vague. For example, a law stating that all contracts "for a lot of money" must be in writing would be unclear and confusing. By comparison the Statute of Frauds states that all contracts for the sale of goods costing $500 or more must be in writing, which is very clear. If one has a contract for $499.99 worth of goods, it need not be in writing; but if the contract is for $500 or more of goods it must be in writing to be enforceable.[2] There is a definite point at which the law requires a writing.

Sometimes the law is unable to state precisely what a person must do. In such cases, the law applies the standard of *reasonable* behavior rather than setting precise boundaries. If an automobile hits a pedestrian and causes injury, the pedestrian may sue the driver of the vehicle. The law does not state that a driver will only be at fault if the driver is driving over a certain speed. If the only information you had was that the speed limit was 55 miles per hour and the car was going 50 miles per hour, is the driver at fault? Under these conditions, the law would ask the question: Was the driver's conduct reasonable under the circumstances? If so, the driver is not liable for damages. If the driver's conduct is not reasonable, the driver is liable to the pedestrian. In the final analysis, the law provides an answer and is definite.

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The Need to Be Flexible To say that the law needs to be both definite and flexible seems like a contradiction in terms. The law needs to be definite in order to establish a standard. In other respects, the law must be flexible so that it can be applied in many different situations. For example, if a drunk driver kills a family wage earner and the family files a wrongful death lawsuit, recovery would be based on the future earning capacity of the wage earner. (*Wrongful death* is unlawful death. It does not necessarily have to involve a crime.) It would not be based on a table of damages. Another aspect of flexibility is the need to adapt to changes in technology. For example, old laws are now being applied to activities on social media, such as Facebook, Instagram, SnapChat, TikTok, WhatsApp, X, and YouTube. If trees did not bend in the wind, they would break. The U.S. legal system is like those trees: It must bend without breaking. However, because of this flexibility, our legal system loses some of its predictability.

The Need to Be Practical Because people depend on the law to guide their actions, the law needs to be practical and oriented to action rather than to thought. The law must deal with real issues created by real people. For example, most U.S. courts will only decide real disputes between the parties. They will not decide hypothetical cases. Courts will also avoid cases where the issue is *moot* (abstract; not properly submitted to the court for a resolution; not capable of resolution) or where there is no real case or controversy. (A *case or controversy* is a case brought before the court where the plaintiff and defendant are really opposed to one another on significant issues.) When the plaintiff and defendant really agree with each other and are trying to get a court decision confirming their position, there is no real case or controversy.

The Need to Be Published If we had the best set of laws imaginable but no one knew about them, they would be virtually worthless, and we would have chaos. Although ignorance of the law is generally no excuse, the legal system does try to provide notice of the rules and laws. In traffic law, for example, speed limits need to be posted so drivers know how fast they can legally drive. Posting also limits arbitrary enforcement by police. People cannot voluntarily comply with secret laws and rules. Consequently, all laws need to be published.

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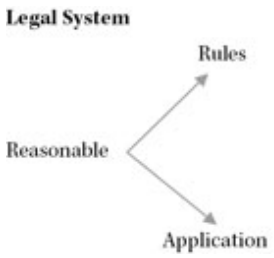
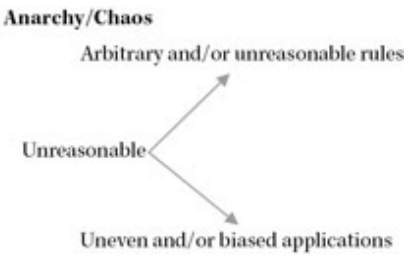
Once a law has been published, we presume that all people know it. Consequently, ignorance of the law is no excuse. For example, even if you did not see the posted speed limit, the police will still enforce it. Statutes are a good example of published laws.

The Need to Be Final If a controversy exists and the parties use the legal system to resolve it, at some point in time the matter will be resolved. It may not be resolved to the full satisfaction of the person who "won" the case, but it will be resolved. Parties who are unhappy with the results can appeal, but eventually the appeals end and the decision is final. Exhibit 1.3 outlines the needs of a legal system.

Exhibit 1.3

The Needs of a Legal System





Definite rules and limits	Vague or unclear rules, no definite standards
Flexible standards—to keep up with changes in society and technology	Rigid and unbending standards; "Stone-Age" rules in a modern world
Practical rules based on reality	Hypothetical or impractical rules based on wishful thinking
Published—communicated	Unpublished—"surprise" rules

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Final—to put an end to a case at a particular time	Ongoing, continuous—never seeming to end

Compliance with the Law

Despite our assumption about voluntary compliance, people do not always comply with the law. When you observe people in your community repeatedly doing something, you might conclude that this behavior is lawful. This assumption may be unwise. For example, on some freeways the flow of traffic may be faster than the posted speed limit. During your study of business law, you should try to distinguish these three distinct questions:

1. What is the law about this topic?
2. How do people and businesses generally behave?
3. What should the law be on this topic?

Answers to these questions will vary based on the state or region under analysis. The most variance will occur about what the law should be. Individuals will disagree based on their views and ethical beliefs. Proactive businesspeople may suggest answers that will benefit their particular situation.

The Purposes of a Legal System

Achieving Justice Justice basically equates to fairness. Sometimes we achieve it and sometimes we do not. To some, the rule of *caveat emptor* (let the buyer beware) is a fair rule. The buyer who did not examine the goods does not receive damages in the courts for defects that would have been revealed by an inspection.

Providing Police Power Because justice is the ultimate purpose of a legal system, providing police power may be viewed as an intermediate purpose of a legal system. When you see the term *police power*, you may envision a uniformed police officer. That is just one part of what we call police power. Police power allows the government to create and enforce laws designed to protect the public's health, safety, and general

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welfare.[3] Laws and ordinances concerning police, fire, sanitation, and social welfare stem from police power.

Maintaining Peace and the Status Quo One of the earliest purposes of the law was to "keep the King's peace." Most modern torts and crimes are based on a simple breaching of the King's peace. Today, laws that govern the relationships between private individuals, such as the laws governing assault, battery, false imprisonment, and trespass are private forms of keeping the peace. Closely associated with keeping the peace is the concept of maintaining the status quo—that is, keeping things the way they are. It is natural for the law to maintain the status quo unless changing things will benefit society. Under the proper circumstance, a court issues a preliminary injunction that maintains the status quo until the lawsuit is resolved. (A *preliminary injunction* is an injunction requiring a party to do something or refrain from doing something. It is granted before or during trial and maintains the status quo until there is a final decision in the case.)

Providing Answers On a practical level, the law should provide answers. A party may appeal a court decision to a higher court if the party does not like the answer. Assume Melanie sues Troy, a neighbor, because Troy is allegedly creating a nuisance on his property. (In this context, a *nuisance* is the unreasonable or unlawful use of a person's own property when it interferes with another person's use and enjoyment of that person's property.) If Troy wins the case in the trial court, Melanie can appeal the decision to the next higher court. In most states this higher court is called an *appellate court* (a court that has the power to review the decisions of lower courts). If an appellate court rules in favor of Troy, a further appeal may be taken to the state's highest court. In that court, Melanie may win or she may lose again. Regardless of the outcome, once the appellate process is completed, Melanie and Troy are provided with an answer.

Providing Protection The law protects all kinds of interests. The tort law of assault and battery is a classic example of protecting the individual. The law also protects people when it protects their civil rights. The U.S. Constitution and its amendments contain (1) the right

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to be protected from unreasonable searches and seizures; (2) the right against compulsory self-incrimination of a crime; (3) the right to be indicted by a grand jury before being tried for a federal capital or infamous crime; [4] (4) the *right against double jeopardy* (a rule of criminal law that states that a person cannot be tried in court more than once by the same government for the same criminal offense); (5) the right to a jury trial; and (6) the right to bail. Most rights, even constitutional rights, have limits and restrictions.

The law is also concerned with the protection of property. All property is characterized as either real or personal property. *Real property* is land and whatever is affixed to land, such as a house. *Personal property* is all property except for real property. In general, if property is movable or intangible, it is personal property. However, personal property can have dual meanings in law. It can also mean property that is owned by individuals, as opposed to public property that is owned by the government or the community. The U.S. legal system has a variety of laws that protect property.

Cyber Guardian 1.2 Management

SECURITY ISSUES

Asher plans to visit Washington, D.C., next week for a conference on AI and related technology, including sessions on possible military uses of AI. Danica and Mai recognize that this trip is important to Cyber Guardian, but they are a little concerned because of the increase in protests and violent crimes in Washington, D.C. [5] Asher told them that there was little reason for concern since security around federal buildings has been strengthened. While Danica and Mai are thankful for the extra security, they do not understand why different rules seem to apply to federal buildings than apply in other areas of D.C. They have asked you to explain how or why this is permitted. What will you tell them?

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BUSINESS CONSIDERATIONS Is it reasonable to have different legal rules about carrying weapons near federal buildings? Should other locations have special rules, too, such as outside the White House or the homes of federal judges? If so, which locations should have special rules? Why? Can a business impose different rules concerning the carrying of weapons on or around its workplace? What factors would cause a business to do so?

ETHICAL CONSIDERATIONS Is it ethical for the government to have different rules near ICE detention centers, the Pentagon, the White House, or other locations? What are the ethical implications of having special rules in certain specified areas or under certain conditions?

Enforcing Intent The law of contracts is based on freedom of contract. When we enter into a contract, we make our own "laws" of conduct. For example, suppose that you have found some merchandise that you can resell at a very good price. You want to make the contract today so that you can "lock in" the price. You have a cash-flow problem, and you cannot pay for the goods today. You are confident that you can quickly and easily resell the goods, so you enter into a contract promising to pay for the goods at the stated price, with payment due two weeks after delivery. Of course, if you cannot resell the goods as quickly as you anticipated, you will have a financial problem, and you may breach the contract. You might be sued, and you would probably be found liable for breach of contract. This potential problem is really an issue of your business judgment and not a question of law.

Providing Rehabilitation Both criminal law and civil law are directed toward rehabilitation. Criminal law should, among other things, rehabilitate the criminal. Civil law is also involved in rehabilitation to some extent. Contract law provides rehabilitation for a party harmed by a breach of the contract. Tort law provides for a form of rehabilitation of tort victims when they are awarded damages. The federal bankruptcy law is directed toward the rehabilitation of honest debtors.

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Facilitating Commercial Transactions One of the major characteristics of the U.S. legal system is that it facilitates commercial transactions. Contract law allows for the use of credit to make sales. For example, very few automobiles would be sold in the United States if car dealers insisted on cash payment. The U.S. economy still relies on the automobile industry. The prosperity of the steel, energy, and transportation industries are directly related to that of the automobile. A loss of sales could hurt the U.S. economy, and not just the automobile industry. When U.S. automobile manufacturers suffered from the economic downturn in 2008-2009, the federal government offered bailout money to some of them.[6] Generally, the U.S. legal system fosters free and open competition and facilitates trade. Exhibit 1.4 outlines the purposes of a legal system.

Exhibit 1.4

The Purposes of a Legal System

Purpose	Reason
Achieving justice	To provide "justice" so that the needs of the members of society are addressed.
Providing police power	To provide a social structure so that "wronged" individuals do not have to resort to self-help; to provide for the health and welfare of the members of society.
Maintaining peace and the status quo	To provide members of society with feelings of personal security and a structure on which they can rely.
Providing answers	To achieve practical justice; permits the members of society to know what is

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Purpose	Reason
	expected of them and what they may reasonably expect from others.
Providing protection	To define and establish social guidelines and protect the entire society if any of these guidelines are not followed and obeyed.
Enforcing intent	To provide some method for permitting private agreements and for ensuring that these agreements are honored or enforced.
Providing rehabilitation	To allow people who violate the guidelines of the society a second chance; recognizes that people make mistakes; reimburses people who are injured.
Facilitating commercial transactions	To support freedom of contract and private ownership of property; these concepts encourage and promote business transactions.

Legal Systems in Other Countries

You should not assume that other countries have the same or similar legal systems. A U.S. citizen may find that behavior that is tolerated in the United States constitutes a crime in a foreign country or is punished more severely there. For example, in 2009, Bernie Madoff was convicted of fraud for running a huge Ponzi scheme and he was sentenced to 150 years in prison. [7] Just a few years later in 2013, Zeng Chengjie, a real estate developer who has been called "China's Bernie Madoff," was also convicted of fraud and illegal fundraising. However, instead of a prison sentence, he was executed by lethal injection by the Chinese government. [8]

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Many of the protections a citizen expects in the United States do not apply abroad. For example, Amanda Knox was retried in Italy for the murder of her roommate. [9] In the United States, the retrials would probably have been barred by the rule against double jeopardy.

Other countries have different historical and sociological backgrounds. Citizens' values and government rules may differ from those in the United States. In Beijing, about 60 Chinese workers who were angry over a pay dispute held their U.S. boss, Chip Starnes, hostage for five days. Apparently, this action, which would be illegal under U.S. law, is a common practice in Chinese employment disputes and police are reluctant to intervene. [10]

Court decision making also differs from nation to nation. Common-law countries such as the United States and Great Britain rely on statutes and precedents in deciding cases. When courts use *precedents*, they look to prior, similar cases for guidance in how to decide this case. In common-law countries, courts tend to follow precedents unless there is a compelling reason to change.

By contrast, civil-law countries such as France and Germany do not rely on precedents. In these nations the court applies statutes without reference to how earlier courts decided similar cases. Each case is treated as unique, and the court tries to apply the law in a logical and fair manner to the facts presented in the case. Thus, precedent is not significant in civil-law systems. It is interesting to note that in the European Union (EU), the role of precedents is increasing even though the EU is primarily a civil-law system. For example, decisions made by the EU Court of Justice become precedents in all the member countries.

In the former Union of Soviet Socialist Republics (USSR), private ownership of property was limited due to the government's socialist philosophy. The primary goal of its legal system was to preserve state ownership of all means of production. Consequently, the USSR's law mainly consisted of public law such as criminal law. The law of property, contracts, and business organizations did not play a role. Many of the former Soviet republics are engaging in *privatization* (the process of going from government ownership of business and other property to private individual ownership), and a body of private law is

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developing as these countries move toward a more traditional civil-law system. The new countries sometimes relied on consultants, like attorneys from the United States, to develop their systems of commercial law.

The Role of Religion There are several legal systems based on religious teachings. The Hindu legal system is one example. This system is a personal and religious law system which states that Hindus should act in accordance with this law wherever they live. The Hindu system has been recorded in law books called *smitris.* Most Hindu law applies to family matters. Anglo-Hindu law evolved in most Hindu countries while they were British colonies, and judges were applying a combination of English and Hindu laws. When India gained its independence from the United Kingdom, it replaced Anglo-Hindu law with a civil code primarily based on Hindu law.

Some Muslims believe in Islamic law or *Shari'a*, which is based on the Qur'an and other religious writings. For example, Saudi Arabia relies on the Qur'an as its constitutional authority.[11] In the United States it is common to charge interest on a loan, whereas interest on loans (known as *riba* in Muslim law) usually is prohibited under traditional Muslim law.[12] The following excerpt describes how one country applies Islamic law.

> *A 24-year-old Norwegian woman who was attending a business meeting in Dubai, United Arab Emirates (UAE), claimed that she was sexually assaulted by a co-worker. After the rape, she asked the hotel staff for help and asked them to call the police. The police came and arrested the victim for having sex outside of marriage. She was sentenced to 16 months in jail for the crime under the UAE's Islamic-influenced legal system. Her alleged attacker received a 13-month sentence for out-of-wedlock sex and alcohol consumption.*[13]

Other religions also have legal systems, including Catholicism and Judaism. These religions generally provide their own tribunals for resolving disputes.

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JURISPRUDENCE

Jurisprudence can be defined as the "general or fundamental elements" of a legal system.[14] It is often thought of as the philosophy underlying the law. In Latin, jurisprudence means the "wisdom of the law." However, there are really many different "wisdoms" of the law reflected in different philosophical views; these views vary based on the values inherent in the law, the development of the law, and its proper role in society. The law continues to change, and knowledge of the legal philosophies will improve your ability to understand the law and predict future trends. Here is a brief introduction to some of the philosophical approaches that affect business. Note that sometimes philosophers who subscribe to the same basic theory disagree.

Natural Law Theory

The *natural law* theory holds that the law should be based on what is correct and moral. It is composed of these four concepts:

1. There are certain legal values or value judgments.
2. These values are unchanging because their source is absolute. Natural law theorists disagree about the sources. Theorists believe that the sources are Nature, God, or Reason.
3. These values can be determined by human reason.
4. Once these values are determined, they supersede any form of human law. Once the natural law is discovered, any contradictory human law is invalidated.

This theory rests on some significant assumptions—the world is perceived as a rational order with values and purposes built into it; the laws of nature describe how things should be; and humans should use reason to grasp what they should do. Many early Greek philosophers were natural law theorists. In the history of Christian thought, the dominant theory of ethics has been the theory of natural law,[15] best exemplified by St. Thomas Aquinas.[16] Natural law theory is found in the words of the Declaration of Independence, "We hold these truths to be self-evident, that all Men are created equal, that they are endowed by

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their Creator with certain unalienable Rights. . . ." The natural law theory focuses on fairness and justice. Some disorder will result when individuals decide that the written law is not "natural law." Criticisms of natural law theory include (1) whose values are to be included in the natural law and (2) who determines whether a man-made law is unjust because it violates natural law.

Legal Positivism

Legal positivism is composed of three theoretical parts:

1. "[L]egal validity is ultimately a function of certain kinds of social facts."[17]
2. Social facts give rise to legal validity, which is authoritative due to some kind of social convention.
3. There is *no* overlap between notions of law and morality. This last part is in direct opposition to natural law theory.

Legal positivists disagree on how these three parts should be interpreted. One alternate statement proposed by some legal positivists includes these primary beliefs: (1) law is the expression of the will of the legislator or sovereign, and must be followed; (2) morals are separate from law and should not be considered in making legal decisions, for example, judges should not consider factors outside the legal system, such as contemporary community values; and (3) law is a closed system in which correct legal decisions are reached by reference to statutes and court precedents. Legal positivists believe that the law is the result of lawmaking by a legitimate government. In the United States, this is primarily executive orders, legislation, court opinions, and administrative regulations. Under this theory, legality and morality are separated. This is opposite from the natural law theory. The positive law approach promotes stability in the law and the supremacy of written laws. Criticisms of legal positivism include that it is too narrow and too literal-minded, and that its refusal to consider social, ethical, and other factors makes it static and unable to serve society well.

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Legal Realism [18]

Legal realism is both a descriptive and prescriptive theory. *Descriptive theories* of jurisprudence explain what the law is. In other words, they describe the law. However, *prescriptive theories* state what the law should do or what should occur. In the prescriptive theory of legal realism, law *should* derive from social interests and public policy.[19] As a descriptive theory, legal realism looks at the reality of the law. Under the theory, most laws are *indeterminant* (lacking clarity or precision). Judges consider statutes and prior court decisions; however, written laws do not fully explain what judges do. In addition, there are often conflicting statutes and court decisions. When the written law does not provide a clear answer, the judge makes decisions based on the judge's political and moral convictions. Judges are also influenced by their cultural, political, and religious beliefs. "It is a sociological study of the Law as it is made, practiced, and interpreted by lawyers. It further seeks to explain the social processes through which the Law changes. . . ."[20] Law, then, is what judges and lawyers say it is. Realists contend judges create new law through their decisions more often than people commonly suppose. Judicial decision making is frequently guided by the judge's political and moral intuitions about the facts of the case, instead of by legal rules. This is especially true when the law on the case is ambiguous.

Jerome Frank said,

> . . . For any particular lay person, the law, with respect to any particular set of facts, is a decision of a court with respect to those facts so far as that decision affects that particular person. Until a court has passed on those facts no law on that subject is yet in existence. Prior to such a decision, the only law available is the opinion of lawyers as to the law relating to that person and to those facts. Such opinion is not actually law but only a guess as to what a court will decide. . . . [21]

Justice Cardozo was also a legal realist. He provided some examples of how the theory works. For example, in writing about contract law, he

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said that when a judge is asked to determine whether one party to a contract exercised duress and undue influence in negotiating a contract (making the contract voidable), judges who are inclined to protect the weaker members of society will interpret the legal terms broadly to protect the weaker members from predatory behavior. Judges who favor stronger members of society will interpret those legal terms narrowly: They will allow the stronger members of society to benefit from their guile, knowledge, and skill.[22] Cardozo also noted that judges often have to decide between competing and contradictory principles that would yield opposite results.[23] Some realists argue that the law should serve the most fragile members of society.[24] Many realists believe that in practice the law represents the interests of the most powerful members of the society.

As a prescriptive theory, realists also believe that jurisprudence should follow the sciences and use empirical information and test hypotheses. The law should not merely rely on theoretical assumptions.[25]

Law and Economics Theory

Law and economics theory applies classical economic theory and empirical methods to explain legal doctrines and to predict judicial decisions. It argues for using economic analysis as both a description about how courts and legislators behave and as a prescription about how courts and legislators *should* behave. The law and economics theory is closely allied with the University of Chicago, where it originated. It is sometimes called The Chicago School. This theory is commonly used in areas such as contracts, property, and tort law. Under the theory, the legal system should be viewed as a system to promote the efficient allocation of resources in society. For example, buyers and sellers in the market exchange goods or services for money. The exchange is maximizing value for both the buyer and seller.

The proper goal of statutory and common law is to promote wealth maximization, which can be accomplished by facilitating the mechanisms of the free market. It is a conservative theory, and most proponents want to maximize the wealth of the society. They are not concerned about whether the wealth is distributed equally or fairly.[26]

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Also, market transactions reflect rational individual judgments about the value of individual preferences. Critics contend that this theory tends to be politically conservative and generally rests on only one type of economic philosophy to the exclusion of others. Another criticism is that the theory could be acceptable as a *descriptive theory,* but it is not helpful as a *prescriptive theory.*

Exhibit 1.5 summarizes the approaches to jurisprudence.

Exhibit 1.5

Theories of Jurisprudence

Theory	Primary Characteristic
Natural Law	Source of law is nature, God, or reason.
Legal Positivism	Source of law is the legislature or sovereign.
Legal Realism	Source of judge's decisions includes the judge's cultural, political, and religious beliefs.
Law and Economics	Classical economic theory should be applied to the law.

SOURCES OF LAW

The U.S. legal system is based on the Constitution, treaties, statutes, ordinances, administrative regulations, common law, case law, and equity. Together they constitute the U.S. system. Although each of the elements is separate, the elements are interdependent. A change in one element will affect one or more other parts of the system. In a civil rights suit, a person may allege a violation of constitutional rights (Fourteenth Amendment), a statutory right (Civil Rights Act of 1964), an administrative regulation (Equal Employment Opportunity Commission

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guideline), past decisions of the court (precedents), and equity (if all else fails, the person should win because it is fair).

Constitutions

A *constitution* is the fundamental law of a nation. It may be written or unwritten. The U.S. Constitution is written. It allocates the powers of government and sets limits on those powers. The Constitution places the power of the purse exclusively with Congress and the power of the sword with the executive branch. The judiciary, the third branch of government, has neither the power of the purse nor the power of the sword. However, it has the power to interpret the meaning of the U.S. Constitution and to decide the constitutionality of the laws passed by Congress.[27] We discuss the unique nature of the Constitution further in Chapters 3 and 5.

States also have constitutions, and they are the fundamental laws of those states. The U.S. Constitution is the supreme legal document in the United States and will take precedence over state constitutions if there is a conflict between them.

Treaties

Treaties are formal agreements between two or more nations. Treaties are often categorized by the number of nations involved. *Bilateral treaties* involve two nations, and *multilateral treaties* involve more than two nations. Treaties that are recognized by almost all nations, such as the Geneva Convention, are *universal treaties.*

The United States makes treaties for a variety of purposes including providing protection, for example, through the North Atlantic Treaty Organization (NATO), and promoting trade through the United States–Mexico–Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA). Treaties are the only elements of the U.S. legal system that do not stem from the Constitution. The power to make a treaty is a function of sovereignty and not one of a constitution. In most cases, treaties are negotiated by the President or the President's designee(s). The U.S. Constitution gives the Senate the power to approve treaties, and a two-thirds vote is

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requir ed for appr oval.[28] The Pr esident sometimes inv olv es senat ors in the negotiation to mak e the appr oval pr ocess easier .[29] The Senate ha s rejected relativ ely few tr eaties.[30] Howe ver, sometimes the Pr esident withdraws a tr eaty rather th an ha ve it def eated.[31] Oth er times the tr eaty dies in a Senate committee or is amended or changed by the Senate. In these situations, usually the United States and the other countr y (or countries) continue their negotiations.[32] (The Pr esident can enter int o ex ecutiv e agr eeme nts which ar e not subject to appr oval by the Senate.[33]) W hile the Constitution is the supr eme law of the land for domestic issues, tr eaties ar e the supr eme law of the land for international issues.

Statutes

Statutes ar e the acts of federal or stat e legislativ e bodies. The y pr ohibit or com mand the doing of so mething. It is pr ef erable to u se the wor d "statute " when you ar e ref errin g to a legislativ e act to distinguish it fr om other types of laws, such as or dinances, regulations, common law , and case law . A good example of state statut or y law is the Uniform Commer cial C ode (UCC). The UCC is a set of laws des igned to aid business. All 50 states, the District of Columbia, and the U.S. Vir gin Islands ha ve adopted at least por tions of the UCC. Unfor tunately for businesspeople, some states adopted modified versions of the UCC, so you should check on the law in y our state.

Or dinances

Or dinances ar e laws pass ed by municipal bodies. Cities, towns, an d incorporated villages ha ve the power to establish laws for the pr otection of the public 's health, saf ety , and welfar e. Counties generally do not ha ve legislativ e power , but the y usually ha ve th e power to enfor ce state laws within their boundaries.

Administrativ e Regulations

Administrativ e regulations ar e rules pr omulgated by go vernment agencies. At the federal le vel and in many states, ther e ar e *ex ecutiv e*

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agencies (created by the president or governor) and *legislative agencies* (created by Congress or the state legislature). Examples of agencies include the Federal Trade Commission (FTC) on the federal level and the public utility commission on the state level. The rules and regulations of these entities have the full force and effect of law. They read very much like a statute.

Common Law

The term *common law* has multiple meanings depending on the context. In its broadest sense, it means the body of law derived from court decisions. Anglo-American common law is the body of English law that the colonists adopted and supplemented with their own local decisions and enactments.[34] All U.S. states except for Louisiana have a common-law system. Louisiana, like most European nations, has a code-based legal system. These code-based legal systems, commonly called civil-law systems, rely on statutory authority in deciding cases rather than following precedent. If there is no statutory authority to decide a case, the court cannot issue a ruling in a civil-law system. Courts in a civil-law system lack the authority or power to "make law" through judicial rulings that establish precedent. Courts in common-law countries do "make law" by establishing and following precedent.

Case Law

Case law comes from court cases that are reported in the law reports and is part of the common law. Quite often, the judges must interpret statutes to apply them to actual cases and controversies. You will not fully understand a particular statute until you have read both the statute *and* the cases that have interpreted it. *Case law*, then, is the law as articulated by judges.

The American Law Institute (ALI) is dedicated to clarifying the law, improving the administration of justice, and drafting the Restatements of the Law. *Restatements* are not actually part of the law; rather they are treatises that summarize the law on a subject. When there are conflicting approaches, the *Restatement* "recommends" one of the

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alternativ es. *Restatements* bec ome par t of the case law when a cour t relies on a par ticular section in r eaching its opinion.

Star e decisis is an ancient doctrine that means the question has been de cided. For example, if a par ticular legal point is well settled in a cer tain jurisdic tion, a futur e case with substantially the same facts will be decided in accor dance with the principle that has already been adopted. This is one of the reasons that lawy ers do a gr eat deal of legal resear ch. The doctrine of *star e decisis* is also called pr ecedents. As the U.S. Supr eme Cour t said, "*Star e decisis* is the pr ef err ed course because it pr omotes the evenhanded, pr edictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and per ceiv ed integrity of the judicial pr ocess. "[35]

When a cour t follows pr ecedent, it is striving to mak e the law *definite* , satisfy ing one of the needs of a legal system. Howe ver, as times and situations change, cour ts need to be able to change. The law would not be *flexible* , another need of a legal system, if pr ecedents could ne ver be changed. Cour ts can ha ve a difficult time balancing the need to be de finite and the need to be flexible. *Br own v. Boar d of Education* [36] is an example of a cour t over turning pr ecedents. In tha t case, th e U.S. Supr eme Cour t over turned pr ecedents and decided that separating ch ildr en in public schools based on their race was unconstitutional. This over turned the pr ecedent that "separate but equal" schools wer e constitutional.

As pr eviously mentioned, the legal system does not remain static. A cour t will over turn pr ecedents when ther e is a str ong reason to do so. Generally , a pr ecedent remai ns in eff ect until it is changed. Lawy ers and petitioners in cour t ma y try to persuade the judge to modify pr ecedents, and sometimes the y ar e successful. When a cour t changes the pr ecedents, it w ill generally suppor t its decision with one of these thr ee r easons:

1. The prio r rule is out of date; it is not appr opriate to pr esent- da y society .
2. The prior case is distinguishable because the facts ar e diff er ent in one or mor e significant details.

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3. The judge or justice who made the prior ruling was incorrect or wrong.

Judges may be reluctant to state that the prior ruling was in error, especially if they participated in making that ruling. It is easier to state that someone else made an error. Judges *sometimes* do admit that the rule they created earlier is not the appropriate response to a particular legal problem.

Dictum is language by a judge that is not necessary to the decision before the court. It is an observation or remark that is not necessarily involved in the case or essential to its resolution. These remarks or asides are not part of the precedents. Dictum can provide valuable clues about how that judge might decide future cases.

An opportunity to "make law" occurs when jurisdictions are in conflict over a point of law. For example, many states are divided into judicial districts, and courts in each of these districts may issue written legal opinions. If two or more districts have published conflicting opinions on a particular point, the issue is ready for the creation of a new statewide rule that will resolve the matter. Until the statewide rule is created, however, each court creates precedents for itself and for any courts directly under it. When there are no prior court decisions on a point of law, the case is one of first impression. *First impression* occurs when an issue is presented to the court for an initial decision; the issue presents a novel question of law and is not governed by any existing precedent.

Equity

Equity is a body of rules applied to legal controversies when no adequate remedy at law exists. Rules of equity were developed outside the common-law courts in England by an officer of the King called the chancellor. The primary reasons for developing equity were the unfair decisions made by the courts of law and the limited types of remedies available in them.

Today, law and equity are joined into one legal system. One of the main distinctions between them is the type of remedy available. Money damages is the primary remedy at law. An injunction is an example of

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an equitable remedy. Before U.S. courts will issue an injunction, the person requesting it must prove that the remedy at law would be inadequate. For example, if your neighbors are burning rubber tires on their property and the wind carries the obnoxious odor directly across your property, their action will destroy the peaceful use and enjoyment of your land. You would not have an adequate remedy at law, since no amount of monetary damages would be sufficient to allow them to continue to burn the tires. You could request that the court issue an injunction to stop your neighbors from burning the tires.

Equity developed a number of doctrines in an attempt to achieve fairness. One of those doctrines is the *clean hands doctrine.* A plaintiff should come into equity with clean hands, i.e., the plaintiff should not have committed fraud, deceit, unconscionability, or acted in bad faith in the plaintiff's treatment of the defendant. In other words, courts should not grant a plaintiff equity if the plaintiff has been unfair in the plaintiff's treatment of the defendant. (This is sometimes stated in the negative, i.e., the plaintiff will not receive equity if the plaintiff has unclean hands.)

In a larger sense, equity is a doctrine that results in the legal system's adhering to the principle of fairness. Exhibit 1.6 summarizes some of the differences between law and equity.

CLASSIFICATIONS OF LAW

Federal versus State Law

The U.S. legal system is divided into two branches: federal and state. Lawyers must learn not only the law of their state but also federal law. In addition, lawyers should know the majority rule. The *majority rule* is simply the rule that most states have adopted. Often there is also a *minority rule*, which a smaller number of states follow. Rarely do the various states agree on all aspects of a law. Exhibit 1.7 outlines the sources of law. Note that there is some overlap between case law and common law.

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Exhibit 1.6

Distinctions Between Actions in Law and in E quity [a]

Characteristic	In Law	In E quity [b]
Type of r elief	Mone y t o compensate plaintiff for the plaintiff 's losses	Action, either in the form of or dering the def endant t o do or not t o do something, or in the form of a decr ee about the status of something [c], [d]
Natur e of pr oceeding	Mor e r estricted by pr ecedents	Mor e flexible and less restricted b y pr ecedents, supposed t o cr eate equity (justice)
Time limit for filing lawsuit	Applicable period fix ed b y the statute of limitations [e]	A r easonable period of time as determined b y the judge on a case-b y-case basis [f]
Decider of fact	Jur y trial, if requested b y a par ty	No jur y trial, judge decides the facts [g]
Enfor cing a decision	Plaintiff ma y begin an ex ecution of the judgment [h]	Plaintiff ma y begin contempt pr oceedings if the def endant does not per form as dir ected; def endant ma y be placed in jail and/or fined [i]

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[a] Actions at law and those in equity are no longer as distinct as they once were. As a result, some states allow "combined" trials, with issues of law and issues of equity being tried together.

[b] Traditionally, a court of equity was called a court of chancery, and the judge was called a chancellor.

[c] Common equitable remedies include injunction, specific performance of a contract, rescission of a contract, and reformation (correcting or rewriting) of a contract.

[d] Courts would prefer to award monetary damages. Equitable relief is only granted when the plaintiff can convince the court that money would be inadequate.

[e] The statute of limitations period will depend on the state and the type of lawsuit. It will be a fixed period.

[f] If the plaintiff has waited too long to file suit under the circumstances, the judge will apply the doctrine of laches, and the suit will be dismissed.

[g] Some states permit the use of an advisory jury.

[h] In an execution, the clerk of the court issues a formal document and the sheriff seizes the defendant's money and/or other property. If property is seized, the sheriff will sell it and use the proceeds to pay the plaintiff.

[i] The court is authorized to place the defendant in jail until the defendant complies (or agrees to comply) with the court decree.

Common versus Statutory Law

The legal system consists of both common and statutory laws. Judges in the United States and England generally have the power to "make law" by interpreting statutes or applying precedents, and those interpretations become "common" law. Judges also apply the statutory law. Statutory law refers to the statutes passed by the legislative bodies. Common law is "unwritten" law developed over time by judicial action. It fills the gaps where other sources of law do not completely cover a particular topic.

Exhibit 1.7

The Sources of Law in the U.S. Legal System

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Legend: F = federal; S = state		
Authority	**Source**	**Definition**
F, S	Constitution	Supr eme law of the land; fundamental basis of domestic law
F	Treaties	Formal agr eements between nations; fundamental basis of international law; not based on the Constitution
F, S	Statutes	Acts of the legislatur e that contr ol conduct; subject t o any limits imposed b y the Constitution
S	Or dinances	Laws passed b y municipal bodies and designed t o contr ol pur ely local pr oblems; subject to any limits imposed b y statutes or b y the Constitution
F, S	Administrativ e Regulations	Acts of administrativ e agencies that contr ol specific ar eas of conduct; subject t o any limits imposed b y statutes or b y the Constitution
F, S	Case Law	Pr ecedents; cour ts define and interpr et ar eas of law
F, S	Equity	Special rules and r elief when “the law” does not pr o vide a pr oper and/or adequate remedy

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Civil versus Criminal Law

The U.S. legal system also separates civil and criminal law. In this context, *civil law* is private law that permits one person to sue another. *Criminal law* is public law in which a government entity files charges against a person. For example, if Bekah becomes violent, attacks another individual, and inflicts bodily harm, the district attorney may prosecute Bekah for assault. The district attorney is the government representative in state court. If convicted, Bekah may go to jail or prison. In addition, the person who was injured may sue Bekah in civil court for money damages. The additional suit would not constitute double jeopardy or its civil-law equivalent, *res judicata*, since two different theories of action exist: criminal and civil. (*Res judicata* is a rule of civil law that prevents a person from being sued more than once by the same party for the same civil wrong.) Some courts permit criminal cases and civil cases to be heard as part of the same trial.

There are several significant differences between civil and criminal law. One of the most significant differences is the burden of proof. In a civil case, the plaintiff must prove the plaintiff's case by a preponderance of the evidence. (A *preponderance of the evidence* means that the evidence on this side is stronger than the evidence on the other side. In other words, the plaintiff must provide evidence of greater weight than the defendant to win.) In a criminal case, the judge or jury must start with the presumption that the defendant is innocent, and the government must convince the judge or jury that the defendant is guilty *beyond* a reasonable doubt. (A *reasonable doubt* means a belief that there is another reasonable explanation for the crime based on the evidence presented.)

It is important to remember that the action itself does not necessarily tell you whether a case is civil or criminal. Exhibit 1.1 outlines some clues that can help you determine whether a case is a tort, a crime, or a contract dispute.

Cyber Guardian 1.3 Management

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LOBB YING THE GO VERNMEN T ON BEH ALF OF CYBER GU ARDI AN

Thought leaders in the ar ea of AI ha v e suggested that use of AI should be regulated. F ederal and state legislatur es ha v e intr oduced pr oposals. Asher , Danica, and Mai ar e concerned that go v ernment re gulation ma y restrict their oppor tunities to mak e mone y. Asher , Danica, and Mai would lik e to testify befor e the legislatur e to discourage it fr om passing legislation. The y ha v e turned t o y ou for advice. What will y ou tell them?

BUSINESS CONSIDERATION S What options ar e a v ailab le to Cyber Guar dian under these cir cumstances? What can or should a busin ess do when it feels that pr oposed legislation will seriously impact its pr ofits?

ETHICAL CONSIDERATIONS W ould it be ethical for a firm to attempt to influence potential legislation? What ethical considerations arise when a firm decides to influence members of the legislatur e?

Substantiv e v ersus Pr ocedural Law

Substantiv e law deals with rights and duties giv en or imposed b y the legal sy stem. *Pr ocedural law* is de v oted to h ow those rights and duties ar e enfor ced. F or example, th e law of contracts is substantiv e law . The law of pleading s describes the steps used to enfor ce tho se rights or duties. (*Pleadings* ar e formal statements filed in cour t identifying the claims of the par ties.) A contr o v ersy o v er the mental abil ity to form a v alid contract is a substantiv e matter . Wher e one files the lawsuit, what must be alleged, how one n otifies the def endant, and how long the def endant has to answer the allegations ar e all examples of pr ocedural law . This book is de v oted primarily t o " substantiv e" law .

Public v ersus Priv ate Law

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Private law is the body of law that deals with the property and relationships of private persons. It includes the areas of *property law* (ownership and transfer of assets), *contract law* (rights and duties that arise from enforceable agreements), *tort law* (other private wrongs such as negligence, invasion of privacy, and defamation), and *business relationships* (agency, partnerships, corporations, and similar entities). *Public law* deals with the relations between private individuals and the government. It also deals with the structure and operation of the government itself. *Constitutional law* (law relating to the government and its activities under the Constitution), *criminal law* (law relating to offenses against society), and *administrative law* (law relating to government agencies) are types of public law. Both private law and public law are very important to business decision making.

Contemporary Case

In this Contemporary Case, the courts are being asked to interpret §1964(c) of the federal Racketeer Influenced and Corrupt Organizations Act (RICO). For a more detailed discussion of RICO, see Chapters 6 and 7. The trial court granted a summary judgment to Medical Marijuana, basically saying that Horn could not recover. The court of appeals disagreed and the U.S. Supreme Court agreed to hear the issue. This is the Supreme Court's opinion. It is common for the Supreme Court's justices to disagree with each other. That occurred here. We include the majority opinion.

MEDICAL MARIJUANA, INC. v. HORN

604 U.S. 593 (2025)

FACTS[37] In 2012, Douglas Horn was working as a commercial truck driver when he crashed his truck and injured his back and shoulder. Months later, he was still suffering from chronic pain, and neither physical therapy nor traditional medicine provided relief. While searching for a natural alternative, Horn came across "Dixie X," a tincture infused with cannabidiol—more commonly known as CBD—

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sold by Medical Marijuana, Inc. CBD, like its cannabis "cousin" tetrahydrocannabinol (THC), is a naturally occurring chemical compound found in the cannabis plant. Only THC, however, has the mind-altering properties associated with marijuana.

Because a positive drug test could cost him his job, Horn was wary of any product that might contain THC. But Dixie X seemed safe. It was described as a "CBD-rich," non-psychoactive medicine that is "0% THC." . . . Medical Marijuana's online FAQ page promised that Dixie X was "legal to consume both here in the U.S. and in many countries abroad." . . . Additional research, including a call to a customer-service representative, reinforced those representations. Satisfied that Dixie X was THC-free, Horn bought a bottle and gave it a try.

A few weeks later, Horn's employer selected him for a random drug screening. To his surprise, the test detected THC in his system. After Horn refused to complete a substance-abuse program—in his view, doing so would constitute "an admission to doing drugs," . . . his employer fired him. Horn then ordered another bottle of Dixie X and sent it to a third-party lab for testing. This test also came back positive for THC. In fact, the lab refused to mail the sample back to him, fearing that doing so would violate federal law.

ISSUES Can a plaintiff recover under civil RICO for a business loss that derives from a personal injury? (Civil RICO specifically denies a remedy for personal injury.) Is Horn entitled to a trial on whether he was injured in his "business"?

HOLDINGS Yes. Civil RICO does not prevent recovery for all business harms that are based on a personal injury. Yes. Horn was fired for using Dixie X. This could be considered an injury in his business under civil RICO.

REASONING Excerpts from the opinion of Justice Barrett:

The Racketeer Influenced and Corrupt Organizations Act (RICO) creates a cause of action for "[a]ny person injured in his business or

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proper ty." . . . We must decide whether the statute . . . denies a remedy for business and proper ty loss that derives from a personal injur y. It does not. . . .

Horn sued Medical Marijuana in Federal District Court. . . . He alleged that Medical Marijuana was a RICO "'enterprise '" engaged in marketing, distributing, and selling Dixie X . . . (a RICO enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct"). He also asserted that Medical Marijuana 's false or misleading advertising satisfied the elements of mail and wire fraud and that those crimes constituted a "'pattern of racketeering activity .'" . . .

Section 1964(c) provides that "[a]ny person *injured in his business or proper ty* by reason of a violation of [RICO] may sue. . . ." . . . The ordinary meaning of "injure" is to "cause harm or damage to" or to "hurt." . . . The meaning of the relevant phrase is therefore straightforward: A plaintiff has been "injured in his business or proper ty" if his business or proper ty has been harmed or damaged. Section 1964(c) requires nothing more.

Even so, §1964(c) does not allow recovery for all harms. Instead, by explicitly permitting recovery for harms to business and proper ty, it implicitly excludes recovery for harm to one 's person. . . . But the "business or proper ty" requirement operates with respect to the *kinds* of harm for which the plaintiff can recover, not the *cause* of the harm for which he seeks relief. . . . In short, a plaintiff can seek damages for business or proper ty loss regardless of whether the loss resulted from a personal injur y. . . .

When a word carries both an ordinary and specialized meaning, we look to context to choose between them. . . . Here, context cuts decisively in favor of ordinary meaning. As an initial matter , the statute uses the word "injured" rather than "injur y." . . .

[In prior cases, we] adopted a contextual, fact-intensive inquir y that accounts for "the nature of the alleged injur y, the racketeering activity

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that directly caused it, and the injurious aims and effects of that activity ." . . .

First and foremost is RICO's direct-relationship requirement. Time and again, we have reiterated that §1964(c)' s . . . language demands "some direct relation between the injury asserted and the injurious conduct alleged. " . . . The key word is "direct" . . . . Given the number of steps in Horn 's theory and the multiple actors involved, this requirement may present an insurmountable obstacle in his case. Indeed, even Horn concedes that he faces "a heavy burden on remand. " . . . There is, after all, some distance between the first link in the chain (Medical Marijuana 's misrepresentations) and the last (Horn 's job loss).

Second , pleading a RICO claim is not as simple as pointing to a business or property harm. A plaintiff must first establish a pattern of racketeering activity . . . . Doing so requires identifying two or more predicate crimes "within a single scheme that were related and that amounted to, or threatened the likelihood of, continued criminal activity ." . . .

Third, the reach of §1964(c) turns on more than the meaning of "injured. " "[B]usiness" may not encompass every aspect of employment, and "property" may not include every penny in the plaintiff 's pocketbook. Accordingly , not every monetary harm—be it lost wages, medical expenses, or otherwise—necessarily implicates RICO . . . .

[C]ivil RICO has undeniably evolved "into something quite different from the original conception of its enactors. " . . . More suits are brought against ordinary businesses than against "archetypal, intimidating mobster[s]" . . . . [G]iven this development, Medical Marijuana is not the first litigant to express concern about "the 'over-federalization ' of traditional state-law claims" . . . . But we respond today as we have before: If the breadth of the statute "leads to the undue proliferation of RICO suits, the ' correction must lie with Congress. '" . . .

The phrase "injured in his business or property" does not preclude recovery for all economic harms that result from personal injuries. We

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therefore affirm the Second Circuit's judgment and remand the case for further proceedings consistent with this opinion.

It is so ordered.

You Be the **Judge**

Hatem Kaisi operated a business selling vehicles. John Isaacs provided accounting services to him. He also prepared Kaisi's tax returns. Kaisi participated in a "family ownership scheme." Kaisi alleges the scheme was created by Isaacs. In the scheme Kaisi allegedly could avoid taxes by diverting income to Kaisi's family members. Part of the scheme involved creating additional business entities. Kaisi was indicted for the crime of tax evasion for improperly reporting income. He was also indicted for falsely claiming he was eligible for low-income Medicaid medical coverage.

Kaisi could have pled not guilty and litigated the federal government's claims. If he had chosen that option, Kaisi could have argued that he relied in good faith on the advice of his tax professionals. Instead, Kaisi pled guilty to the charges. The plea agreement included the following language, "because he is in fact guilty of the charges." Kaisi agreed to the factual basis for the charges and that he "willfully" participated in tax evasion. Kaisi received a prison sentence and was required to pay the federal government some money.

Kaisi is suing Isaacs to recover for his losses for supposedly advising him to create the scheme. Kaisi alleges several types of losses, including loss of reputation. (This case is being decided based on the civil complaint. However, Isaacs claims that Kaisi did not follow all of his instructions.) Most of Kaisi's claim is based on Issacs' malpractice as an accountant. Should Kaisi be allowed to litigate his civil dispute? Assume that Kaisi files his malpractice claim in *your* court. How will *you* decide? What decision would best serve the public policy? Why? What purposes of the legal system would be served by

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your approach? Why? [See *Kaisi v. Isaacs*, NO. 2023-CA-0511-MR, 692 S.W.3d 405 (Ky. Ct. App. Jun. 21, 2024).]

Summary

- The U.S. legal system seeks to balance law, order, and justice.
- The law has an artificial language system.
- Studying the law of business helps you learn how to avoid legal problems and when you should consult an attorney.
- A legal system needs to be reasonable, definite, practical, published, and final.
- A legal system focuses on achieving justice by properly using police power; by keeping the peace or maintaining the status quo; by providing answers; by providing protection; by enforcing intent; by rehabilitating people; and by facilitating commercial transactions.
- U.S. law and legal procedures can be very different from the law in foreign countries.
- There are various theories of jurisprudence concerning how the law works or how it should work.
- The sources of law in the U.S. legal system are constitutions, treaties, statutes, ordinances, administrative regulations, common law, case law, and equity.
- U.S. law consists of common and statutory law, civil and criminal law, substantive and procedural law, public and private law, and federal and state law.

Discussion Questions

1. Assume you are a business owner. Ask AI which types of law might apply to your chosen field of work. Be sure to specify exactly what your business does and where your business is located. This is up to you. Review the results. How many of the examples provided are statutes? Regulations? Court cases? If there are any areas of law not mentioned, ask AI whether laws in that

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categor y apply to your business. How did you adjust your pr ompts to get information that was useful and r ele v ant?

2. What ar e the adv antages of ha ving cour ts follow pr eceden ts? What happens when a cour t changes a long-standing pr ecedent? How does that aff ect U.S. society? (Remember that not all legal systems follow pr ecede nts. In some countries, cour ts do not w rite and publish opinions because their decisions do not set pr ecedents.)

3. John R awls writes about justice and the elements that ar e necessar y for a just society . He describes the "Bar gaining Game, " a theor etical community of men and women who come together to bar gain for a completely new set of moral rules (laws) which the y must all obe y in the futur e. Once the rules ar e selected, the pla yers must adher e to the rules, e v en if the rules ar e not in their self-inter est in a par ticular situation. The pla yers choosing the rules do not kno w their own position in society , talents, or abilities. Rawls calls th is the v eil of ignoran ce.[38] R awls has be en interpr eted as sa ying, "In eff ect, the par ties choose principles for the design of society as if th eir places in it wer e to be determined b y th eir worst enemies. "[39] What rules do you think the pla yers would choose and why?

4. Consider the theories of jurisprudence discussed in this chapter . Which one do y ou agr ee with most? Why?

5. Ronald Lesnick took Brad Wi nter 's winning tick et fr om a gambling machine at the Wynn casino . Lesnick took the tick et to the main cage clerk at the casino, cl aiming that it was his. He receiv ed pa yment on the tick et. Lesnick was convicted of grand lar ceny for stealing the tick et fr om Winter and theft and commission of a fraudulent act in a gaming establishment for pr esenting the tick et for pa yment to the Wynn cage clerk. Lesnick claims that the multiple convictions v iolate his right to pr otection against double jeopar dy .[40] Do y ou agr ee? Why or why not?

Case Problems and W riting Assignments

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1. Robyn Potter worked part-time as a registered nurse at a facility run by the Essentia Health (Essentia) integrated healthcare system. Essentia revised its flu vaccination policy in August 2017 to "help protect Essentia Health staff, visitors, patients, and families from acquiring and transmitting seasonal influenza disease." Under the revised policy, all employees, vendors, contractors, and volunteers had to receive the influenza vaccine "unless they qualified for a religious or medical exemption." Employees who wanted an exemption had to complete a request form which was reviewed by a committee. The committee "reviewed the exemption requests based upon legal standards and Equal Employment Opportunity Commission guidelines." There was also an appeal procedure for employees "whose exemption requests were denied." The requests of some employees were granted. Employees who did not either get the vaccine or an exemption were fired.

In November 2017, Potter filed an exemption request form which "indicated that she is Catholic and that the 'Bible, both the Old and New Testaments reference keeping [the] body blemish-free so [one] might have abundant life.'" She also said the policy discriminates against her "own personal beliefs." Her request was denied because the request "[did] not appear to be based upon any religious reasons." Her appeal was also denied. She was given a deadline for getting a vaccination. Potter was terminated in December 2017 when she did not obtain one. She then filed for unemployment benefits. The Minnesota Department of Employment and Economic Development (DEED) denied her benefits because they determined she was fired for employment misconduct. States do not provide unemployment benefits to employees who are fired for good cause. Potter appealed DEED's determination. An unemployment-law judge (the ULJ) held a hearing. Testimony indicated that Potter had received flu shots while she was in the military and she recently had other vaccinations. She said that some vaccines save lives but that she did not believe the flu vaccine could save lives. "Potter testified that her belief that the influenza vaccine is not effective is 'a personal belief based on numbers from the government.'" She could not quote any Bible passages or other church documents that indicated people should not be vaccinated. The ULJ decided "Potter

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was driven by a personal, secular belief." "Potter is unwilling to inject what she considers scientifically ineffective impurities but is willing to inject what she considers scientifically effective impurities." "The ULJ determined that Potter's refusal to be vaccinated displayed a serious violation of the standard of behavior that Essentia had a right to reasonably expect." Were Potter's beliefs "sincerely held religious beliefs" entitled to protection? Why or why not? Is this an example of public law or private law? Why? [See *Potter v. St. Joseph's Medical Center*, A18-0736, 2018 WL 6729836 (Minn. Ct. App. Dec. 24, 2018) (unpublished opinion).]

2. Evangelisto Ramos was convicted of second-degree murder in the Louisiana trial court based on a 10-to-2 jury verdict. He was sentenced to life in prison without possibility of parole. Forty-eight states and the federal court system require a unanimous verdict in criminal cases. In those courts, Ramos would have been acquitted. However, Louisiana and Oregon punish suspects based on 10-to-2 verdicts. The Sixth Amendment right to a jury trial applies to the states under the Fourteenth Amendment. The Sixth Amendment does not say anything specific about what a trial by a jury includes. However, in 1791, when the Sixth Amendment was ratified, a trial by jury meant a trial by a unanimous jury. Ramos raises the issue of whether his trial complied with his constitutional right to a jury trial.

"Louisiana first endorsed nonunanimous verdicts for serious crimes at a constitutional convention in 1898. According to one committee chairman, the avowed purpose of that convention was to 'establish the supremacy of the white race,' and the resulting document included many of the trappings of the Jim Crow era: a poll tax, a combined literacy and property ownership test, and a grandfather clause that in practice exempted white residents from . . . these requirements. Nor was it only the prospect of African-Americans voting that concerned the delegates. Just a week before the convention, the U.S. Senate passed a resolution calling for an investigation into whether Louisiana was systemically excluding African-Americans from juries. . . . [Aware that courts] would strike down any policy of overt discrimination against African-American jurors . . . , the delegates sought to

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undermine African-American participation on juries in another way. With a careful eye on racial demographics, the convention delegates sculpted a 'facially race-neutral' rule permitting 10-to-2 verdicts in order 'to ensure that African-American juror service would be meaningless.' "[41]

In 1972, the U.S. Supreme Court examined Louisiana's and Oregon's unconventional schemes in *Apodaca v. Oregon*[42] and *Johnson v. Louisiana*.[43] In both cases, it upheld the legality of the 10-to-2 jury verdicts in a badly fractured set of opinions with a four-Justice plurality. *Apodaca* did not provide an opinion in which the Justices agreed on the reasons. Four dissenting Justices determined that the Sixth Amendment requires a unanimous jury and that it applied to the states. The four Justices who made up the plurality said the real question was whether unanimous juries serve an important function in contemporary society. They then concluded that the cost of requiring unanimous juries outweighs the benefits to society, so they are not required. Justice Powell, the ninth Justice, argued that the jury trial requirement for the states can be less than the jury trial requirement for the federal government; his opinion disagreed with many cases of precedents that had already been decided.

When a court considers whether to follow precedent it generally considers (1) the quality of the reasoning; (2) the consistency with related decisions; (3) legal developments since it was decided; and (4) the amount of reliance there has been on the precedents.

When should the court follow precedents? Why? When a court overturns precedents, how does that affect whether the law is definite? Was Ramos deprived of his Sixth Amendment right to a trial by an impartial jury? How should the court decide this case? Be certain that you explain and justify your answer. [See *Ramos v. Louisiana*, 590 U.S. 83 (2020).]

3. On September 24, 2007, Sandra A. Sheldon and James J. Sheldon (defendants or mortgagees) signed a promissory note in which they promised to pay $182,000, plus interest, to GMAC Mortgage, LLC (GMAC). A short time later, they accepted GMAC's offer to join its bisaver program. Under the program, payments would be withdrawn

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directly from Sandra Sheldon's checking account. GMAC started withdrawing the payments. GMAC ceased withdrawing the biweekly payments around August 2008. No reasons were given for this change. The missed payments were GMAC's fault. However, GMAC reported the nonpayments to several credit reporting agencies. This quickly damaged the defendants' credit. James Sheldon's credit cards were cancelled. Since he needed at least one credit card to travel out of town for work, he had to stop work and his income dropped significantly. Defendants complained to the state Department of Business Regulation, Division of Banking. "An officer there told GMAC that it 'screwed up and you gotta fix it.'"[44] A GMAC representative admitted that it was its fault for not withdrawing the payments. GMAC continued to report that defendants were in default to the credit reporting agencies.

On July 14, 2009, defendants and GMAC orally agreed that if defendants paid all their unpaid installments and made three regular payments that GMAC would restore their credit. The defendants lived up to these terms. GMAC did not restore their credit. At some point, GMAC did send the defendants a letter acknowledging its mistake and said the defendants could share the letter to try to fix their credit. The defendants did not believe this letter lived up to the terms of their 2009 agreement. The defendants stopped making future payments based on advice they received. GMAC resumed the negative credit reports.

On August 20, 2010, GMAC transferred the mortgage to Ocwen Loan Services, LLC. This transfer is called an assignment, and the new loan company stands in the legal position of GMAC. James Sheldon explained the background to Ocwen. Ocwen refused to restore their credit or consider the effect of GMAC's mistakes. Neither GMAC nor Ocwen sent letters to the credit reporting agencies acknowledging GMAC's error. Instead, under the terms of the mortgage, Ocwen accelerated the mortgage so that the entire unpaid balance was due. The poor credit rating continued to harm the defendants. In 2017, Ocwen began foreclosure proceedings.

Foreclosure on a mortgage is an equitable remedy. It is a more flexible approach. Courts of equity use the clean hands doctrine. Under the doctrine, plaintiffs may not obtain equity if the plaintiff has unclean

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hands. There is no rigid rule for what is unclean hands. In the words of the court, to constitute misconduct, it must be "of such a character as to be condemned and pronounced wrongful by honest and fair-minded people."[45]

Should the mortgage company be allowed to foreclose on the property? Should the equitable remedy be disallowed based on unclean hands? How would you decide the mortgage company's foreclosure action? Why? [See *Ocwen Loan Servicing, LLC v. Sheldon*, 208 Conn. App. 132, 264 A.3d 106 (Conn. Ct. App. 2021).]

Notes

1. *Barlow v. United States,* 32 U.S. 404 (1833).
2. In 2003, the Uniform Law Commission (ULC) enacted proposals to raise the dollar amounts for the sale of goods and leases. States did not adopt the 2003 revisions to UCC Article 2 and 2A. The ULC withdrew both revised Article 2 and 2A (2003) in 2011. Henry Gabriel, "Uniform Commercial Code Article Two Revisions: The View of the Trenches," 23 Barry L. Rev. 130 (Issue 2, Article 4, 2018), *available at* https://lawpublications.barry.edu/barrylrev/vol23/iss2/4/ (last visited Jun. 11, 2025); and Legal Information Institute, Cornell Law School, "U.C.C.—Article 2A—Leases (2003 Revision—Withdrawn)," https://www.law.cornell.edu/ucc/2a/article2a (last visited Jun. 11, 2025).
3. *Drysdale v. Prudden*, 195 N.C. 722, 143 S.E. 530, 536 (N.C. 1928).
4. The grand jury requirement is included in the Fifth Amendment and applies to federal criminal cases. This is not a requirement at the state level under the U.S. Constitution, although it may be required under the state's constitution or statutes.
5. "Violent Crime in D.C. Surges in 2012," *The Washington Times*, Feb. 19, 2012, https://www.washingtontimes.com/news/2012/feb/19/violent-crime-dc-surges-2012/ (last visited Jun. 11, 2025).
6. John Paul MacDuffie and The Detroit Bureau's Paul Eisenstein, "The Auto Bailout 10 Years Later: Was It the Right Call?," Knowledge at Wharton Podcast, Sep. 12, 2018. https://knowledge.wharton.upenn.edu/podcast/knowledge-at-wharton-podcast/auto-bailout-ten-years-later-right-call/ (last visited Jul. 19, 2025).
7. Janet Morrissey, "The Penalty for 'Extraordinary Evil': Madoff Gets 150 Years," *Time*, Jun. 29, 2009, https://time.com/archive/6906194/the-penalty-for-extraordinary-evil-madoff-gets-150-years/ (last visited Jun. 11, 2025).
8. The businessman allegedly defrauded more than 57,000 investors out of approximately RMB 2.8 billion (US $460 million). Zeng's family claims that they were not notified by the Chinese government prior to his execution. Headsman, 2013: Zeng Chengjie, China's Bernie Madoff, Executed Today, Jul. 12, 2014, https://www.executedtoday.com/2014/07/12/2013-zeng-chengjie-chinas-bernie-madoff/ (last visited Nov. 1, 2025).
9. Jeffrey Scott Shapiro, "Amanda Knox Murder Conviction Reversed by Italian Court," *The Washington Times*, Mar. 27, 2015, https://www.washingtontimes.com/news/2015/mar/27/italian-court-decides-fate-amanda-knox-murder-case/ (last visited Jun. 11, 2025).

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10. Starnes claimed that it was all a misunderstanding about layoffs and severance packages. Some workers had a different story, claiming that they were owed back pay. They also thought that the factory was going to be closed and everyone was going to be laid off. David McKenzie and Connie Young, "U.S. Businessman Held Hostage by His Workers in China, He Says," *CNN*, updated Jun. 25, 2013, https://www.cnn.com/2013/06/25/world/asia/china-us-businessman-hostage (last visited Jun. 11, 2025); Cy Xu and Holly Yan, "After 6 Days, U.S. Boss Held 'Hostage' by His Chinese Workers Freed," *CNN*, Jun. 27, 2013, https://www.cnn.com/2013/06/27/world/asia/china-us-businessman-freed/index.html (last visited Jun. 11, 2025).
11. See Anthony Shoult, *Doing Business with Saudi Arabia,* 88 (3d ed. 2006), as cited in Cooper C. Millhouse, "Injustice Anywhere: A Comparative Law Analysis of Saudi Arabia's Criminal Justice System," 47 UC L. SF Int'l L. Rev. 33, 35, Feb., 2024.
12. See Kerrie Sadiq and Ann Black, "Embracing Sharia-Compliant Products Through Regulatory Amendment to Achieve Parity of Treatment," 34 Sydney L. Rev. 189 (Mar. 2012).
13. After a public outcry and high-level discussions between Norway and UAE, Sheikh Mohammed bin Rashid Al Maktoum pardoned Dalelv. She was permitted to leave UAE. Nicola Goulding, Jennifer Z. Deaton, and Laura Smith-Spark, "Dubai Ruler Pardons Norwegian Woman Convicted after She Reported Rape," *CNN*, updated Jul. 22, 2013, https://www.cnn.com/2013/07/22/world/meast/uae-norway-rape-controversy/index.html (last visited Jul. 28, 2022). "In the United Arab Emirates, as in some other countries using Islamic law, a rape conviction can require either a confession or the testimony of four adult male witnesses." See Amena Bakr, Sami Aboudi, Kevin Liffey, Mirna Sleiman, and Balazs Koranyi, "Dubai Pardons Norwegian Woman Convicted After Reporting Rape," *Reuters*, Jul. 22, 2013, https://www.reuters.com/article/us-emirates-norway-pardon/dubai-pardons-norwegian-woman-convicted-after-reporting-rape-idUSBRE96L0TV20130722 (last visited Jul. 28, 2022).
14. Bryan A. Garner, *Black's Law Dictionary*, 7th ed. (St. Paul: West Publishing Co., 1999), at 858.
15. James Rachels, *The Elements of Moral Philosophy*, 2d ed. (New York: McGraw-Hill, 1993), at 50.
16. *Id.* More recently, John Finnis has written about natural law theory in *Natural Law and Natural Rights* (1980) and *Aquinas: Moral, Political, and Legal Theory* (1998). Richard W. Wright, "The Principles of Justice," 75 Notre Dame L. Rev. 1859 (2000), nn. 3 and 4.
17. Kenneth Einar Himma, "Natural Law," *The Internet Encyclopedia of Philosophy,* https://iep.utm.edu/natlaw/ (last visited Jul. 28, 2022).
18. There is both American Realism and Scandinavian Realism. We will only focus on American Realism.
19. Legal Realism, Cornell Law School, Legal Information Institute (LLI), Wex, Jun., 2023, https://www.law.cornell.edu/wex/legal_realism (last visited Jun. 26, 2025).
20. Noah Hornberger, "An Introduction to American Legal Realism," Northwestern Law Journal des Refusés, Vol. 1: Iss. 1, Article 4, https://scholarlycommons.law.northwestern.edu/nljr/vol1/iss1/4 (last visited Oct. 31, 2025), at p. 41. See also Legal Realism, LII, Cornell Law School, *id.*
21. Joel Feinberg, Jules Coleman, and Christopher Kutz, *Philosophy of Law* (9th ed.), p. 149. Copyright © 2010 and 2014, from Wadsworth, Cengage Learning. The Philosophy of Law anthology reprinted the paragraph from Jerome Frank, "Legal Realism," from the *Law and the Modern Mind* (New York: Doubleday and Co. Anchor edition 1963), pp. 46-52. Originally published by Brentanos. Inc., in 1930. Copyright © 1930, 1933, 1949 by Coward McCann.

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22. A modern example is whether the court should require an employee to arbitrate the employee's claims against the employer when the employee had no choice of whether to agree to the arbitration clause if the employee wanted the job.
23. Encyclopedia.com, Legal Realism, https://www.encyclopedia.com/law/encyclopedias-almanacs-transcripts-and-maps/legal-realism (last visited Jun. 12, 2025).
24. *Id.*
25. *Supra* note 19.
26. *Supra* note 23.
27. See *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 2 L. Ed. 60 (1803).
28. U.S. Constitution, Article II, Section 2. The case of *Missouri v. Holland*, 252 U.S. 416 (1920), established that statutes passed in accordance with a valid treaty cannot be declared unconstitutional.
29. United States Senate, "About Treaties/Historical Overview," https://www.senate.gov/about/powers-procedures/treaties/overview.htm (last visited Jul. 28, 2022).
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. Bryan A. Garner, *Black's Law Dictionary*, 11th ed. (St. Paul: West Publishing Co., 2019).
35. *Janus v. American Federation of State, County, and Municipal Employees, Council 31,* 138 S. Ct. 2448, 2478 (2018), quoting *Payne v. Tennessee,* 501 U.S. 808, 827, 111 S. Ct. 2597, 115 L. Ed. 2d 720 (1991).
36. *Brown v. Board of Education,* 347 U.S. 483 (1954).
37. The Facts for this case are quoted from the Court's opinion.
38. John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, Belknap Press, 1971).
39. Chandran Kukathas and Philip Pettit, *Rawls: A Theory of Justice and Its Critics* (Palo Alto, CA: Stanford University Press, 1990), p. 39.
40. *Lesnick v. State*, No. 84577, 528 P.3d 1135 (Nev. May 11, 2023).
41. Citations omitted. *Ramos v. Louisiana*, 590 U.S. 83 (2020).
42. *Apodaca v. Oregon*, 406 U.S. 404 (1972).
43. *Johnson v. Louisiana*, 406 U.S. 356 (1972).
44. *Ocwen Loan Servicing, LLC v. Sheldon*, 208 Conn. App. 132, 135, 264 A.3d 106 (Conn. Ct. App. 2021).
45. *Id.* at 146.

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2

Business Ethics

Learning Objectives

After completing this chapter, you should be able to:

- Explain why ethics are important to business
- Describe the main ethical theories
- Distinguish consequential and nonconsequential theories
- Recognize the ethical perspective of an author or speaker
- Select an ethical theory and analyze a dilemma from the perspective of that theory
- Identify the stakeholders in a business decision

Outline

- Introduction
- Ethical Theories
- A Synthesis for Ethical Decision Making
- Informal Approaches
- The Evolution of Businesses as Ethical Entities
- Multinational Ethics
- A Recommendation for Business

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Agenda

Asher , Danica, and Mai need to understand and appr eciate the ethical obligations and expectations under which the y will operate Cyber Guar dian. A business toda y is expected to act ethically , even if it has not adopted any par ticular ethical theor y or written a formal statement of its ethical principles. This expectation is lik ely to incr ease. The principals also need to realiz e that a business must satisfy the *social contract* it has with soc iety , even if th e business or its owners and managers ar en't awar e that the y ha ve enter ed int o such a "contract. " This is a significant por tion of the social responsibility of a business.

The principals must weigh their decisions, consideri ng the potential posit ive and negativ e impact on each of the firms' s constituent gr oups. The y ma y also want to decide how the y should measur e the ethical implications and impact of any business decisions. How does a mana ger know what society expects under the social contract theor y?

The y will need to know who the constituents of the business ar e and ho w the conduct of the business leaders can aff ect each of these diff er ent constituent gr o ups. These and other issues need to be addr essed in co vering the ma terial in this chapter . Be pr epar ed! You ne ver know when the firm or one of its members will need your advice.

Classic Case

In Chapter 1, the focus was on the law . In this chapter , the focus is on business ethic s. As you read the cases in this chapter , consider the ethics of th e par ticipants. F or examp le, in this Classic Case consi der the ethics of Jacobson and the city of C ambridge officials. In this decision, the U.S. Supr eme Cour t analyz ed whether the smallpo x vaccine requir ement was constitutional under the polic e power of the state. The Cour t consider ed whether one person had the right to refuse a mandat or y vaccination when the pr ogram was intended t o help the common good.

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JACOBSON v. MASSACHUSETTS

197 U.S. 11 (1905)

FACTS Henning Jacobson lived in the city of Cambridge. Cambridge had a smallpox outbreak that seemed to be getting worse. The Cambridge Board of Health passed a regulation that required all adults to get the smallpox vaccination. The city provided the vaccinations for free. Jacobson refused to have the vaccination. He appeared to be healthy at the time of the regulation. Jacobson did experience a negative reaction to a vaccination as a child.

ISSUE Must adults within Cambridge comply with the Board of Health's regulation to have a smallpox vaccination?

HOLDING Yes. The vaccination requirement is constitutional.

REASONING Excerpts from the opinion of Justice Harlan:

. . . The authority of the State to enact this statute is . . . commonly called the police power—a power which the State did not surrender . . . under the Constitution. . . . [This court] has distinctly recognized the authority of a State to enact quarantine laws and "health laws of every description." . . . According to settled principles, the police power of a State must be held to embrace . . . such reasonable regulations . . . as will protect the public health and the public safety. . . . It is equally true that the State may invest local bodies . . . with authority . . . to safeguard the public health and the public safety. The mode or manner in which those results are to be accomplished is within the discretion of the State, subject . . . to the condition that no rule prescribed by a State, nor any regulation adopted by a local governmental agency . . . shall . . . [violate] the Constitution of the United States or infringe any right granted or secured by that instrument. . . .

The defendant insists that his liberty is invaded when the State subjects him to fine or imprisonment for neglecting or refusing to submit to vaccination; that a compulsory vaccination law is unreasonable, arbitrary and oppressive, and, . . . hostile to the inherent right of every freeman to care for his own body and health in such way as to him seems best. . . . But the liberty secured by the Constitution of the United States . . . does not

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impor t an absolute right in each person to be, at all times and in all cir cumstances, wholly fr eed fr om restraint. Ther e ar e . . . restraints to which ev ery person is necessarily subject for the common good. . . . [A society] based on the rule that each one is a law unt o himself would soon be confr onted with disor der and anar chy . Real liber ty for all could not exist under the operation of a principle which recogniz es the right of each individual person [to mak e his own decisions] . . . regar dless of the injur y that ma y be done to others. . . . "[P]ersons and pr oper ty ar e subjected to all kinds of restraints and bur dens, in or der to secur e the general comfor t, health, and pr osperity of the State. " . . . "[A]ll rights ar e subject to such reasonable con ditions as ma y be deemed b y the go verni ng authority . . . essential to the saf ety , health, peace, good or der and morals of the community . Even liber ty itself, the gr eatest of all rights, is not unr estricted license to act accor ding to on e's own will. . . . It is . . . liber ty regulated b y law ." . . .

[T]he legislatur e of Massachusetts requir ed the inhabitants of a city or town to be v accinated only w hen, in the opinion of the Boar d of Health, that was necessar y for the pub lic health. . . . [I]t was appr opriate for the legislatur e to ref er that question . . . to a Boar d of Health, composed of persons residing in the locality aff ected and appointed . . . because of their fitness to determine such qu estions. To inv est such a body with authority o ver such matters was not an unusual nor an unr easonable or arbitrar y requir ement. . . . [A] commun ity has the right to pr otect itself against an epidemic of disease which th reatens the saf ety of its members. . . . [W]hen the regulation in question was adopted, smallpo x . . . was pr evalent . . . in the city of Cambridge and the disease was incr easing. . . . [T]he cour t would usurp th e func tions of another branch of go vernment if it adjudged . . . that the mode adopted . . . to pr otect the people . . . was arbitrar y and not justified b y the necessities of the case. . . . Ther e is, of course, a spher e within w hich th e individual ma y asser t the supr emacy of his own will and rightfully dispute the authority of any human go vernment . . . to inter fer e with the ex er cise of that will. But it is equally true that in ev ery well-or der ed society char ge d with the duty of conser ving the saf ety of its members the rights of the individual in respect of his liber ty ma y at times . . . be subjected to such restraint . . . as the saf ety of the general public ma y demand. . . .

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[If there were two ways to protect the public from a disease, it is not the court's function to determine which one should be used.] That was for the legislative department to determine in . . . light of all the information it had or could obtain. . . . The state legislature proceeded upon the theory which recognized vaccination as . . . an effective if not the best known way in which to . . . suppress the evils of a smallpox epidemic. . . .

"It must be conceded that some laymen . . . and some physicians of great skill and repute, do not believe that vaccination is a preventive of smallpox. The common belief . . . is that it has a decided tendency to prevent the spread of this fearful disease and to render it less dangerous to those who contract it. While not accepted by all, it is accepted by the mass of the people, as well as by most members of the medical profession. . . ." A common belief, like common knowledge, does not require evidence to establish its existence, but may be acted upon without proof by the legislature and the courts. . . . "The fact that the belief is not universal is not controlling, for there is scarcely any belief that is accepted by everyone. The possibility that the belief may be wrong, and that science may yet show it to be wrong, is not conclusive. . . . "

We are not prepared to hold that a minority, residing or remaining in any city or town where smallpox is prevalent, and enjoying the general protection afforded by an organized local government, may . . . defy the will of its constituted authorities, acting in good faith for all, under the legislative sanction of the State. . . . While this court should guard with firmness every right appertaining to life, liberty or property as secured to the individual by the Supreme Law of the Land, . . . it should not invade the domain of local authority except when it is plainly necessary to do so in order to enforce that law . . . .

The judgment of the court below must be affirmed.

It is so ordered.

INTRODUCTION

Some people view "business ethics" as a contradiction in terms. Exchange is essential to business. We frequently purchase goods or services, from the cold drink at the fast-food restaurant to the Uber® or Lyft® ride. We

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also enter into rental agreements for an apartment or a Bird® scooter. Sometimes we are the seller of the goods or services. Since we cannot avoid business transactions, we cannot avoid business ethics. Our ethics and those of the other party will be important in our transaction.

Recent corporate scandals and the resulting loss of trust by the public demonstrate that ethics is important in business. Even a *perceived* lack of ethics in a firm or in an industry can have devastating effects on the firm, the industry, or even the entire U.S. economy. Scandals in college admissions, entertainment, police forces, and politics have increased the public's awareness of and concern over ethical issues and attitudes in our society. These scandals often lead to additional government regulation. Remember the impact of these events, including the economic harm they cause, while studying this chapter.

Business ethics involves the ethics of individuals *and* the ethics of the organization to which they belong. For example, a chief financial officer (CFO) has ethics and the corporation has ethics. Or a senator will have certain ethics and the Congress as a whole has ethics. The individual's ethics may be the same or similar to those of the organization. Sometimes there is a mismatch between the two. Assume that Luciana is the CFO of Travel.com. If Travel.com frequently asks Luciana to do acts that she feels are not ethical, the views of the two do not match well. In this text, we will discuss the perspectives of both the individual and the organization.

Ethics and Law

Ethics and law are interrelated. For some individuals, ethics and law are synonymous. For example, when these individuals face an ethical dilemma, they ask whether the behavior that they are considering is legal. In their minds if it is legal, it is ethical. If it is not legal, it is not ethical. However, for many people, these questions are not identical. To illustrate the two positions, assume Clayton oversleeps and leaves for work late. Clayton is considering driving over the speed limit. If he believes that ethics and law are synonymous, he would believe that exceeding the speed limit is unethical *and* illegal. If he believes that they are separate questions, he would recognize that exceeding the limit is illegal. He may believe that speeding so that he can arrive at work on time is ethical. He may believe that speeding is not an ethical question at all. In this chapter, we will focus on ethics.

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Some laws are based on the ethical beliefs of some members of society. Murder is a crime because most people believe that it is wrong to kill other human beings. The prohibition movement to prohibit alcohol consumption in the United States occurred because some people felt that consuming alcohol and drunkenness were unethical. The constitutional amendment and the related laws that enforced prohibition were not successful. Eventually, the laws were repealed. [1] One of the reasons for repeal was that many U.S. residents felt that the consumption of alcohol was not intrinsically unethical. Throughout the book it is important to pay attention to the interrelationships between ethics and law.

Ethics and Morality

It is fairly common for people to equate ethics with morality, and to use the words *ethics* and *morals* interchangeably. In so doing, they find it easier to discuss the topic of ethics. However, such usage is not altogether accurate. *Ethics* refers to a guiding philosophy—the principles of conduct governing an individual or a group. [2] By contrast, *morals* relate to principles of right and wrong behavior as sanctioned by or operative on one's conscience. [3] From the perspective of an individual, ethics and morals frequently have the same meaning. However, from the perspective of a group—including a society—it is more appropriate to speak of ethics. When we speak of ethics, we will be talking about societal values, the accepted standard of conduct within a given society. In contrast, when we speak of morals, we will be talking about individual values, a person's accepted standard of behavior for that individual.

Exhibit 2.1 provides a few examples of how ethics and morals may be compared.

Exhibit 2.1

Ethics and Morals: A (Limited) Comparison

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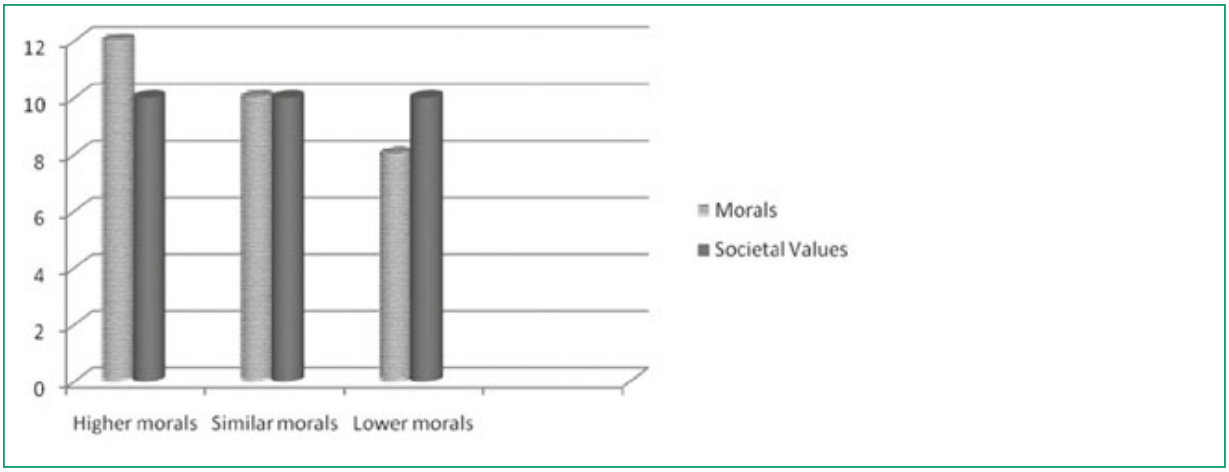

Source: Courtesy of Daniel V. Davidson, © 2026.

An individual with higher morals than society's values is one whose actions exceed those that are generally accepted. For example, while society may frown on jaywalking, it does not consider such conduct unethical. The person with higher morals might consider jaywalking to be wrong and immoral. A person with lower morals than society's values is one whose actions, or at least whose accepted values, fall below those of society at large. Such a person may see nothing wrong with looting during a riot or robbing a convenience store.

Different societies may have different ethics, but the morals of any given individual should remain relatively constant no matter which society that person should happen to be in at any point in time. Ethical conduct is conduct that is deemed right—or at least accepted as not wrong—within a societal setting. Moral conduct is conduct that the individual considers right—or at least does not consider wrong—without regard to the attitude of the society.

To further complicate this issue, societies also have standards that go beyond ethics. The ethical standards of a society reflect what is considered "right" and "wrong" within that society in a general manner. Some wrong behavior may be merely a matter of rude conduct, frowned on within the society. However, it is not so severe as to merit more than a social dislike of the conduct. For example, conducting a loud cell phone conversation in a public place is likely to be considered rude, but it is not likely to merit an official sanction. Other "wrong" conduct may be considered to be much more serious; this conduct may be so inappropriate that society fines or even incarcerates the person who acts in this "wrongful" manner. For

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example, kidnapping a person is a crime. To help ensure that people within a society act in a socially acceptable manner, the society enacts laws and regulations. Society usually imposes penalties for violations of the laws or regulations. These laws provide a minimum standard of behavior that is expected from each member of that society.

Although it is a broad generalization, conduct that violates a law or a regulation of a society is generally deemed unethical by that society. This is not to say that all unethical conduct is also illegal; rather, it says that all illegal conduct is generally viewed as unethical. Of course, there are situations where some members of a society will act in a manner that violates a law or a regulation to force the society to reconsider its official position and change the law. One such example involves Dr. Martin Luther King Jr., who encouraged civil disobedience in the 1950s and 1960s. Much of his conduct was illegal at the time. People who view ethics and legality as the same would also view his conduct as unethical. The civil rights movement ultimately changed the laws regarding equal rights and racial discrimination and changed the social values in the United States. In retrospect, many believe that Dr. King acted in a *moral* manner by helping to change laws that they believe were unethical. There is a potential problem when an individual's personal morals call for conduct prohibited by society's ethics. For example, suppose Sydnie feels that stealing is moral *if* the victim of the theft is wealthy. Sydnie will encounter problems if she acts on this moral value by stealing from a wealthy person. If Sydnie decides to steal from the wealthy, she may be acting morally (adhering to her personal values), but she will be considered to have acted unethically by society (violating the society's values). U.S. society has decided that theft is both an illegal and an unethical act. Sydnie will find that her morals conflict with society's ethics and its law.

ETHICAL THEORIES

It is important to begin with an introduction to some of the more widely used ethical theories and principles. This section introduces several of these ethical theories and compares them to one another. Each theory has proponents who argue for its use. Each also has critics who point out the weaknesses of the theory. The theories are also evolving as ethicists look at the weaknesses and attempt to improve the theory. As we study these ethical theories, remember that we do not have consensus on what is the

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"best" ethical theory. Each individual and each organization must choose the theory that best suits their beliefs, morals, and values. Even people who are applying the same theory may come to a different conclusion as to what they should do. Some people combine theories or look at an ethical problem from the perspective of several different theories.

Although a business may be recognized as a legal person, the business is not a "particular person." It is really a collective of people. Generally, one individual is not a significant influence in providing moral or ethical guidance for the firm. The group to which a business belongs is generally too diverse to have a single system or code of morals.

Similarly, "business" is not a single profession, like accounting or law, which could adopt a single code of ethical conduct. The study of business ethics often comes down to the morals of a particular person, the specific businessperson whose conduct is being evaluated. Unfortunately, the ethical standard often applied in this situation is the ethical standard of the onlooker and not that of the person being observed. To properly treat the ethical issues of a businessperson, some kind of analytic framework must be established and some basic understanding of the ethical parameters of business needs to be developed.

Cultural Relativism

Cultural relativism holds that what is good or bad depends on what is approved by the majority of a given society. It is a descriptive theory.[4] (*Descriptive theories* explain what people actually do.) Cultural relativism claims that ethics is a product of the culture. For example, the death penalty is a socially acceptable punishment in some societies, but not in others. Two societies may hold ethical views that are opposed to one another, and there is no clear way to resolve the differences. No culture is superior to any other culture. Other societies are different, but they are not "wrong." Cultural relativists view themselves as being tolerant of the differences.

Critics of cultural relativism say that there are universal norms or hypernorms: Many diverse societies prohibit the same things, such as lying, stealing, adultery, and killing human beings. Critics also say that if a society does not prohibit something, such as killing other human beings, it is acceptable to judge that society and to point out that the society is defective.

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Consequential and Nonconsequential Principles

Many ethical theories are based on either consequential (teleological) principles or on nonconsequential (deontological) principles. Consequential principles judge the ethics of a particular action by the *consequences* of that action. Consequential ethics determine the "rightness" or the "wrongness" of any action by comparing the amount of good to the amount of evil that the action will produce. A person using consequential ethics needs to evaluate each possible choice, measuring the good (and the evil) that is likely to result from the alternatives. The "right" action is that action that will produce the greatest amount of good compared to evil. The major theories applying consequential principles include ethical egoism and utilitarianism. These theories will be examined in more detail later in this section.

Nonconsequential principles tend to focus on the concept of *duty* rather than on the results of the action. Nonconsequential ethical theories are rule-based. Under the nonconsequential approach, a person acts ethically if that person is faithful to the person's duty, regardless of the consequences that follow from the person's action. The nonconsequential ethical theories are likely to reflect the values of the society. Remember that society imposes duties (in the form of rules and regulations) to maximize the values it wants. By meeting those duties, the individual is furthering the interests of that society. The *categorical imperative* advanced by Immanuel Kant and the *veil of ignorance* advocated by John Rawls are two of the best-known nonconsequential theories. Both of these theories will be discussed in detail later in this chapter.

Ethical Egoism

Ethical egoism is a prescriptive theory that says the proper goal of all people is their own self-interest.[5] (*Prescriptive theories* state what people should do.) Ethical egoism says you should do those things that maximize your own self-interest. (Do not confuse an *egoist*, a person who follows the ethical theory of egoism, with an *egotist*, a person who has an exaggerated sense of self-importance.) In ethical egoism, each person is expected to act in a manner that will maximize that person's long-term self-interests. In so doing, society will benefit because when each individual acts in a manner that produces the greatest good for that individual, the sum of all of these individual acts will produce the greatest total good for the society. Under

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this theory, an action is morally right if it maximizes the actor's self-interest. It does not need to do anything else.

One common misconception about egoism is that all egoists are hedonistic pleasure-seekers who emphasize instant gratification. This interpretation treats one's pleasure as being equal to one's best interests.[6] Most egoists take a broader view of what is in "one's best interests." Consequently, many egoists may decide to act in a manner that appears to be "selfless" because doing so will further their long-term self-interest. These egoists may be willing to make a personal sacrifice today to receive some benefit in the future. Doing so is perfectly consistent with the doctrine of egoism. An egoist may cooperate with others so that others will cooperate with the egoist in the future. So, an egoist may decide that it is in the egoist's interest to live up to a promise so that others will accept the egoist's promises in the future or so that others will not sue the egoist for breach of contract. One weakness with ethical egoism is whether a person can accurately choose what is in the person's best interest. The actor may not be able to foresee the good or bad consequences of an act.

An organization may follow egoism in the same manner that an individual can. From an organizational perspective, egoism involves those actions that best promote the long-term interests of the organization. A corporation using egoism may establish a college internship program. This program may advance the long-term interests of the corporation by (1) improving its public image; (2) reducing social tensions; or (3) providing skilled employees in the future. The short-term expenses incurred in such a program can be offset by future benefits. So the program may appear to be generous and public-spirited, when in reality, the program is undertaken for self-interested reasons.

Utilitarianism

The second major consequential approach is utilitarianism. To a utilitarian, the proper course of conduct in any given setting is the course that will produce the greatest good (or the least harm) for the greatest number.[7] Rather than focusing on the interests of the individual (as an egoist would), the utilitarian focuses on the overall interests of the group. The ethical course of conduct is the alternative that best serves the interests of the social group as a whole, regardless of the impact on any individuals or any subgroups of the social system. Classical utilitarians equated good as pleasure and bad as pain. Under this hedonistic approach, the amount of

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good created would be the amount of pleasure minus the amount of pain.[8] Many utilitarians today use a broader definition of good. Most utilitarians do not care if the "good" is felt immediately or if it is felt later. One weakness of the theory, though, is determining at what point in time the "goodness" should be measured. In other words, should the goodness be measured next week, next year, or ten years from now. There are two primary types of utilitarianism, act utilitarianism and rule utilitarianism.

Act Utilitarianism Act utilitarianism is concerned with individual actions and the effect of those actions on the social group. The decisions are made on a case-by-case basis. A proponent of act utilitarianism expects each person to act in a manner that will produce the greatest net benefit for the group. An act utilitarian makes each ethical decision by examining the options and selecting the option that will maximize the goodness. To an act utilitarian, telling a "little white lie" may be the most ethical course of conduct in a given situation: Telling the lie may produce more total good than would be obtained by telling the truth, by avoiding the answer, or by any other alternative.

Despite some of its attraction, act utilitarianism is not particularly easy to apply. Act utilitarians do not agree among themselves on several key issues. As previously mentioned, one of the main problems with the theory is deciding which "future point" should be used. Utilitarians also disagree on how you define and measure benefit and goodness. (Hedonists would define it as pleasure.) Another point on which act utilitarians disagree is whether the "good" should be the expected good or the actual good. Many utilitarians take the first approach, called the "foreseeable consequence" approach. For example, they would decide that saving a life is good because the foreseeable consequence would be positive. Sometimes it turns out that saving a life was actually bad because the person saved does something very heinous in the future like commit mass murders. Another weakness of the theory is the difficulty in deciding how large the group is. An act utilitarian needs to decide if the "group" is a town, a state, or the world. In practice, some act utilitarians use a rule-utilitarian process to make decisions.[9]

Rule Utilitarianism A rule utilitarian also wants to maximize goodness. The person takes a different approach to do so. A rule utilitarian believes that the morality of a decision should be determined in reference to moral rules. Moral rules are those that create the greatest good. There are two

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parts to the theory: (1) an action or behavior is morally justified if it complies with a justified moral rule; and (2) a rule is morally justified as part of the moral code if it would create more utility than other possible rules or no rule at all. The rule utilitarian then acts in accordance with the moral rule.

A rule utilitarian would (1) make a list of every possible combination of moral rules (the lists can be very short or very complex, with different circumstances and contingencies); (2) select the set of rules that would maximize the utility if everyone followed them all the time; and (3) decide moral questions by asking, "Is the action I am contemplating permitted by the rules? If so, I may do it." The best rule is the rule that causes the best consequences. However, the best rules may not be simple because they may have a long list of exceptions. For example, the formulation for promise-keeping might be "always keep your promises, except . . . " followed by a long list of exceptions. [10] "The rule utilitarian measures the consequences of the act repeated over and over again through time . . . as a rule whenever similar circumstances arise."[11] One criticism of rule utilitarianism is that when it is extended, it becomes the same as act utilitarianism. [12]

The key difference between act and rule utilitarianism is that act utilitarians apply the utilitarian principle directly to the evaluation of individual actions while rule utilitarians apply the utilitarian principle directly to the evaluation of rules and then evaluate individual actions by seeing if the act obeys or disobeys those rules whose acceptance will produce the most utility.

Kant and the Categorical Imperative

The nonconsequential ethical theories are best exemplified by the categorical imperative developed by Immanuel Kant, an eighteenth-century German philosopher. Kant thought that certain universal moral standards existed without regard to the circumstances of the moment or the values of any particular society.[13] Under Kant's theory, when people follow these universal moral principles, they are acting morally and ethically. When people do not follow these universal principles, they are acting unethically. Individual variations and consequences are irrelevant. The universal moral principles impose a duty on each person, and the performance of that duty is what determines the "rightness" or the "wrongness" of any action.

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Based on his theories, Kant developed his *categorical imperative*. The categorical imperative says that each person should act in such a manner that the person's actions could become the universal law. In other words, the actor should ask "Am I willing to have everyone act this way even if the action is directed at me?" The rules to be followed are unconditional, and adherence to these rules is imperative. If each person carries out the person's duty by following these "universal rules," society will be properly served by each individual.

Kant's approach is also applicable to organizations. An organization is judged in the same manner as an individual. The organization is expected to obey the categorical imperative, just as an individual is expected to obey it. The organization is to act according to its duty, with its actions being judged against the "universal law" standard: Would such conduct be proper if all organizations were to act in the same manner? The organization is expected to act in a manner that discharges its duty to every aspect of society, which would include recognition of the rights of others and the duty owed to others.

Kant also believed that there were perfect duties and imperfect duties. Perfect duties are those things a person must always do or refrain from doing, such as the duty of a merchant to never cheat a customer. Imperfect duties involve things a person should do, but not necessarily things a person must do. For example, a person should contribute to charities, but a person is not required to contribute to all charities. A person does not have to contribute to any particular charity every time that charity requests contributions.

Feminist Philosophy

The feminist philosophy is also sometimes called the ethics of caring. Advocates of this theory argue that men and women have different attitudes about how social life should be organized and how ethical conflicts should be resolved. The theory is based on the concept that everyone is interdependent. The feminist philosophy gives a high priority to (1) empathy; (2) healthy and harmonious relationships; (3) caring for one another; and (4) avoiding harm. This ethical theory specifies that particular attention should be paid to the effect of decisions on individuals, especially those individuals in a close relationship with the decision maker.[14] This philosophy focuses on character traits such as sympathy, compassion, loyalty, and friendship. Important factors are social cooperation and the

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realization that in many situations the parties are not of equal power or ability. The social context of the decision is important. The structure of the society must be protected, and the rights and interests of the less capable people should be protected as well.

This philosophy is not considered to be a consequential theory due to its approach. All the theories continue to develop, although this philosophy may be developing more than others. During the evolution of the feminist philosophy, some aspects are more important to some philosophers than others. For example, some argue that this approach is a human strength and both men and women should be trained to use it. This approach with its focus on relationships may be difficult to use in business.

Virtue Ethics

Virtue ethics is also not categorized as a consequential theory. Virtue ethics emphasizes moral character. In Western thought, most versions of virtue ethics are based on the teachings of Aristotle and Plato.[15] As the name implies, virtues are central to this theory. A virtue is an excellent character trait. Some examples of virtues are honesty, courage, compassion, generosity, fidelity, integrity, fairness, self-control, and prudence. (As with the law, these terms have special meanings to virtue ethicists. They are not the same as common usage.) Virtues are desirable habits. A person develops virtues through learning and practice.

Once a person acquires the habit it becomes a character trait of that person. Habits are not acquired in isolation. They are acquired in community with others. People are influenced by the traits that their community prizes. Consequently, people should pay attention to the traits their communities value, including the traits portrayed in the media, e.g., literature, movies, and television.

As with the other forms of ethics, different versions of virtue ethics have developed. Most modern forms of virtue ethics consider (1) arête (excellence or virtue); (2) phronesis (practical or moral wisdom); and (3) eudaimonia (usually translated as happiness or flourishing). A virtue is an excellent trait of character. It is a deep-seated, complex mindset. A significant aspect of this mindset is the wholehearted acceptance of a virtue as a reason for action. For example, many actors may choose to tell the truth. That does not mean that the actors believe in virtue ethics. A person who subscribes to virtue ethics believes that one should always tell the truth. The person would not be impressed by someone who gets ahead

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in life by telling falsehoods. These are individuals that value honesty and would surround themselves with other honest people whenever possible. The person would be shocked or distressed when people close to the actor do something dishonest.

Possessing a virtue is a matter of degree and most people are not 100 percent successful with it. They may have blind spots where they fall short. Virtue ethicists consider why they fall short. Is it due to their circumstances and/or an inner conflict? Virtue ethicists distinguish between full or perfect virtue and strength of will (called continence). "The fully virtuous do what they should without a struggle against contrary desires; the continent have to control a desire or temptation to do otherwise."[16] For example, the continent person may emotionally be unwilling to admit to making a mistake. Consequently, the person may have to struggle against a desire to be dishonest in a particular situation. A virtuous person acts and feels as the person should.

Phronesis is a Greek term for moral or practical wisdom. Children and adolescents lack phronesis. "It is part of practical wisdom to know how to secure real benefits effectively."[17] "Correct application requires situational appreciation—the capacity to recognize, in any particular situation, those features of it that are morally salient."[18] "Those who have practical wisdom will not make the mistake of concealing the hurtful truth from the person who really needs to know it in the belief that they are benefiting him."[19] Practical wisdom is the knowledge or understanding that enables the actor to "do the right thing." It comes with the experience of life. Practical wisdom includes being knowledgeable about human beings and human life. The wise actor can determine what features of a situation are most relevant.

Virtue ethicists acknowledge that most ethical decisions are complex. A person who is not virtuous may perform a right action. On the other hand, a person who is virtuous may perform a wrong action. To determine if a person possesses a virtue, the observer would need to know why the person did the action. For example, people subscribing to various ethical theories might do the same thing. Virtuous agents pay attention to the consequences of their possible choices. If they acted otherwise, they would be reckless, thoughtless, and short-sighted which are vices. Virtue ethics encourages thoughtful reflection on what we as human beings have the potential to become.

All the modern versions of virtue ethics agree that virtue is central and practical wisdom are important. They combine them in different ways and

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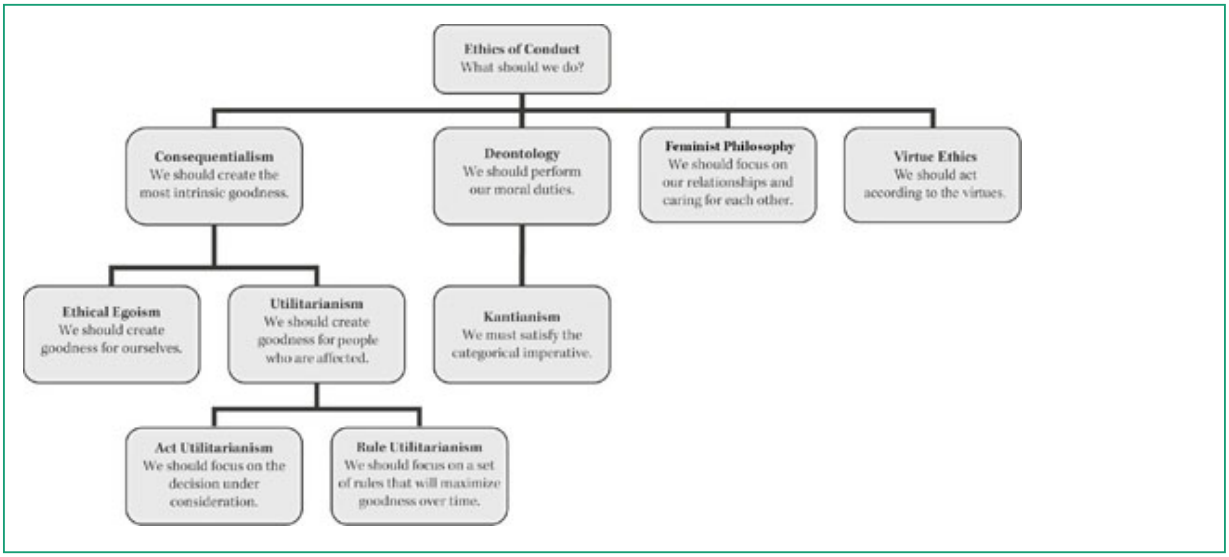
add other concepts to their theories. Modern virtue ethics theories also emphasize the importance of moral education. Some of the modern versions minimize the role of eudaimonia.

Objections to virtue ethics include that morality is supposed to be about other people. Virtue ethics is self-centered because it focuses on the character of the actor. Critics complain about the versions that focus on the actor's well-being and having a flourishing life. Virtue ethics is also criticized as not providing helpful advice on how to behave. It is too imprecise. Another objection is that it requires some degree of moral luck. For example, an individual may need friendships with other moral agents in order to develop a good moral character.[20]

The relationships among these ethical theories are summarized in Exhibit 2.2.

Exhibit 2.2

Ethics of Conduct*



* This exhibit only includes prescriptive theories.

Rawls and the Veil of Ignorance

John Rawls based much of his work on Kant as he developed his own theory about what constitutes a just society. Rawls described his theory,

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called *Rawlsianism*, by using the "Bargaining Game," a theoretical community of men and women who join together to bargain for a completely new set of moral rules (laws) that they must all obey in the future. The players start from the "Original Position." Once the rules are selected, the players must adhere to the rules, even if the rules are not in their self-interest in a particular situation. The players choosing the rules do not know their own positions in society, talents, or abilities. Rawls calls this the *veil of ignorance*.[21] Rawls argued that a society developed behind this veil of ignorance would be a just society. Since the people making the rules were wholly ignorant of their own unique combination of race, religion, color, gender, wealth, age, and/or education, they would enact rules they would be willing to live under regardless of which combination of factors they might, theoretically, possess. Assume the people were deciding if the society would provide health care for everyone, they would have to ignore whether they could afford to pay for health care for themselves. Rawls has been interpreted as saying, "In effect, the parties choose principles for the design of society as if their places in it were to be determined by their worst enemies."[22]

True justice can be obtained by the society, with each member willing to live under the rules developed behind the veil. A proper constitution will be adopted; an appropriate method for legislation based on the constitution will be created; and a proper method for dispute resolution will be developed.[23] The rules will be applied by judges and administrators and generally followed by the citizens. Rawls is often considered a political philosopher. Rawls's articles and presentations helped to revive the social contract theory, which will be discussed later in this chapter.

These theories and their relationship to business are summarized in Exhibit 2.3.

Exhibit 2.3

Comparison of Prescriptive Ethical Theories

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Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
Ethical Egoism [24] (Consequential theory—An act is ethical when it promotes the best long-term interests of the firm.)	1. Provides a basis for formulating and testing policies. 2. Provides flexibility in ethical decision making for a business. 3. Allows a business to tailor codes of conduct to suit the complexity of its particular business dealings.	1. May ignore blatant wrongs. 2. Incompatible with the nature and role of business in society. 3. Cannot resolve conflicts of egoistic interests. 4. Introduces inconsistency into ethical decision making.
Utilitarianism [25] (Consequential theory—The most ethical decision is the one that produces the greatest good or the least harm.)	1. Provides a basis for formulating and testing policies. 2. Provides an objective manner for resolving conflicts of self-interest. 3. Recognizes the constituent groups of a business.	1. Ignores conduct that appears to be wrong in and of itself. 2. May be in conflict with the principles of justice. 3. May be difficult to determine which constituent groups

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Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
	4. Provides the latitude in ethical decision making that business seems to need.	should be considered.
Kant and the Categorical Imperative[26] (Nonconsequential theory—Only when we act from a sense of duty do actions have ethical value.)	1. Takes the guesswork out of ethical decisions. 2. Introduces a needed humanistic dimension into business ethics decisions. 3. Concept of duty implies the ethical obligation to act from a respect for rights and the recognition of responsibilities.	1. Provides no clear way to resolve conflicts among duties. 2. Provides no compelling reason why certain rules should be absolute.
Feminism Philosophy[27] (The ethics of caring—Recognizes the importance of personal	1. Provides a basis for formulating and testing policies. 2. Provides an objective	1. Places undue emphasis on those closest to the decision maker.

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Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
relationships in decision making.)	manner for resolving conflicts of self-interest. 3. Recognizes the constituent groups of a business. 4. Provides flexibility in ethical decision making for business.	2. May be more concerned with the community than with the business. 3. Difficult to formulate satisfactory rules.
Virtue Ethics [28]	1. Flexible and sensitive to the particular situation. 2. Encourages actors to behave virtuously and avoid the vices.	1. Takes time to fully develop a moral character. 2. Some actors do not have the experience of life. 3. Moral learning is a life-long process. Some individuals are not successful in the process. 4. Does not resolve

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Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
		conflicts of virtues. 5. Does not provide direct guidance on how to act. 6. Focuses on what kind of person I should be and not what I should do.
Rawls and the Veil of Ignorance [29] (Nonconsequential theory—Rational agents, unaware of their personal characteristics or places in society, choose the principles they wish to have govern the society.)	1. Takes the "guesswork" out of ethical decisions because the rules have been established. 2. Introduces a needed humanistic dimension into business ethics decisions. 3. Implies the ethical obligation to act from a respect for rights and the	1. Uses the better-off members of society to assume the welfare of the worse-off. 2. Provides no compelling reason for following universal principles that are agreed to by members of the society.

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Ethical Theory	Positive Aspects in a Business Context	Negative Aspects in a Business Context
	recognition of responsibilities.	

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A SYNTHESIS FOR ETHICAL DECISION MAKING

Each of these ethical theories provides a possible framework for evaluating the ethics of a business and the ethics of the people who operate it. Remember, there is no one universally accepted theory or approach to ethics in general or business ethics in particular. Each firm can select a theory of ethics to follow in developing its own ethical approach to conducting its business. Before choosing a theory, the businessperson should also consider several other factors. These factors should include, but are not limited to, the short-term versus the long-term impact of any decisions, the constituent groups that will be affected by the decision being made (constituent groups are discussed later in the chapter), and the way in which the ethical decision fits within the legal environment.

One problem that many people face in making ethical decisions is recognizing that an ethical issue is present. Before you can use the "tools" in your ethics toolbox, you need to recognize that you are facing an ethical issue. When a business or economic issue is addressed, it is normally obvious, and the decision is made on business and/or economic bases. Sometimes a prudent economic decision must be balanced against ethical considerations. For example, while most people agree that slavery is wrong and that having slaves is unethical, slavery was allowed in the United States for decades and was often justified as being the natural order of things. In fact, slavery was economically beneficial for the slaveholders, and its existence was rationalized on economic grounds. In a similar manner, unequal pay for women has been rationalized to justify the economic benefits to the employer rather than being addressed as an ethical issue. Once an ethical issue is identified, it is logical to also apply your ethical tools to the decision in front of you.

Perhaps a business would be best advised to seek a synthesis of different ethical theories as it develops its approach to ethical issues. After

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all, other people will judge the business, and they may view its decisions from a different ethical perspective. This approach would provide a structure for evaluating actions and options regardless of the ethical theory that most closely reflects the values of the business. One such synthesis is suggested by the work of Vincent Ruggiero.[30] Ruggiero suggests that there are three common concerns in ethical decision making: obligations, ideals, and effects. From this foundation we can develop a framework for ethical decision making. In making a decision, the following three factors should be considered:

1. The obligations that arise from organizational relationships
2. The ideals involved in any decisions that are made
3. The effects or consequences of alternative actions

Any actions that (1) honor obligations; (2) simultaneously advance ideals; and (3) have the effect of benefiting people can be presumed to be moral actions. Any actions that fall short in any respect become suspect.[31] This is not to say that these latter actions are necessarily unethical. However, since these actions have a negative impact on one or more of the areas of concern, the actions should be very carefully evaluated, and alternatives should be examined to see if a better choice has been overlooked.

With this in mind, the business should follow a two-step process to ensure that it is making ethical decisions. The first step is to identify the important considerations involved (obligations, ideals, and effects). The second step is to decide where the emphasis should lie among these considerations. This approach allows the firm to apply its ethical principles while also taking into account the relative positions of each of the constituent groups of the business.

INFORMAL APPROACHES

An individual, including a businessperson, may want to adopt a less formal approach to the individual's ethical decision making. There are several informal approaches that can be used. Some of the more popular and effective approaches are:

1. The "Golden Rule" Test—The decision maker should "do unto others as you would have others do unto you." This is a generally accepted principle in Judeo-Christian religions.

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2. The "Front Page" Test—Would the decision maker be comfortable seeing this decision or course of action as the lead story on the front page of local and national newspapers?
3. The "Other Side of the Fence" Test—How would the decision maker feel if the decision maker was standing on the "other side of the fence" observing someone else making this decision?
4. The "What Would Your Mother Think" Test—Is this a decision that would make the decision maker's mother proud when she learns that her child made it?

While none of these possess the elegance of more formal ethical theories, each provides an evaluation method that forces the decision maker to consider the impact of the decision from an outsider's perspective and may help the person reach a decision in which the person can take pride and/or avoid embarrassment. Sometimes it is helpful for the individual to just stop and "think." For example, Amy Cooper falsely reported that a black bird watcher was threatening her in Central Park.[32] Would she have behaved in this manner if she had used one of the informal approaches to ethical decision making? Other individuals have had racist or sexist rants in public.[33] (Some of these individuals have lost both their jobs and their reputations over their behavior.) Most individuals today always carry a cell phone camera with them. What a person says or does in public can easily be documented and posted to social media. In effect, this *can* make a person's behavior "front page" news.

THE EVOLUTION OF BUSINESSES AS ETHICAL ENTITIES

Business as an Amoral Institution

Historically, many people viewed business as an amoral institution. Since any given business was inanimate, and since only animate objects could be expected to possess morality, it stood to reason that a business was not expected to possess morality. Because it could not be expected to be moral, it also could not be immoral. Morality and immorality were reserved for animate beings, and inanimate objects were *amoral*. This historical view did not present much of a problem when most businesses were relatively small and local in nature. The owners and operators of businesses were known in the community. Even though the business was viewed as amoral,

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the owner or operator was held to community standards. Most businesses were operated in an ethical manner to satisfy the local customers.

As businesses grew larger and more complex, they lost this local flavor. Businesses no longer operated in a restricted geographic market and no longer had to adhere to community standards. Eventually, society began to demand some minimal ethical standards from businesses. Included among these standards were (1) the expectations of fair play and honesty; and (2) the expectation that a business would seek profits for its investors. If a business did not meet these demands voluntarily, society could seek intervention and help from the legislature. Sometimes the legislature would respond by setting minimum standards for business behavior. If the business obeyed these laws, it met the duty of fair play. If the managers did not blatantly lie to the customers, the business met the duty of honesty. And if the firm generated profits for its investors, it met its duty toward them.

Sometimes courts were asked to enforce the standards. The 1919 Michigan Supreme Court's opinion in *Dodge v. Ford Motor Company*[34] is an example. Ford Motor Company was an extremely successful enterprise at the time, and it was paying substantial dividends reflecting that success. Stockholders were receiving ordinary dividends of 5 percent *per month* and special dividends that had averaged more than *400 percent* per annum over the previous five years. Then Henry Ford and the board of directors announced a change. While Ford would continue to pay regular dividends of 5 percent per month, it would stop the special dividends. Instead, the board announced its intention to reduce the price of new cars *and* to make substantial investments in socially beneficial programs for the employees and the community. Two of the stockholders, the Dodge brothers, filed suit to prevent the implementation of the programs proposed by Ford. The Michigan Supreme Court ruled that the board of directors of a corporation may *not* place the interests of the public ahead of the interests of the stockholders and may *not* divert corporate funds to non-corporate purposes. The court instructed the board to continue to maximize profits and to leave any charitable or public benefit contributions to individuals who chose to make such contributions from their personal funds.

The *Dodge v. Ford Motor Company* case was viewed as a landmark opinion, providing guidance for boards of directors in closely held corporations. While this opinion deals directly with the conflict between the desire of the Ford board to provide for the workers and society and the

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challenge by shareholders who want dividends, the basic thrust of the opinion is that the board has a legal duty to the shareholders to maximize the return on their investments. It is not supposed to look out for others.

Notice what the court said a corporation is expected to do. If a corporation followed this rule today, would it be considered ethical? If not, what has changed? Investors still want a return on their investments, and they expect to receive dividends from the corporations in which they invest. Businesses are still expected to earn a profit and to return at least a portion of that profit to the shareholders.

Game Theory of Business

As society and the courts began to recognize the existence of corporate duties, the concept of business as an amoral institution became indefensible. If a business had duties, it also had some ethical responsibilities. These responsibilities tended to be based on adherence to those rules. If a business obeyed the rules and stayed within the law, it was considered to be ethical. This approach to business ethics led to the development of *game theory* as a means of judging the ethical stance of the business.[35] Game theory equates the operation of a business with playing a game, and the rules of the game determine the ethics of the business. If a manager of a firm lied to the business's customers, the managerand consequently, the business had acted unethically. If the manager bluffed the firm's customers, the manager and the firm may have acted in an ethical manner, presuming that bluffing is an acceptable part of the game. Bluffing is an accepted part of several games, including poker. Of course, one person's bluffing may be another person's lying, but such problems were left for others to solve.

There is a basic flaw in the game theory of business ethics. Game theories and game rules are fair and equitable only if all the participants in the game are aware that a game is being played. If any of the participants do not realize a game is being played, they will not be aware of the rules and they will be at a disadvantage. To take advantage of people under such circumstances would not be ethical.

Under game theory, several rules were developed and followed. For example, *caveat emptor* (let the buyer beware) was a "rule" of the business game for a substantial period in U.S. history. Similarly, *laissez faire* economic regulation was a rule of business in the United States. Business and its customers were aware of these rules and played the business game

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accordingly. Eventually, business began to industrialize and to gain an increasing ability to produce for larger markets. The game was no longer quite as fair. As the game became more one-sided in favor of business, the other "players" (the customers) began to seek new rules for the game. When business did not voluntarily change the rules, the customers asked the government to intervene. This led to government regulation of business and eventually an entirely new playing field for conducting the game of business. This new playing field is the one on which business must operate today.

Cyber Guardian 2.1 Sales/Manufacturing

IS BUSINESS A GAME?

Danica recognizes that there is a market for the venture's services and products, but she is afraid that creative criminals may devise ways to use the venture's software to commit crimes, such as identity theft. She is concerned that Cyber Guardian will be sued for their behavior. Asher insists that Cyber Guardian will not be held liable. It is up to its business customers to secure the software. Asher also points out, cheating is prohibited in most games, and yet some people still cheat. If it happens in a game, you must expect it to happen in business.

Danica is not satisfied with Asher's analogy, and she has asked for your advice. To what extent can/should a business be compared to a game? If business is to be compared to a game, what are the rules to be followed?

BUSINESS CONSIDERATIONS What business problems might arise for Cyber Guardian if its software is misused and the product is identified by name in news stories about the misuse? Should a business take steps to try to ensure that its product is not used in an inappropriate manner? Should warning labels be added to the user manual concerning the legal consequences of misuse?

ETHICAL CONSIDERATIONS Can the ethical theory followed by the firm help the principals in determining how to address issues such as

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this? Should a business assume the worst of people and act accordingly? Explain your reasoning.

Social Contract Theory

Many business executives today argue that the U.S. government regulates business too much. These people want their businesses to be unfettered, set free from the "excessive" regulations imposed by the government and allowed to compete freely with foreign producers. Although this attitude can possibly be justified from a simplistic economic position, it fails to consider two factors: the spillover costs society must pay when a business fails to act in a responsible and ethical manner and the "social contract" between business and society. When businesses became too large for local control, the society sought legislative intervention to force compliance with social demands. This is the basis of the social contract theory. Business must comply with the demands of society if it wants to continue to exist and to operate within that society. The social contract defines the permissible scope of business conduct and goes beyond the purely economic issues. If society wants more from business than profits, business must accept this directive to survive in society. To do otherwise is to breach the social contract.

Social contract theory assumes that a business can exist only because society allows it to exist. Today, society expects (and demands) more from business than mere profits. Business must respond to many issues including consumer safety, environmental concerns, and quality of life. If these added demands cause costs to rise, so be it. If business will not meet these demands voluntarily, these demands will be enforced by regulation. In other words, society will change the rules of doing business. The Dodd-Frank Wall Street Reform and Consumer Protection Act is an example of society changing the rules. Note that the rules under Dodd-Frank changed again with the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act, which rolled back several sections of the Dodd-Frank Act.[36] Not only has the game theory of business been rejected by society, but the rules by which business is allowed to exist have also been changed by the social contract theory.

Under social contract theory, the United States has responded to recent business problems from Ponzi schemes to sales of defective mortgages. In dealing with the social contract theory and in evaluating the ethical stance

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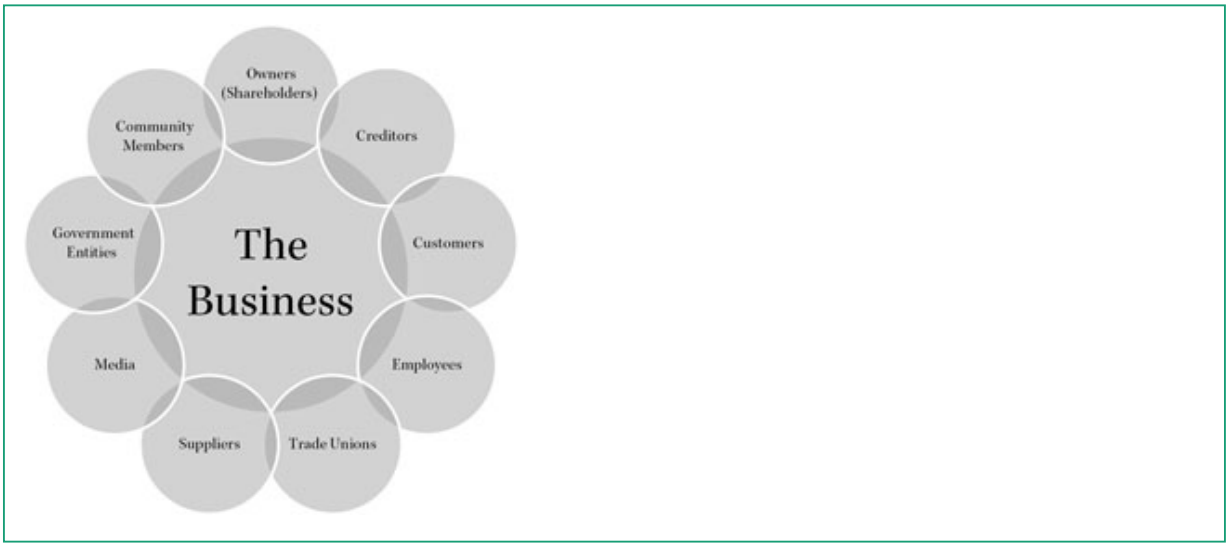
of any given business, it is important to recognize that each business has several constituent groups (or stakeholders). Each group of constituents will have different desires, needs, motivations, and wants. How the constituent groups are viewed, and how they are counted, is a matter of interpretation. More members or more groups could easily be used, if so desired.[37] The business manager must base decisions affecting the business, at least in part, on the impact these decisions will have on the various stakeholders. Some decisions will affect all of the constituent groups, although not equally. Others will only affect some of the groups. Some decisions will have a positive impact on some groups and a negative impact on others. Considering how each group will be affected, and how much weight to give to each group, is essential in reaching ethical decisions. Exhibit 2.4 shows *some* of the constituent groups a business must consider.

Exhibit 2.4

Stakeholders



Corporate Social Responsibility (CSR)

Social contract theory has influenced the development of corporate social responsibility (CSR). Although it is called "corporate" social responsibility, most individuals feel that it applies to all businesses and not just those organized in the corporate form. CSR is the concept that businesses can

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and should act ethically and that they are responsible for their conduct. "While CSR does not have a universal definition, many see it as the private sector's way of integrating the economic, social, and environmental imperatives of their activities."[38] As CSR evolves, it has developed several competing theories about how a responsible business should make decisions and what a responsible business should do. Some of these developments are discussed below.

Critics complain that there is no consensus on which CSR theory to use. They also complain that CSR is only used to improve the corporate image; in other words, it is a public relations effort. CSR is also criticized for distracting businesses from their economic responsibility to be profitable. There is an active debate about whether social responsibility helps or hinders a firm's profitability. There is some evidence that a company's reputation for being socially responsible helps it to attract and retain workers.

Maximize Profits Approach The maximize profits approach is the traditional view of CSR. Under this theory, a business's duty is to maximize profits for its owners. For corporations, the owners would be the shareholders. The effect of a business's decisions on others is not important by itself. This approach is illustrated by the court's decision in *Dodge v. Ford Motor Company*.[39]

Moral Minimum Approach The moral minimum approach to CSR states that a business's duty is to make a profit and avoid causing harm to others. If it does cause harm to others, it has a duty to correct that harm or compensate those who are injured. Under this view, if a business pollutes a river, it has a duty to clean up the river or compensate those who are injured by the pollution. A business does not have an obligation to correct a problem when it did not contribute to the problem. Laws of the community may help establish what the moral minimum is.

Stakeholder Interest Approach Another view of CSR is that a business owes duties to other groups in addition to its owners (shareholders). The business should consider the impact of its decisions on various stakeholders. Businesses owe duties to the constituent groups, and the constituent groups are likely to owe duties to the businesses. Thus, there is a reciprocal set of duties and expectations, as illustrated in Exhibit 2.4.

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Consider the following example of how these duties can affect a business in its decision making. A firm has developed a new production method that will lower costs, increase profits, and make safer products. Adopting this new method will primarily benefit two constituent groups, owners and customers. However, this new method will require relocating the plant, and it may produce several pollutants. Relocating the plant will cause harm to current employees who may be unable or unwilling to relocate and to the current community, which will suffer economic harm from reduced employment. The possible increase in pollutants will harm the community at the site of the new plant, although this harm will be offset to some extent by the increase in employment and the economic "ripple effect" a new plant will cause. Somehow the firm must undertake to balance these competing interests to reach a decision that reflects the best short-term and long-term interests of the firm. As this example also illustrates, one problem with the stakeholder approach is that of how to select which group's interests deserve the greater weight in any particular decision. The interests of the stakeholders often will conflict.

Corporate Citizenship Approach According to the corporate citizenship theory of CSR, businesses should be good citizens in the community by advancing society's goals. Businesses have a duty to "do good." A business should actively try to solve social problems, even social problems that it did not cause. For example, during the pandemic caused by COVID-19 (the respiratory disease caused by the novel coronavirus SARS-CoV-2), and the resulting shortage of medical equipment, many businesses assisted by converting their operations to produce face shields and ventilators. The corporate citizenship theory is based on the concept that businesses control much of the wealth and power; consequently, they have a responsibility to use the wealth and power in ways that benefit society. Under this view, a business would be evaluated based on (1) its contribution to social causes; and (2) its business operations, especially how it deals with issues such as human rights, employment discrimination, and the environment. Businesses have finite resources, and there will always be social problems, so one difficulty with this approach is deciding how the business should choose which causes to support. Should it limit itself to causes that are related to its business operations? Should it choose causes that are important to its stockholders or key personnel? How much should it contribute? If a business spends too much on social

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problems, investors may be reluctant to invest in the business due to reduced profits and dividends.

There are risks to this approach. For example, the Walt Disney Company tried to dissuade the Florida legislature from enacting a state statute that limited school discussions about gay and transgender individuals. (Disney World is located in Florida.) When it was not successful working behind the scenes and Florida enacted the law, Disney representatives spoke out against it. This has created an open dispute between Disney and Florida officials. [40] The dispute appears to be harming the value of Disney stock and consequently, harming the shareholders.

Currently, most people seem to subscribe to either the stakeholder interest approach or the corporate citizenship approach.

Environmental, Social, and Governance Factors (ESG) ESG is closely related to CSR. ESG stands for a company's environmental, social, and governance factors (ESG). The factors are also sometimes stated as ethical, sustainability, and corporate government. (You should notice that this can also be abbreviated ESG.) Some members of society, including some investors, may be more interested in some ESG factors than others. For example, some may be more concerned about the quality of water and others may be more concerned about the impact on endangered species. Generally, society seems to desire more information about the corporation and its ESG factors. Increasingly managers need to provide information about ESG to comply with the social contract theory. It is important to note that some investors and politicians oppose using ESG factors. ESG is discussed in more detail in Chapter 22.

Problems with Business Ethics

Any business that seeks to act in an ethical manner faces a basic problem. There are no fixed guidelines to follow, no formal code of ethics to set the standards under which the business should operate. Numerous professional organizations have their own codes of ethics or conduct. For example, (1) the legal profession has the Code of Professional Responsibility; (2) the medical profession has its Hippocratic Oath; (3) the accounting profession has a code of ethics and it also has generally accepted auditing standards (GAAS) and generally accepted accounting principles (GAAP); (4) the real estate industry has a code of conduct; and (5) various other groups or organizations have similar codes. However,

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"business" as a separate entity has no code of ethical conduct. The closest thing business has to an ethical guideline is the law. If a business is acting within the law, it is acting legally and is arguably meeting its minimum social requirements. However, this forces business into a reactive posture, always responding to legislative demands. It would seem that a proactive position in which business establishes its own path would be preferable.

Given this overriding problem, what can be done to provide a solution? At the present time, probably nothing can be done in the global, or even national, sense. But it may be possible for each industry to develop a code of ethics for that particular industry, in much the same manner that the real estate industry has developed a code for its members. If such an industry-wide approach does not prove feasible, each individual firm can develop its own personal code of ethics. Although such a micro-approach may not be ideal, it at least encourages a business to begin formalizing its ethical posture.

Cyber Guardian 2.2 Marketing/Manufacturing

SHOULD CYBER GUARDIAN ADOPT A CODE OF ETHICS?

Danica and Mai recently attended a business ethics webinar conducted by several prominent ethics professors. After the webinar they discussed several of the corporate scandals that were mentioned and how the businesses involved in the scandals were affected. Danica believes that Cyber Guardian should adopt a formal "Code of Ethics" for the firm to follow. She asserts that such a code will help the company not only to respond to ethical dilemmas as they arise, but also to avoid ethical problems in the future. She also states that such a code, if properly publicized, can help the firm improve its image. This could potentially increase profits. Mai disagrees with Danica. She points out that each of the three principals are ethical so that a code is not necessary. She also states that a code may in fact inhibit ethical behavior, since employees may think that only those actions proscribed in the code are considered inappropriate workplace behaviors. Consequently, any behaviors not covered in the code could be considered ethical. She believes a less

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formal standard would better serve the business as it grows and develops.

Both want to operate the business with a strong ethics culture, but they are unsure as to how to achieve this goal. They have asked for your advice. What will you tell them?

BUSINESS CONSIDERATIONS Even if the firm is owned and operated by people who are already ethical, what would be the advantages of adopting a Code of Ethics now? By having a Code of Ethics, what message does it convey to the customers of Cyber Guardian?

ETHICAL CONSIDERATIONS Do you agree with Mai when she states that a code may in fact inhibit ethical behavior, since employees may think that only those actions proscribed in the code are considered inappropriate behaviors on the job? Why or why not? Following Danica's suggestion, if the firm is to adopt a Code of Ethics, what ethical theory do you believe should be selected as the foundation for the code? Explain your reasons. What should Cyber Guardian's Code of Ethics include?

The Legal Aspect

The U.S. legal system contains numerous ethical components. For example, a person is presumed to be innocent until proven guilty in criminal law. Each person is entitled to due process of the law and to equal protection under the law. Protections exist against compulsory self-incrimination and cruel and unusual punishment. The Constitution provides for free speech, free exercise of religion, and the right to counsel, among other rights and guarantees.

Business law also attempts to reflect the ethical standards of the society and to promote ethical conduct in the realm of business. The law of sales imposes a duty on each party to a sales contract to act in good faith. Bankruptcy is designed to give an honest debtor a fresh start. Agency law imposes the duties of loyalty and good faith on the agent.

The laws that regulate business have developed, to a significant extent, under social contract theory. In many cases, governmental regulations of business were enacted in response to a public demand for protection from

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the abuses and excesses of big business. Antitrust laws were intended to control business and to protect the ideal of a free and competitive economy and the Federal Trade Commission was established to stop unfair and deceptive trade practices.

The government stepped in to deal with problems, ranging from unpaid wages and dangerous workplaces to coercive bill collection practices. In each of these areas, the application of social contract theory is apparent. Society perceived problems and demanded that corrective steps be taken to alleviate the problems. Business had an opportunity to take corrective steps in a manner devised by business but failedor refused to do so. When no satisfactory solutions were proposed by business, the government stepped in to resolve the problem in a rigid, statutory manner. By failing to respond in a proactive manner, which would have permitted a custom-tailored, micro-focused solution by the affected business or industry, the business community was presented with a reactive, macro-oriented solution that extends across industry lines and that is intended to control all aspects of the business community with one broad regulation. Government regulation often adds to the costs of doing business.

MULTINATIONAL ETHICS

Businesses involved in international transactions have additional complications. How should they deal with constituents in multiple countries? For example, assume that a U.S. business opens two factories in foreign countries. It plans to produce and sell its products abroad and import them into the United States. Whose ethics should the business apply? How should it treat its employees in these other countries? When a firm operates within only one society, the ethical stance of the firm is *more* likely to be consistent with the ethical values of that society. If the firm does not conform to socially acceptable standards, the social contract theory is used to change the permissible scope of the firm's conduct.

What happens when a company reassigns one of its agents to a foreign post within the company? This reassignment may have serious ethical implications. The social contract between the new location and its businesses may well be different from the social contract between the firm and its home country. This calls for a reassessment of what is acceptableor desirablebehavior. For instance, a firm may open a new plant in a nation with very lax environmental protection statutes. This same firm,

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in its home country, has been an environmentally concerned business that has taken many steps to reduce its water pollution. If the firm tries to be pro-environment in its new location, it will be at a competitive disadvantage. If the company seeks to be economically competitive, it will be acting in a manner contrary to its stated policy of environmental concern and protection. What should the firm do?

Although there is no perfect solution, any firm that is considering expansion into another country needs to make every effort to learn about the cultural differences that exist between the two nations and to take steps to reduce any culture shock or conflict prior to the expansion. The firm may consider hiring citizens of the other nation, or it may consider requiring an educational program to prepare its employees for the move. The employees should be taught as much as possible about the new country, and they should also be urged to watch and learn. The firm and its employees should be aware that they are visitors, guests in another nation, and they should act as they would if they were personal guests at the home of a new friend. The firm and its employees should avoid being judgmental. New countries and new cultures may seem strange and exotic, or they may merely seem different, but the new country will provide the social values that drive the social contract under which the firm will now be conducting business. Assimilation and acceptance are essential!

A RECOMMENDATION FOR BUSINESS

U.S. businesses need to develop a model or a framework of ethical behavior. It is likely that no single model can be developed that will apply equally to every industry, but it is possible to suggest a general outline for business. This general outline can then be tailored by each industry to the needs and the demands of that specific industry. For example, business should probably lean toward the consequential ethical theories rather than the nonconsequential theories. Consequential theories are more readily understood and more easily accepted by the public than nonconsequential approaches. Additionally, consequential theories are more flexible and more responsive to social and technological changes.

Regardless of the overriding theory, business should adopt a "synthesis" approach for resolving ethical issues. The firm should first identify the important considerations involved (obligations, ideals, effects) and should then decide where the emphasis should lie among them. The business

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should consider its impact on its constituents (owners, creditors, employees, customers, community, etc.). This approach (1) works well with any ethical principle; (2) takes into account the people to whom the firm must answer; and (3) provides a framework for decision making that is comparable to other types of business decisions regularly made by managers.

Business should also consider its public relations image in deciding how to proceed within the consequential area. A utilitarian approach that is concerned with the greatest good for the greatest number is more acceptable to society than an egoistic approach. Society already tends to view business as being too egoistic. Also, many people seem incapable of distinguishing between *egoistic* and *egotistic*. (As previously mentioned, *egoists* measure their conduct based on self-interest, choosing the course of conduct that will provide the greatest benefit to themselves. *Egotists* are self-centered, characterized by excessive references to themselves.)

Next, business should avoid rigid rules that force specific actions or reactions, especially with the rapid changes that occur with modern technology, such as AI. This does not mean business should not have rules and standards, but rather that the rules and standards should be flexible enough to change as society and the business environment change. Business should also emphasize that its agents will act within the law while keeping the best interests of the principal in mind.

Whenever possible, businesses and industries should try self-regulation. Business should also learn to work with the government in establishing regulations. By taking a proactive role in regulation, business can not only help to protect its own best interests but also can demonstrate its concern for society and its various constituents.

The development of a comprehensive business ethic will not be easy, nor will it be greeted with open arms by all businesses or business leaders. The alternative, however, is increasing regulation, public distrust, and a general malaise in the business community. Proactive steps can be taken to benefit *both* business and society.

Cyber Guardian 2.3 Marketing/Management

OPERATING CYBER GUARDIANETHICALLY

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Asher , Danica, and Mai have each seen numerous examples of what they consider unethical conduct, both in the workplace and in society at large. Asher has several friends who are part-time salespeople, who believe that it is perfectly legitimate to say virtually anything short of an outright lie to close a sale with a customer . They frequently "push the envelope" to the edge, grossly exaggerating qualities of the product, often to the detriment of the purchasers of that product. Danica knows several people who would not hesitate to claim credit for the work of others, and she also knows a few who would even assert privileges based on their seniority to gain credit for the work of others. (Of course, both know even more people who do not act in this manner , but these others do not disturb them.) Mai knows people who have lied on their resumes or job applications, claiming accomplishments that were totally fictitious. Mai even knows one woman whose resume and cover letter were written by AI, and were not accurate. She has also seen situations in which a person was hired who did not meet the criteria set out in the job description. This usually happened because the applicant knew someone who was able to influence the hiring decision, an example of "it's who you know , not what you know ." All three principals believe that such conduct is generally harmful to a business and its reputation. They also know they would like Cyber Guardian to operate ethically , and for their managers and employees to go through an ethics training program. They have asked you for your advice. What will you tell them?

BUSINESS CONSIDERATIONS Based on the various examples and areas of concern expressed by Asher , Danica, and Mai, what type of ethics training program would you put together for their managers and employees? What topics would the ethics training program include?

ETHICAL CONSIDERATIONS Should the principals adopt a formal ethics code or policy as they begin the company , or should they be less formal until they see what sorts of ethical issues arise in the operation of the firm? What advantages are there for having a formal written code for a firm? What advantages are there to taking an informal and flexible approach to ethics?

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Contemporary Case

This Contemporary Case is a decision of the U.S. Supreme Court. The federal courts of appeal will be discussed in more detail in Chapter 3. However, the Supreme Court is more likely to agree to hear a case if the circuit courts of appeal disagree on an issue. Analyze this case from the perspective of business ethics. Based on the conduct of the parties involved, what were the ethics of the federal and state government agencies? Why? What were the ethics of Kousisis? Alpha? Markias? Why?

KOUSISIS v. UNITED STATES

605 U.S. 114 (2025)

FACTS Stamatios Kousisis managed an industrial-painting company, Alpha Painting and Construction Co. (Alpha). Alpha submitted bids for two government contracts for painting projects in Philadelphia, Pennsylvania. The federal government was going to provide a large portion of the funds for both projects through grants from the U.S. Department of Transportation (DOT). Consequently, both Pennsylvania, acting through the Pennsylvania Department of Transportation (PennDOT), and the federal government had a say in the project specifications. "DOT requires that grant recipients like PennDOT establish and 'actively implemen[t]' a disadvantaged-business program." A disadvantaged business enterprise is "a for-profit small business" that is majority owned and controlled by "one or more individuals who are both socially and economically disadvantaged." Both bids required the participation of a disadvantaged business by requiring that a specified percentage of the total contract go to a disadvantaged business. The disadvantaged business must perform a commercially useful role. DOT documents stated, a disadvantaged business "does not perform a commercially useful function if its role is limited to that of an extra participant in a transaction, contract, or project through which funds are passed to obtain the appearance" of disadvantaged-business "participation." Failing to comply with this requirement would be a material breach and could result in the termination of the contract.

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Alpha stated in its bids to PennDOT that Alpha would purchase materials from a qualifying supplier. This was a false statement. Alpha created a scheme where Alpha would get its paint from its usual paint supplier. Kousisis negotiated directly with its normal suppliers. The bill for the paint would be sent to Markias, a qualifying disadvantaged business. Markias would tack on an additional fee and forward the inflated bill to Kousisis. Kousisis would issue two checks, one for the markup and one for the paint. Markias was merely a paper pusher, funneling checks and invoices. Alpha and Kousisis tried to cover up their scheme by submitting false certifications. Alpha's paint work was acceptable. However, it did not comply with the disadvantaged-business requirement. Once the scheme was detected, Alpha and Kousisis were indicted for the crimes of wire fraud and conspiracy to commit wire fraud.

ISSUE Did Alpha and Kousisis commit wire fraud under the federal statute?

HOLDING Yes. They did not materially involve a disadvantaged business, so they violated the terms of the bid. Causing a financial loss to the government is not a requirement for wire fraud.

REASONING Excerpts from the opinion of Justice Barrett:

. . . The circuits are divided over the validity of a federal fraud conviction when the defendant did not seek to cause the victim net pecuniary loss. Several circuits . . . hold that such convictions may stand. . . . Others disagree. . . . We granted certiorari to resolve the split. . . .

[W]e recently reiterated that the federal fraud statutes reach only "traditional property interests." . . . Schemes that target the exercise of the Government's regulatory power, for example, do not count. . . . Obtaining the victim's money or property must have been the "aim," not an "incidental byproduct," of the defendant's fraud. . . .

[We should start] with the statute. To be guilty of wire fraud, a defendant must (1) "devis[e]" or "inten[d] to devise" a scheme (2) to "obtai[n] money or property" (3) "by means of false or fraudulent pretenses, representations, or promises." . . . The prototypical fraudulent-inducement scheme plainly satisfies each of these statutory elements. Under the theory, a defendant

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(1) "devise[s]" a "scheme" (2) to induce the victim into a contract to "obtai[n]" her "money or property" (3) "by means of false or fraudulent pretenses." . . . [T]he broad, generic language of . . . [the statute] leaves us struggling to see any basis for excluding a fraudulent-inducement scheme. . . .

Take the facts of this very case. By using Markias as a pass-through entity, petitioners "devised" a "scheme" to obtain contracts through feigned compliance with PennDOT's disadvantaged-business requirement. . . . Their goal? To "obtai[n] money" (tens of millions of dollars) from PennDOT. . . . And how? By making a number of "false or fraudulent . . . representations"—first about their plans to obtain paint supplies from Markias and later about having done exactly that. . . . Section 1343 [of the statute] requires nothing more. . . .

[T]he wire fraud statute is agnostic about economic loss. The statute does not so much as mention loss, let alone require it. Instead, a defendant violates . . . [the statute] by scheming to "obtain" the victim's "money or property," regardless of whether he seeks to leave the victim economically worse off. A conviction premised on a fraudulent inducement thus comports with . . . [the statute]. . . . Fraudulent inducement "has long been considered a species of actionable fraud." . . . Because the Third Circuit's judgment comports with . . . [the statute], we affirm it.

It is so ordered.

You Be the **Judge**

In January 2012, DeShawn Gervin pled guilty to attempted burglary in violation of Georgia law. The Georgia state court sentenced him to one year of incarceration and nine years of probation. The only condition of the probation was that Gervin could not return to the South Georgia Judicial Circuit (Mitchell, Baker, Calhoun, Decatur, and Grady Counties). The court did not include any general probation conditions, such as reporting to a probation officer or informing a probation officer of a change in residence. Those boxes were not checked on the sentencing form. Gervin was released from jail after his term. A sheriff's deputy escorted Gervin to the bus station. The deputy

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watched him get on the bus headed to Missouri and watched the bus pull awa y. Ger vin subsequently mo ved t o Nor th Car olina.

P amela Flor ence, a pr obation officer , was assigned to super vise Ger vin during his pr obation. In April 2012, Flor ence learned that Ger vin had been released fr om a Geor gia jail and was incar cerated in Nor th Car olina. Flor ence applied for a warrant to arr est Ger vin. Flor ence said that Ger vin had "failed to repor t" and "absconded fr om pr obation super vision. " She also falsely said "his wher eabouts [wer e] unknown. " Depar tment policy requir ed Flor ence to look at Ger vin 's sentence befor e asking for an arr est warrant. Flor ence later testified that she was sur e she look ed at Ger vin 's sentence befor e seeking a warrant. In addition, the trial judge who sentenced Ger vin generally reads the sentence in open cour t, but Flor ence did not request the transcript of the trial. Based on the false information Flor ence pr o vided, a county judge granted her r equest for the arr est warrant.

After se rving his jail sentence in Nor th Car olina, Ger vin was released. P olice arrested Ger vin during a traffic st op on April 26, 2019, and extradited him to Geor gia. Tandria M ilt on, a pr obation officer under Flor ence 's super vision, petitioned to revok e Ger vin 's pr obation for failing to repor t. Milt on also testified that she reviewed Ger vin 's sentence befor e asking to revok e Ger vin 's pr obation. "The Superior Cour t held Ger vin 's revocation hearing on A ugust 7, 2019. In the meantime, Ger vin spent 104 da ys in a Geor gia jail waiting for that hearing. " At the revocation hea ring, Milt on was ask ed to examine Ger vin 's sentence. Milt on conceded that Ger vin 's pr obation included only one condition: to not return to the South Geor gia Judicial Cir cuit during its term. The state cour t did not revok e Ger vin 's pr obation.

Then Ger vin sued Flor ence an d Milt on, claiming violations of his F our th, Eighth, and F our teenth Amendments to be fr ee fr om unr easonable seizur es. Ger vin alleges the pr obation officers' misconduct caused his arr est and pr olonged confin ement. Ger vin claims he suff er ed "loss of liber ty, humiliation, emotional distr ess, and physical pain and suff ering" and he seeks damages. Assume that Ger vin 's suit against Flor ence and Milt on has been filed in *your* cour t. How would *you* rule? Why? Analyz e the ethic al perspectiv es of the original sentencing judge, Flor ence, a nd Milt on. [See *Ger vin v . Flor ence* , 139 F .4th 1236 (11th Cir . 2025).]

Summar y

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- "Ethics" refers to either individual or group (including society) values, whereas "morals" refers to individuals' values and matters of conscience.
- There is no single ethical theory or model that is universally followed. There are a number of ethical theories, each with many adherents.
- Egoism and utilitarianism are consequential ethical theories, theories that measure the ethics of conduct by the consequences that follow the conduct.
- Nonconsequential ethical theories are more concerned with rules than results. In these theories, the emphasis is more on developing appropriate rules that the members of society will accept and follow.
- The social environment in which businesses operate has changed dramatically over the years. These changes in the social environment have led to changes in what society expects from businesses.
- Business was originally viewed as an amoral institution. When this perception changed, business followed the "game theory." When the game theory became unacceptable to society, the social contract theory developed. Today business operates under the social contract theory.
- The social contract theory requires a business to meet the demands of society to be allowed to continue to exist. If business does not follow the social contract, society can terminate its right to operate.
- It is sometimes difficult for business to act ethically because there is no universal "code of conduct" that exists to provide guidance. Each business must develop its own "moral compass" and devise its own code—keeping in mind the limitations imposed by the social contract.
- In developing a code of ethics, the business needs to remember both the human and the legal elements with which it must work.
- Developing a strong ethics culture in a business is a positive step toward reducing misconduct by employees, increasing employee satisfaction and loyalty, and being perceived as an ethical business.
- Businesses that operate in multiple countries need to be aware of the ethical standards and expectations of each nation in which they operate. Remember that what is acceptable in one culture may be taboo in another. Pay attention to local and national expectations.

Discussion Questions

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1. Ask AI whether a business owner should speak up when the owner disagrees with a proposed government action. Also ask AI what the potential consequences may be of speaking up. What about the consequences of staying quiet? Do you agree with the answers from AI? Why or why not? Would you prefer a nonconsequential approach? Why?

2. There are some concerns about the use of AI in academic settings. Is it cheating to use AI, such as ChatGPT, to complete an assignment when the faculty member has not said anything about its use? Is it cheating if the faculty member has stated that students are not allowed to use AI? Analyze this from different ethical perspectives. What about using the spell checkers or grammar checkers in word processing programs? Is this the same or different? Why?

3. Some local police or sheriffs have been accused of picking up homeless people in their territory and dropping them off in another town. Assume that this is true. Analyze the ethical perspective of the law enforcement officers who do this.

4. Greenwashing occurs when a company makes misleading or false claims about the impact of its products or processes on the environment. Consumers, investors, and government agencies believe the company is acting as a steward for the environment, but its claims are not accurate. The claims may be technically true, for example, it may filter its wastewater as it claims. However, it is also dumping harmful chemicals on the land that will eventually seep into the ground water. What is the ethical perspective of these companies? Why? Should U.S. government agencies treat this as fraud? Why or why not?

5. In a just society, who should pay for research into new drugs and medical devices? Why? Is it just to charge residents of different countries different prices for a drug? Is it just to charge patients with insurance different prices than patients without insurance? Why?

Case Problems and Writing Assignments

1. David Hunter (75) and his wife, Janice Hunter (74), moved to the Republic of Cyprus when he retired. They were still British nationals. They

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had bee n marr ied for 52 yea rs. Da vid admitted killing his wif e but denied that it was mur der. He was char ged with mur der, which carried an aut omatic lif e sentence if he was convicted.

Janice Hunter had a rar e type of blood cancer. She was in constant pain and allegedly ask ed her husband repeatedly to help her die. She complained to her doct ors about her sympt oms. Da vid testified that Janice was dying. She was quickly losing her sight. Janice also lost the ability to walk. Da vid said that she was miserable and in pain. Da vid suffocated her with his hands. He then tried to commit suicide with pills and alcohol. The paramedics arriv ed in time t o sa ve his lif e.

At the trial "M rs. Hunter 's doct or told the cour t she had a rar e blood cancer, but might not ha ve had terminal leukaemia [sic]." "Haemat ologist [sic] Dr. Ourania Seimeni said her patient [Janice Hunter] had my elodysplastic syndr ome (MDS), which was not nece ssarily terminal. Howe ver, she told the cour t 30 per cent of MDS cases do lead to leukaemia [sic]. Another doct or who ga ve evidence . . . put the figur e at about 45 per cent, which Dr. Seimeni attributed to diff er ent literatur e. . . . [Seimeni] told the cour t she could not say how long her patient had to liv e—wh ether it was tw o months, two years or mor e." Shor tly befor e her death Janice Hunter skipped a medical appointment to determine w hether she had leuk emia at that time. [41]

Assisted suicid e is not permi tted in the countr y of Cyprus. The society on Cyprus is socially conser vativ e. Euthanasia is outlawed. Prior to this case e ven discussing it publicly was taboo. [42]

At the end of the trial the cour t determined that Da vid's acts wer e not pr emeditated. The y wer e the impulsiv e acts of a man "in to rment" and the y wer e no t mur der. He was co nvicted of manslaughter. Da vid was released due to the time he had alr eady ser ved in prison. The lead judge in the case said, "T his is a crime that goes against human lif e, whic h is the highest vir tue. Taking it is a crime."[43] "Befor e us is a unique case of taking human lif e on the basis of feelings of lo ve, with the aim of relie ving the person of their suff ering that came due t o their illness."[44]

Some states in the United States ha ve passed statutes permitting assisted suicide. Other states ha ve not. Is assisted suicide ethical? Why or why not? Analyz e the questio n fr om the diff er ent ethical pe rspectiv es. [See BBC, "Cyprus Mur der Trial: Kil led Wif e 'Might Not Ha ve Been Terminally Ill'," *BBC*, Ma y 10, 2023, https:/ /www .bbc.com/news/uk-england-tyne-65536711 (last visited Ju n. 19, 2025); BBC, "Da vid Hunter: British Husband

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2. Sinister Manufacturing Co. is a Rosedale, California, company. One of its products is a kit that permits truck owners to avoid government mandated emissions standards on their vehicles. Sinister sold 39,792 defeat kits and at times earned one-fourth of its gross revenue from the kits. Diesel truck owners who installed the kits could increase horsepower and reduce maintenance costs. However, the kits also caused emissions to greatly increase. Sometimes Sinister's marketing materials said that the kits were for racing or off-road use. It is alleged that Sinister knew that most of its customers used the kits for regular trucks. Sinister gave customers advice on how to remove the kits for emissions tests and reinstall them after the tests.

"Sinister Diesel sold products that allowed drivers to strip the emissions controls from their trucks, causing a dramatic increase in the release of pollutants that worsen air quality and harm the quality of life," U.S. Attorney Talbert said. "Environmental laws that control diesel pollution are especially important to protect sensitive populations such as the young, the elderly, and people who suffer from respiratory conditions."[45] "EPA testing has shown that a vehicle altered with these parts can emit more than 100 times the amount of certain harmful air pollutants, compared to a vehicle with an intact emissions control system."[46] EPA's Air Enforcement Division released a report in November 2020. The report found that more than 500,000 diesel pickup trucks in the United States, approximately 15 percent of U.S. diesel trucks that originally had emissions controls, have had the controls illegally removed or bypassed.[47]

The federal Clean Air Act (CAA) prohibits the sale or manufacture of devices that bypass, defeat, or render inoperative emissions controls.

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Sinister agreed to pay $1 million as part of its consent decree. This consent decree is still subject to the approval of the court. Sinister is also facing a criminal case for its actions. What is the ethical perspective of Sinister? Why? What is the ethical perspective of truck owners who purchased and installed the kits? Why? [See Sam Stanton, "California Company Pleads Guilty to Selling Thousands of Kits to Defeat Emission Controls," *The Sacrament o Bee*, republished by Yahoo!Life, Aug. 2, 2023, https://www.yahoo.com/news/california-company-pleads-guilty-selling-120000720.html (last visited Jun. 19, 2025); and U.S. Department of Justice, Office of Public Affairs, Press Release, "California Truck Parts Manufacturer Sinister Diesel Agrees to Pay $1 Million After Pleading Guilty to Conspiracy and for Manufacturing and Selling Illegal Defeat Devices," Aug. 1, 2023, https://www.publicnow.com/view/D289A2F6907B042D4B89DD8AB927D3934FB9E265 (last visited Jun. 19, 2025).]

3. Elizabeth Holmes claimed to have "revolutionized" blood testing by her invention. Holmes claimed that an array of diseases could be diagnosed with a single drop of blood from a patient. Innovative technology such as this would not only modernize medicine, but would create incredible cost savings and bypass the traditional practice of drawing multiple vials of blood from a patient. Millions of dollars were quickly invested into her company Theranos. Holmes became a billionaire. She was on the cover of many prestigious magazines. Many admired her for her entrepreneurial leadership. However, this all came crashing down when, in 2015, *The Wall Street Journal* exposed the truth about Theranos. There was nothing "new" about the technology Theranos was using; the company was simply using traditional machines for testing blood.

While Holmes claims that she never meant to mislead anyone, she was "charged by federal prosecutors with nine counts of wire fraud and two counts of conspiracy to commit wire fraud over allegations that she deceived investors and patients with her company's failed blood-testing technology. Each count carries a maximum sentence of 20 years in prison." She was found guilty on four of the criminal charges brought against her.

The doctrine of egoism involves those actions that best promote the long-term interests of the organization. While what Holmes did was legally wrong, could she have felt that she was acting in a manner that would maximize her long-term interests? Did she break a social contract with her investors, her employees, and/or society at large? Explain your answer.

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With respect to the investors, is this a matter of *caveat emptor*? Should they have done a better job of vetting the claims made by Holmes? Explain and justify your answer. Holmes's partner, Billy Evans, has started a new biotech testing company named Haemanthus. Although Holmes has no formal role in the company she is advising Evans from her prison cell. What concerns should potential investors in Haemanthus have? Why? [See Christopher Weaver, Heather Somerville, and Sara Randazzo, "The Elizabeth Holmes Verdict: Theranos Founder Is Guilty on Four of 11 Charges in Fraud Trial," *The Wall Street Journal*, updated Jan. 3, 2022, https://www.wsj.com/health/healthcare/the-elizabeth-holmes-verdict-theranos-founder-is-guilty-on-four-of-11-charges-in-fraud-trial-11641255705 (last visited Jun. 20, 2025). See also Bobby Allyn, "Elizabeth Holmes' Partner Raises Millions for New Biotech Testing Startup," Heard on Morning Edition, *NPR*, May 10, 2025, https://www.npr.org/2025/05/10/nx-s1-5393950/elizabeth-holmes-theranos-billy-evans-blood-testing (last visited Jun. 20, 2025).]

Notes

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2. *Merriam Webster's Collegiate Dictionary* 398 (10th ed. 1993).
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20. Athanassoulis, *supra* note 15.
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22. Chandran Kukathas and Philip Pettit, *Rawls: A Theory of Justice and Its Critics* (Palo Alto, CA: Stanford University Press, 1990), at 39.
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29. Rawls, *supra* note 21, at 195-210.
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3

The U.S. Legal System and Court Jurisdiction

Learning Objectives

After completing this chapter, you should be able to:

- Describe the power of the executive, judicial, and legislative branches of government Explain the role of standing in federal courts
- Recognize the major provisions in the U.S. Constitution
- Discuss the Bill of Rights
- Define subject matter jurisdiction
- Differentiate the type of cases that can be heard in federal court and state court
- Identify how courts obtain jurisdiction over defendants
- Distinguish jurisdiction from venue
- Interpret the citation for a court case

Outline

- The Federal Constitution
- The Courts and Jurisdiction
- How to Find the Law

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Agenda

Asher , Danica, and Mai are beginning to realize the importance of the U.S. legal system for owners and operators of a business. Now several questions have arisen. What do the Cyber Guardian entrepreneurs need to know about state and federal court systems and the different types of jurisdiction? Could they be sued in states other than their state of residence? How does a court obtain jurisdiction over business entities? What courts decide which types of cases? Asher , Danica, and Mai obtained a U.S. copyright on their software. However, they are not sure how well this copyright will protect Cyber Guardian 's software. Will the government protect Cyber Guardian 's copyright or does Cyber Guardian have to bring suit itself? Can Cyber Guardian test its copyright in court before there is a challenge to it? They also have discovered that they will have to distinguish the rules applicable to the federal government and those applicable to the states.

These and other questions will arise as you read this chapter . Be prepared! You never know when the firm or one of its members will seek your advice.

Classic Case

In this Classic Case, the U.S. Supreme Court considered whether the State of Washington had jurisdiction (or authority) over the International Shoe Company . Washington wanted the company to pay its state unemployment compensation tax. International Shoe had salespeople who lived in Washington and sold its shoes in that state. The company itself did not have facilities within the state.

INTERNATIONAL SHOE CO. v. STATE OF WASHINGTON

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326 U.S. 310 (1945)

FACTS International Shoe manufactured and sold shoes. It was a Delaware corporation with its principal place of business in St. Louis, Missouri. It had places of business in several states, but not in Washington. Its merchandise was distributed through several branches located outside Washington. It had no office in Washington, made no contracts, and maintained no inventory there. During the years in question, International Shoe employed 11 to 13 salesmen under direct supervision and control of sales managers in St. Louis. These salesmen lived in Washington, their principal activities were confined to that state, and they were compensated by commissions based upon the amount of their sales. The commissions for each year totaled more than $31,000. The company supplied its salesmen with a line of samples that they displayed to prospective purchasers. Occasionally, they rented rooms to display samples. The cost of the rent was reimbursed by the company. The authority of the salesmen was limited to exhibiting their samples and soliciting orders at prices fixed by the company. The salesmen sent the orders to the company's principal office to be accepted or rejected. When the orders were accepted, the merchandise was shipped and invoiced from outside Washington. No salesman had authority to enter into contracts or to collect payment. Notice of the tax assessment was served on a salesman in the State of Washington. A copy was mailed by registered mail to International Shoe at its address in St. Louis, Missouri.

ISSUES Can the State of Washington require International Shoe to appear in its courts without violating the Due Process Clause of the Fourteenth Amendment? Can the state require International Shoe to pay the state unemployment compensation tax without violating the Due Process Clause?

HOLDINGS Yes, to both questions. The State of Washington's lawsuit and assessment of the unemployment contribution do not violate the Fourteenth Amendment.

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REASONING Excerpts from the opinion of Chief Justice Stone:

. . . The statutes in question set up a comprehensive scheme of unemployment compensation, the costs of which are defrayed by contributions . . . by employers to a state unemployment compensation fund. The contributions are a specified percentage of the wages payable annually by each employer for his employees' services in the state. . . .

26 U.S.C. §1606 (a) provides that "No person required under a State law to make payments to an unemployment fund shall be relieved from compliance . . . on the ground that he is engaged in interstate . . . commerce, or that the State law does not distinguish between employees engaged in interstate . . . commerce and those engaged in intrastate commerce." It is no longer debatable that Congress . . . may authorize the states, in specified ways, to regulate interstate commerce or impose burdens upon it. . . .

Since the corporate personality is a fiction, . . . it is clear that unlike an individual, its "presence" . . . can be manifested only by activities carried on in its behalf by those who are authorized to act for it. . . . [T]he terms "present" or "presence" are used merely to symbolize those activities of the corporation's agent within the state which courts will deem to be sufficient to satisfy the demands of due process. . . . Those demands may be met by such contacts of the corporation with the state . . . as make it reasonable . . . to require the corporation to defend the particular suit which is brought there. An "estimate of the inconveniences" which would result to the corporation from a trial away from its "home" or principal place of business is relevant in this connection. . . .

"Presence" in the state . . . has never been doubted when the activities of the corporation . . . have not only been continuous and systematic, but also give rise to the liabilities sued on, even though no consent to be sued or authorization to an agent to accept service of process has been given. . . . Conversely it has been generally recognized that the

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casual presence of the corporate agent or even his conduct of single or isolated . . . activities in a state . . . are not enough to subject it to suit on causes of action unconnected with the activities there. . . . To require the corporation in such circumstances to defend the suit away from its home or other jurisdiction where it carries on more substantial activities has been thought . . . too great and unreasonable a burden on the corporation to . . . [comply] with due process. . . .

It is evident that the criteria by which we mark the boundary line between those activities which justify [subjecting] . . . a corporation to suit, and those which do not, cannot be simply mechanical or quantitative. . . . Whether due process is satisfied must depend . . . upon the quality and nature of the activity in relation to the fair and orderly administration of the laws. . . . [The Due Process Clause] does not contemplate that a state may make binding a judgment *in personam* against an individual or corporate defendant with which the state has no contacts, ties, or relations. . . .

But to the extent that a corporation exercises the privilege of conducting activities within a state, it enjoys the benefits and protection of the laws of that state. The exercise of that privilege may give rise to obligations. . . . [S]o far as those obligations arise out of or are connected with the activities within the state, a procedure which requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue. . . .

[T]he activities carried on in behalf of . . . [International Shoe] in the State of Washington were neither irregular nor casual. They were systematic and continuous throughout the years in question. They resulted in a large volume of interstate business, in the course of which appellant received the benefits and protection of the laws of the state. . . . The obligation which is . . . sued upon arose out of those very activities. It is evident that these operations establish sufficient contacts or ties with the state of the forum to make it reasonable and just, according to our traditional conception of fair play and

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substantial justice, to permit the state to enforce the obligations which appellant has incurred there. . . . [W]e cannot say that the maintenance of the present suit in the State of Washington involves an unreasonable or undue procedure. . . .

[Washington] . . . imposes a tax on the privilege of employing appellant's salesmen within the state measured by a percentage of the wages. . . . The right to employ labor has been deemed an appropriate subject of taxation in this country. . . . [A] tax imposed upon the employer for unemployment benefits is within the constitutional power of the states. . . .

Affirmed.

THE FEDERAL CONSTITUTION

The Constitution of the United States is a unique document for two reasons: It is the oldest written national constitution, and it was the first to include a government based on the concept of a separation of powers. The Constitution was intended to prevent many of the problems the founders felt were present in Great Britain. The U.S. Constitution established a government structure that has three separate "divisions" and a series of checks and balances in which the power of one branch is offset, at least to some extent, by that of the others.

The Constitution places the power of the purse (fiscal and monetary control) in the legislative branch of government and the power of the sword (control over armed forces) in the executive branch. The power of the executive branch expands during times of emergencies. [1] The judicial branch does not have the formal, written power that exists in the other branches of government. It does possess what may be the most important power, at least from a constitutional perspective. The judicial branch has the power to decide where and how the other two branches may properly exercise their powers. This power was "created" by the court itself in the

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landmark case, *Marbury v. Madison*,[2] and is called the power of judicial review. We will discuss judicial review in greater detail later in this chapter.

Allocation of Power

Legislative Power Article I of the Constitution creates a Congress consisting of two houses: the Senate and the House of Representatives. Congress has the power to levy and collect taxes, pay debts, and pass all laws with respect to certain enumerated powers, such as (1) providing for the common defense and general welfare; (2) regulating commerce; (3) borrowing and coining money; (4) establishing post offices and building highways; (5) promoting science and the arts; and (6) creating courts inferior to the U.S. Supreme Court.

Executive Power Article II creates the executive branch of government by establishing the offices of President and Vice President. The President is the Commander-in-Chief of the armed forces of the United States. In addition, the President has the power to make treaties and to nominate ambassadors, judges, and other officers of the United States. The Senate must ratify all treaties, or the treaties will not be effective. The Senate must also confirm all presidential appointments or the appointee cannot take office. The Vice President is the president of the Senate and also serves for the President when the President is unable to serve.

Administrative Agencies Administrative agencies also wield power, even though they are not discussed in the U.S. Constitution. These agencies are sometimes called a fourth branch of government. They are generally considered part of the executive branch. Agencies are created by Congress through the passage of a statute, often at the request of the executive branch. The statute that creates the agency is called the *enabling statute*, and it specifies the power and authority of the agency. Most federal agencies have the power, within their authority, to make rules and regulations that are similar to statutes.

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They also decide controversies involving these rules and regulations. (These controversies are resolved in administrative hearings; they are not cases in the literal sense of the word.) The exact authority and the organization of the agencies vary greatly. Administrative agencies exist on the federal, state, and local levels. Administrative agencies will be discussed in more detail in Chapter 5.

Judicial Power Federal judicial power is placed in one Supreme Court and in such other inferior courts as Congress may create. The U.S. President nominates all Article III federal judges. When the judges are confirmed by a majority of the Senate, they are permitted to serve in office for the rest of their lives, as long as their behavior is "good."

The actual wording of Article III limits rather than expands judicial power. Under Section 2 of Article III, generally the federal courts may only hear and decide *cases or controversies* (claims brought before the court in regular proceedings to protect or enforce rights, or to prevent or punish wrongs). Legally, cases or controversies can be defined as matters that are appropriate for judicial determination. For a matter to be appropriate for judicial determination,

> [t]he controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests. It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts. [3]

Constitutional law has evolved through precedents so that, today, the following are *not* considered to be a case or a controversy:

- **Advisory opinions.** Opinions rendered by a court at the request of the government or of an interested party that indicate how the court would rule on a matter should such litigation develop. [4]

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- **Moot cases.** Cases in which a determination is sought on a matter that, if decided, will not have any practical effect on the controversy; a question is moot when it presents no actual controversy or when the issues have ceased to exist. [5]
- **Cases where parties lack standing.** Standing means that the party has a sufficient interest in the outcome of a controversy to assert the parties' rights. [6]
- **Political questions.** Questions that the court refuses to decide, due to their purely political character or because their determination would encroach on powers of the other branches. [7]

The doctrine of the separation of powers requires that *federal* courts deal only with judicial matters. An *advisory opinion* is one in which the executive branch or an interested party refers a question to the judicial branch for a nonbinding opinion. However, that is not the purpose of the federal judicial system. Accordingly, whenever a member of the executive branch requires an advisory opinion, the question is referred to the justice department within the executive branch for an opinion from the attorney general. Under the U.S. federal system, the attorney general is the appropriate person to issue an advisory opinion. Contrary to the federal rule, some state courts are empowered to give advisory opinions. The International Court of Justice and the courts of several other nations also will issue advisory opinions.

The federal courts only hear cases that are appropriate for a judicial solution. *Moot cases* are those cases in which the matter has already been resolved or those cases in which any attempt at a resolution would have no practical effect. Sometimes the "resolution" occurs through the passage of time or a change in circumstances. In the case of *DeFunis v. Odegaard*,[8] the Supreme Court stated that the question of whether a student should be admitted to a law school was a moot case. While the case was moving through the court process the student had been admitted to the law school and was completing his degree. The law school informed the Supreme Court

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that regardless of the outcome of the suit, the law school would award DeFunis a degree if he passed his final quarter of coursework. Accordingly, the court chose not to write an opinion on the merits of the suit.

Only persons who can demonstrate that they have actually been harmed or will be harmed have *standing* to sue. Courts will generally define standing as having a direct and immediate personal injury. For example, if you saw Taylor punch Kristen in the nose, you would not have standing to sue Taylor for *assault* (a threat to touch someone in an undesired manner) or *battery* (the unauthorized touching of another person without either legal justification or that person's consent); only Kristen would have standing to sue Taylor because she was the one who was injured. However, statutes may grant standing to sue in situations where it would not otherwise exist. For example, the Endangered Species Act (ESA) contains a citizen-suit provision that provides that in general, "any person may commence a civil suit" to enforce the ESA. [9]

Even though many political questions involve real controversies, U.S. courts will not hear political questions. While a political question may be considered a very real controversy, it is not considered to be a *judicial question* (a question that is proper for a court to decide). This rule is based on the concept of *judicial restraint*, a judicial policy of refusing to hear and decide certain types of cases. For example, if Darlene contends that a state is not based on a democratic form of government, she cannot argue that issue in a U.S. federal court because it is a political question. Similarly, if Luis thinks that a U.S. foreign policy is incorrect, he cannot debate that point in court because foreign policy is a political question. What constitutes a political question is not always clear. For instance, is *legislative apportionment* —the ratio of legislative representation to constituents —a political question? Historically courts have said yes. However, recently the courts have reviewed several legislative districting cases.

The Constitution contains four limits on judicial power but does not mention the one concept that has *expanded* judicial power. The specific power of judicial review is not mentioned in the Constitution.

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The Supreme Court created this doctrine for federal courts in the landmark 1803 case of *Marbury v. Madison.* [10] This power is based on an interpretation of the Constitution, which states that U.S. courts may examine the actions of the legislative and executive branches to ascertain whether those actions conform to the Constitution. If they do not, the courts have the power to declare those actions unconstitutional and unenforceable. Under this doctrine, the Supreme Court can declare an act of Congress invalid if the congressional act does not conform to the Constitution. Similarly, the court can declare conduct by the President, or any other member of the executive branch, invalid if the conduct conflicts with the Constitution. This concept of judicial power does not exist in Great Britain, where the parliament is supreme. The U.S. judicial branch, which has neither the power of the purse nor the power of the sword, has significant power because it can determine what action by the other branches is legal.

Since 1803, the power of U.S. courts to judicially review all actions of the legislative and executive branches has gone unchallenged. It has become the cornerstone of the doctrine of the separation of powers. This power of the Supreme Court to invalidate legislation also extends to all state legislation because of the Supremacy Clause in the federal Constitution.

Cyber Guardian 3.1 Management

PRODUCT SAFETY LAWS

Asher read an article in a business publication that predicted which states would pass the strictest AI statutes in the next 12 months. The author thought Cyber Guardian's state would treat tech companies more harshly than other states. Asher, Danica, and Mai believe that their software is not likely to be affected by such statutes at this time. However, Asher is still concerned about the long-term effects on the company that the passage

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of addit ional regulation could cause. He asks what you would advise the company t o do. What will y ou tell him?

BUSINESS CONSIDERATIONS What practical steps can a business tak e to avoid the impact of new state regulation? What le gal steps can a busin ess tak e to avoid new regulation? Can the firm a void the jurisdiction of the state 's cour ts? How?

ETHICAL CONSIDERATIONS Is it ethical for a busines s to attempt to avoid go vernment regulation? W ould it be ethical for a firm to attempt to discou rage state legislation that might harm the firm while helping cust omers?

Cyber Guardian 3.2 Management

HOW T O PRO TEC T CYBER GU ARDI AN'S COPYRIGH T

Mai is ver y concerned that another firm will "steal" the pr oprietar y so ftwar e behind Cyber Guar dian 's ser vices and under cut it on price. Although Cyber Guar dian holds a cop yright on its softwar e, Mai knows that cop yrights ar e not alwa ys upheld in cour t. Consequently , she would lik e to file a suit with the cour t to de termine if the cop yright will be upheld *befor e* a competit or duplicates it. She asks you how she should pr o ceed. What advice will y ou giv e her?

BUSINESS CONSIDERATIONS What can a business do to reduce the risk that its cop yright will be held inv alid? What technique or techniques would be most eff ectiv e? Ar e businesses mor e or less concerned about pr otecting their patents? How does uncer tain ty about a cop yright or a patent aff ect a business?

ETHICAL CONSIDERATIONS Analyz e the ethical perspectiv e of any busines s that would attempt to "steal" Cyber Guar d ian 's

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cop yright or patent. Is commer cial or industrial espionage an ethical method of doing business?

Role of Judges and Juries The role of a judge varies with the type of cour t over whi ch the judge presides. In a trial cour t the judge has se veral diff er ent r esponsibilities. If it is a jur y trial, the judge:

1. Pr esides o ver the trial
2. Determines the admissibility of any evidence either sid e wants t o pr esent
3. Rules on any motions or objections raised b y either side
4. Instructs the jur y about the applicable law in the case an d the standar ds that must be met in or der to decide for the plaintiff or the def endant in a civil suit, *or* to decide for the go vernment or the def endant in a criminal case
5. Awar ds remedies to the successful plaintiff in a civil suit or imposes a sentence on a criminal def endant who is foun d guilty of the crime

In a jur y trial the jur y decides which evidence is mor e belie vable and whether a par ty has pr oduced sufficient cr edible evidence to win. W e called this role the "decider of fact." If ther e is no jur y, the judge ser ves as the " decider of fact" in its place. The judge is the " decider of law ."

A ju dge or justice ser ving on an appellate cour t has a significantly diff er ent role. An appellate ju dge is expected to r eview th e recor d of the trial cour t or a lower cour t of appeals to ensur e that the law was applied corr ectly . Generally , new evidence is not pr esented in appellate cour ts. The appellate cour ts ar e examining potential err ors of law— mistak es in how the law was applied or interpr eted b y the lower cour t. When ther e ar e err ors, the appellate cour t justices must decide whether to r everse the lower cour t's opinion, remand the case for a new trial, or r ecommend other appr opriate r emedies.

Despite the role, the robes, and the titles, judges ar e people, too. As a result, the personalities of individual judges and justices ma y aff ect their rulings in any giv en case. The influence of the U.S. Supr eme Cour t Justices is par ticularly str ong. As of this writing, the

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curr ent Justice s on the Supr eme Cour t ar e Chief Justice John G. Rober ts, Jr., and Associate Justices Samuel A. Alit o, Jr., Amy Cone y Barr ett, Neil M. Gorsuch, K etanji Br own Jackson, Elena Kagan, Br ett M. Ka vanaugh , Sonia Sot oma yor, and Clar ence Thoma s.[11] Wh en ther e is a vacancy on the Cour t, the remaining Justices continue to do the work of the Cour t. Th e personal and jurisprudential views of the judges impact the rulings in par ticular cases and the pr ecedents being set for a jurisdiction. F or example, ther e ar e numer ous ar ticles about how Justice Ruth Bader Ginsbur g's work experiences and views aff ected her decisions when she was on the Cour t.[12] The same is tr ue of other judges and justices. Justice Clar ence Thomas made some pointed obser vations from the bench during a case inv olving cr oss burning that r epor tedly changed the t one of the pr oceedings.[13]

Judges who fa vor judicial res traint belie ve that the judge 's role is to m ak e sur e that a law is legal and constitutional. The se judges belie ve that if ther e is something wr ong with the legal system, judges should not corr ect it. Corr ections should be left to the legislatur e. F or example, in addr essing asbest os litigation, Justice Sou ter wr ote, "[T]his litigation defies cust omar y judicial administration and calls for national legisla tion."[14] J udges who ar e activists belie ve that their role is to encourag e social change: These judges often belie ve it is not necessar y to wait for the le gislatur e to addr ess the issue. This is often ca lled "making law ." Sometimes judges claim to be of one view , and the n author opinions that actually ar e contrar y to tha t view . F or example, a judge ma y claim to fa vor judicial restraint and then mak e decisions that ar e ver y activist in natur e. Those who belie ve that judges should not be activis ts often complain when the y feel that judges ar e " making law ."[15]

F ederal judges and the judges in most states ha ve a code of ethics.[16] In 2023 , the U.S. Supr eme Cour t members agr eed to a code of cond uct to go vern their beha vior .[17] In the pr eam ble of the document, the Justices state that the y ha ve had a "common law" code of ethics. Howe ver, the lack of a written code prior to 2023 has caused some obser vers to belie ve that the y did not ha ve a code.

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Some members of Congress have called for a more stringent code of ethics and enforcement procedures for the Supreme Court.[18]

Original Constitution

The original Constitution, signed on September 17, 1787, contained several rights pertaining to individuals. We will discuss some of the most significant rights. Among these rights is the right of habeas corpus. *Habeas corpus* is the name given to a variety of writs issued to bring a party before a court or judge (a *writ* is a writing issued by a court in the form of a letter ordering some designated activity). In Latin, *habeas corpus* means "You have the body."[19] Habeas corpus may be used by all persons who have been deprived of their liberty. There are special forms of the writ; however, when the words "writ of habeas corpus" are used alone, the writ is addressed to the person who detains an individual. The writ commands the recipient to produce the individual in court and to comply with any order by the court issuing the writ. This is probably the most common form of the writ.[20] Note that habeas corpus is a way to have the issue heard in court; it does not assure that the person will be released.

Another right established by the Constitution is that Congress may pass no bills of attainder. A *bill of attainder* is a "legislative trial," whereby a person is judged a felon or worse by act of the legislature and not by a court of law.

Congress also may not enact ex post facto laws. An *ex post facto* law is a law passed after an occurrence or act that retroactively changes the legal consequences of such act. Assume that Iron Fortress Defense, Inc. legally purchased some equipment in January. In March, Congress enacted a statute making the purchase of such equipment illegal. Iron Fortress Defense could not be prosecuted for making the purchase since it did so before the statute was enacted. Of course, Congress *can* declare illegal similar transactions in the future. The constitutional prohibition on ex post facto laws applies only to criminal law. This prohibition includes laws that (1) make an act a crime; (2) make a crime into a more serious crime; (3) change the punishment for a crime; or (4) alter the legal rules of evidence for

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proving a crime.[21] The constitutional basis for regulating businesses is discussed in greater detail in Chapter 5.

Selected Amendments to the Constitution

Four years after the U.S. Constitution was signed, the first ten amendments were passed. These amendments, known as the Bill of Rights, spell out individuals' rights when dealing with the federal government. In all, 27 amendments to the Constitution have been passed. The amendments to the Constitution reflect the citizens' concerns about particular topics and reflect changes in the society. The Constitution itself serves as the supreme law of the land for U.S. society. All of the amendments are important because they affect the rights of the citizens and/or limit the power of the government. Not all of the amendments have a significant impact on the rights of businesses. In this section, we will briefly discuss the amendments that are most likely to impact business.

First Amendment The First Amendment provides that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." The First Amendment provides the basis for the separation of church and state. This amendment also provides for freedom of speech, freedom to assemble, and freedom of the press. For example, California passed a statute that prohibited the sale or rental of "violent video games" to minors. Members of the software and video game industries challenged the statute on the grounds that it interfered with their free speech. The U.S. Supreme Court decided that the statute violated the businesses' rights under the First Amendment.[22] More recently, a 2023 Texas law required pornography websites to verify that their visitors are 18 or older. A group representing the pornography industry brought an action against Texas. The group argued that the statute violated the First Amendment. In Texas, minors are not permitted to access obscene materials even though adults can. The U.S. Supreme Court ruled that requiring proof of age is an ordinary and appropriate means of restricting access to adults.[23]

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Fifth Amendment The Fifth Amendment protects individuals from self-incrimination and double jeopardy. These protections are important in criminal matters. This amendment also provides that a person cannot be deprived of life, liberty, or property without due process of law. This provision applies to individuals and corporations. Sometimes courts expand their definition of "life, liberty, or property" and at other times they narrow their definition.

There are two types of due process—procedural due process and substantive due process. Procedural due process deals with the government's procedures when it deprives a person of life, liberty, or property. Procedural due process gives a person a right to a proper notice and hearing. The specifics of what will satisfy due process depend on the type of case. Generally, the more serious the case the more rights the person has. For example, if Avi is charged with murder, she will be entitled to a jury trial. If Matthew is charged with speeding, he will not be entitled to a jury trial in traffic court.[24]

Substantive due process refers to the basic fairness of the laws that may deprive an individual of life, liberty, or property. Privacy rights are often protected under substantive due process. If the government passes a law that limits a person's liberty or limits how the person uses the person's property, the government must have a proper purpose.[25] This will be discussed in more detail in Chapter 5.

Sixth Amendment The Sixth Amendment includes the right to a speedy and public trial. It is limited to criminal cases. One of the purposes for requiring a speedy trial is that some suspects have to remain in prison until their trial dates. We do not want them to remain in prison for a long time when they may actually be acquitted at their trial. During the 2020 novel coronavirus (COVID-19) pandemic, many courts were closed due to shelter-in-place orders. Officials responsible for administering the courts struggled with how to provide speedy and public trials while containing the spread of COVID-19. Many courts experimented with online hearings and trials.[26]

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Four teenth Amendment The original Bill of Rights applied to the federal go vernment. Ov er time and numer ous decisions, the Supr eme Cour t has decided that under the Four teenth Amendment most of the guarantees in the Bill of Rights also apply to actions by state and local go vernments. Under this amendment, the states cannot depriv e individuals of lif e, liber ty, or pr oper ty without due pr oces s. In many states, a driv er's license is consider ed to be a pr oper ty right, so the state ca nnot te rminate a person 's driv er's license without giving the driv er an oppor tunity to be hear d. A business license wou ld also be consider ed a pr oper ty right.

In one case, Jeff Quon work ed for the City of Ontario Police Depar tment (O PD). He was a ser geant and member of the Special W eapons and Tactics (SW AT) Team. The city pr ovided Quon and a number of other officers with alphanumeric pagers. The bills fr om the ser vice pr ovide r indicated high usage, and for a while the city ask ed the officers to pa y for their o verages. Then the city decided to audit the usa ge for some of the offi cers who wer e ex ceeding the number of characters allo wed under the basic plan. The city ask ed the ser vice pr ovider to transcribe the officers' messages. The city then read the messages and determined wh ich ones wer e personal and which ones wer e work related. Quon "sen t or receiv ed 456 messages d uring work hours in the m onth of A ugust 2002, of which no mor e than 57 wer e work related."[27] S ome of the messages wer e sexually explicit. Quon ar gued that the city violated the ban on "unr easonable sear ches and seizur es" under the F our th Amendment and made applicable to the states under the F our teenth Amendment. The Supr eme Cour t found that the sear ch was reasonable because it was "motiv ated by a legitimate work-r elated purpose, and because it was not excessiv e in scope."[28]

THE COUR TS AND JURISDIC TION

Jurisdiction is the power of a cour t to affect legal relationships. W e will examine four aspects of jurisdiction:

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1. *Subject matter jurisdiction*, which is the power of a court to hear certain kinds of legal questions
2. Jurisdiction over the persons or property
3. Concurrent versus exclusive jurisdiction
4. Venue

Subject Matter Jurisdiction

Subject matter jurisdiction refers to the power of the court to hear and decide particular types of cases. Article III of the Constitution defines the Supreme Court's subject matter jurisdiction as including all cases in law and equity arising under the Constitution, the statutes of the United States, and treaties. The subject matter jurisdiction granted to the Supreme Court is extensive. A state juvenile court, on the other hand, is limited solely to hearing matters concerning children that arise within that state and under its laws. If an adult were brought before a juvenile court, the court would lack subject matter jurisdiction. Likewise, a federal bankruptcy court may not decide a criminal matter because its jurisdiction is limited to bankruptcy matters. Subject matter jurisdiction deals with which court is the "right" court to hear a particular type of case or controversy.

Jurisdiction over the Persons or Property

In addition to the appropriate subject matter jurisdiction, a court must also have jurisdiction over the persons or property whose rights, duties, or obligations the court will decide. The defendant may not want to have the case decided where the plaintiff filed the suit. Jurisdiction may be a particular problem for businesses that enter contracts with people outside their state or country. It may also be an issue for businesses that sell their products in many states and countries. Such a business may be subject to suits in many different locations, each of which may be able to assert jurisdiction over the business. A purchaser of the company's product may prefer to litigate any disputes in the consumer's "home court" rather than the home

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court of the business. This may be due to convenience, cost, or an implicit bias. For example, some people believe that Apple had this type of "home court" advantage in one of its U.S. patent infringement suits with Samsung because the dispute was litigated close to Apple's corporate headquarters. [29]

Three bases exist for obtaining jurisdiction over persons or property— *in personam, in rem*, and *quasi in rem.*

***In Personam* Jurisdiction** *In personam* jurisdiction refers to the court's authority over the defendant. It is also called personal jurisdiction. We will use both terms. Questions do not arise about the court's jurisdiction over the plaintiff. The plaintiff chooses to file the suit in a particular court and so implicitly consents to the court's jurisdiction. It is inconsistent to allow the plaintiff to file the suit in a court and then complain that the same court lacks jurisdiction over the plaintiff.

The defendant does not choose the court. Often, if the defendant were given a choice, the defendant would choose to avoid a trial altogether. If a trial must take place, the defendant might well prefer to have it held somewhere else. The question, then, is how to get *in personam jurisdiction* of the defendant. When can the court legally compel the defendant to attend or face a *default judgment* if the defendant refuses to attend the trial? (A *default judgment* is a civil judgment against a defendant who does not appear in court. It is only valid when the court has jurisdiction over the court case and the defendant.)

Consent The defendant may simply consent to the court's jurisdiction. Consent can occur either by express consent or by failure to raise the issue of jurisdiction and, instead, responding to the legal questions in the lawsuit. Consent can also be given prior to the lawsuit. This is commonly accomplished by a contract clause or by appointment of an agent to accept service of process. (*Service of process* is the delivery of a legal notice to inform the defendant of the nature of the legal dispute.) Generally, a corporation is considered to have given consent when it registers with a state as a *foreign*

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corporation (a corporation that had its articles of incorporation approved in another state) and asks permission to conduct business in a state. This depends on the specific language of the relevant statutes and court interpretation of it.[30] Some courts have concluded that a corporation has given implied consent when it engages in business as a foreign corporation without the required registration.

Physical Presence A court will also have *in personam* jurisdiction over a defendant who is physically present in the state when the defendant is served with process. This would include a person who is on a trip to the state or even merely passing through the state on the way to another destination. Courts will usually decide that there is no jurisdiction over a defendant who is tricked into entering the state by the plaintiff. A corporation is physically present in a state in which it is *doing business.* (Doing business is also used as the basis of implied consent by some states.) The courts have decided numerous cases about what constitutes doing business and have devised various tests for recognizing doing business. Two of these tests are (1) whether the corporation's activities were single, isolated transactions or continuous and substantial activities; or (2) whether the corporation's agents were only soliciting offers in the state or were engaged in additional activities.

In the Classic Case of *International Shoe Co. v. State of Washington*,[31] the U.S. Supreme Court concluded that before a defendant is required to appear in a state court, the defendant must have certain *minimum contacts* with the state. Otherwise, the suit would offend traditional concepts of fair play and substantial justice. This decision created a constitutional test for *in personam* jurisdiction. The defendant in this case was a corporation, but the ruling now applies to other business entities and individuals as well.

Domicile In personam jurisdiction also exists in the defendant's state of domicile. Domicile is a complicated legal doctrine (and most of its complexity is outside the scope of this text). Human beings have one and only one domicile. A person may choose a domicile or the law may assign it. *Domicile* is usually the place where a person is

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physically present and the person considers as home; it is the person's permanent home. When the person leaves for a while, the person intends to return to this place. Domicile does *not* require that a person live in a state for a certain minimum time. Consequently, domicile contrasts with residency statutes that require, for example, a person to live in a state for a set period of time before voting in the state or being eligible for in-state tuition at its colleges and universities.

Suppose that both the plaintiff and the defendant are domiciliaries of Alaska; Alaska has jurisdiction over them. If the plaintiff is a domiciliary of Oregon and the defendant is a domiciliary of Alaska, Alaska would once again have *in personam* jurisdiction. The defendant's domicile would create jurisdiction in the Alaskan court. On the other hand, if the plaintiff is a domiciliary of Alaska but the defendant is a domiciliary of Oregon, Alaska may not have proper jurisdiction over the defendant. If the plaintiff wants to sue the defendant in a state court, the plaintiff might need to go to Oregon and sue the defendant there, since a defendant's domicile is almost always an appropriate forum. (*Forum* is the court that is or will be conducting the trial.) Potential jurisdiction in a federal court is discussed later in this chapter.

A corporation may be sued where it is domiciled. A corporation is domiciled in the state in which it is incorporated. It is also considered to be domiciled in the state where it has its corporate headquarters, if this is a different state. A corporation is also subject to *in personam* jurisdiction in all states in which the corporation does business because it is physically present in these states.

There are different rules for other types of business entities. A general partnership is domiciled in every state where a partner is domiciled. Similarly, a limited liability company will be domiciled in every state where a member is domiciled. (*Members* are the owners of limited liability companies.) A state has general *in personam* jurisdiction over a defendant domiciled within it, meaning that the defendant can be sued on any issue in that state.

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Long-arm Statutes Most states have laws called *long-arm statutes.* The purpose of these statutes is to permit the state to exercise *in personam* jurisdiction when ordinarily this would not be possible. A common long-arm statute permits a state to exercise authority over a person who drives on its roads. This type of long-arm statute is also called a *nonresident motorist statute* .[32] (Note that despite the use of the term "resident" in many statutes, the legislatures probably mean "domiciliary.") Suppose that Cara, a domiciliary of Ohio, drives a car on the roads of Kansas and injures Colin, a domiciliary of Kansas. In this situation, the courts of Kansas would have *in personam* jurisdiction over Cara, because Kansas feels that it would be unfair to force Colin to go to Ohio to sue. Some states have enacted much broader long-arm statutes. For example, Illinois enacted a statute that listed certain acts that would confer jurisdiction if the acts were completed in the state. California, Iowa, Kansas, Nebraska, [33] and Pennsylvania, [34] on the other hand, enacted long-arm statutes that provide for *in personam* jurisdiction whenever it complies with the federal and state constitutions. [35] As with other matters under the control of the states, there is great variation among long-arm statutes.

Web-based Businesses E-commerce has created new challenges in applying *in personam* jurisdiction. U.S. courts rely on the precedent established by *International Shoe* and try to apply it to internet cases. If a defendant simply posts information on a passive internet website in another jurisdiction, [36] there are not sufficient contacts with any "foreign" jurisdictions to permit the exercise of personal jurisdiction over the defendant posting the information. Such passive websites do no more than make information available. At the other extreme are websites that actively engage in selling products and services in the forum state. Between these two extremes lies the troublesome area. In this area, a defendant might host an interactive website that allows for the exchange of information between the user and the host computer . The plaintiff may have interacted with this website. In these situations, personal jurisdiction will depend on the level of interaction and , also, on whether the exchange of information is

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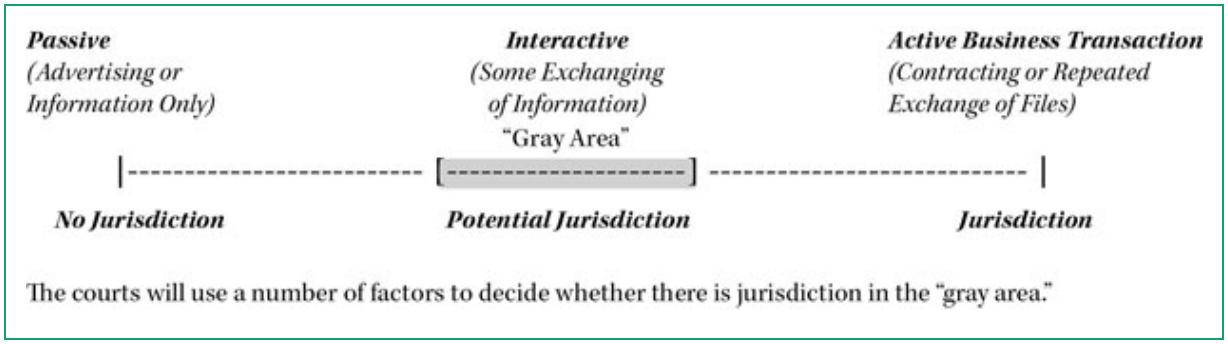
commercial in nature.[37] In reaching a decision, courts look at the extent to which the defendant actually and purposefully conducted commercial or other transactions with residents in the forum state through its website. Courts also consider whether the website specifically targets residents in the forum state or knowingly receives substantial revenue from forum residents.[38] Websites can be categorized as three types for purposes of *in personam* jurisdiction: (1) a passive website which only advertises on the internet: personal jurisdiction is inappropriate; (2) a website that permits a user to exchange information with a host computer: jurisdiction is determined by the degree of interactivity and whether the exchange of information is commercial in nature; and (3) a website that clearly engages in business over the internet through repeatedly entering into contracts: personal jurisdiction is proper.[39] For a graphic representation of the rules, see Exhibit 3.1 .

There is still a lot of uncertainty in this area. One solution for some e-commerce businesses is to specify in their contracts where they should be sued. X (formerly known as Twitter®) is one business that took this approach.[40]

Exhibit 3.1

General *In Personam* Jurisdiction Over Web-based Businesses



General and Specific In Personam Jurisdiction Courts have developed two types of *in personam* jurisdiction—specific and general. Specific personal jurisdiction (case-linked jurisdiction) is

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jurisdiction over cases related to the defendant's actions within the forum state. It depends on a connection between the state and the underlying controversy, i.e., something took place in the state, like a tort, and it is subject to the state's regulation. In specific jurisdiction the case must relate to the defendant's activities within the forum. The court will examine the interrelationship among the defendant, the forum, and the litigation. On the other hand, general personal jurisdiction (all-purpose jurisdiction) is the state's power to decide any cause of action involving the defendant, regardless of where the cause of action arose. It allows jurisdiction over a defendant based on the defendant's connection to the forum unrelated to the underlying suit. An example is domicile. The court can hear the claim even if all the activity occurred in another state.

***In Rem* Jurisdiction** If a state cannot obtain *in personam* jurisdiction on any of these grounds, it may be able to use *in rem* jurisdiction. *In rem* jurisdiction exists when the court has authority over property or status of something that is located within the control of the court. *In rem* jurisdiction allows the state to exercise its authority over something such as land, a marriage, or a partnership within its boundaries. The court's judgment will affect everyone's rights in that "thing." It cannot be used to impose a personal obligation on the defendant. For example, if an individual or a corporation has real property in one state but is domiciled in another, the state where the property is located can exercise *in rem* jurisdiction in a dispute over ownership of the property. However, *in rem* jurisdiction cannot be used to force a party to pay damages or publish an apology.

***Quasi in Rem* Jurisdiction** In this type of jurisdiction, the court determines the rights of particular persons to specific property. (It is distinct from *in rem* jurisdiction because a court with *in rem* jurisdiction will determine the rights of all persons in the thing. It differs from *in personam* jurisdiction because there is no authority over the person of the defendant.) *Quasi in rem* jurisdiction is authority obtained through property under the control of the court. Depending on the state, the court obtains control of the property

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through one of two methods. In one, the property is within the jurisdiction of the court, and the plaintiff wishes to resolve issues of ownership, possession, or use of the property—for example, to foreclose a mortgage. In the second method, the dispute does not concern the property, but is personal to the plaintiff, such as a breach of contract or the commission of a tort. Jurisdiction will exist if the plaintiff can locate the defendant's property within the state and bring it before the court by *attachment* (seizure of the defendant's property) or *garnishment* (procedure to obtain possession of the defendant's property when it is in the custody of another person). The state will have limits on when attachment or garnishment is allowed. When the plaintiff 's suit is successful, the recovery is limited to the value of the property. Exhibit 3.2 summarizes the techniques for obtaining jurisdiction over the defendant.

Service of Process Regardless of the type of jurisdiction, the plaintiff must properly serve the defendant with process to inform the defendant of the suit. One type of service is *actual notice*, where the defendant is personally served by an officer of the court or is mailed service by registered mail. If the plaintiff cannot arrange actual notice after reasonable attempts to do so, the plaintiff may serve notice publicly by posting on the property or in a newspaper. This is called *constructive service* or *constructive notice*. For a business entity, constructive notice may also include service at the office of the state 's secretary of state. For example, when an out-of-state corporation registers in Virginia, the state may specify that process may be served on Virginia 's secretary of state.

The person who serves process is considered an officer of the court because the person is performing an important judicial function. In most states, you do not have to be a court employee to be a process server. In many states, any adult can serve process on the defendant. Some states even permit the plaintiff to serve the process. Even where it is permitted, you should not serve the defendant yourself. This could possibly lead to an exchange of heated words or even the commission of a battery. It is better to pay

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someone else, such as a sheriff, to hand the legal papers to the def endant.

Concurr ent v ersus Ex clusiv e Jurisdiction

Exhibit 3.2

Methods to Obtain Jurisdiction o ver the Defendant

Type of Jurisdiction	Type of Judgment	Differences Between Individual and Corporate Defendants	
		Individual	*Corporation* [a]
In personam			
A uthority o ver a specific person or corporation within the contr ol of the state. A uthority ma y deriv e fr om consent, domicile, physical pr esence, or long-arm statutes.	Aff ects the person.	**Consent** Def endant consents t o personal jurisdiction; consent can occur befor e or after a suit has begun. **Domicile** Def endant has a residence, usually a home, at which the def endant	**Consent** A corporation generally consents when it registers as a for eign corporation with the state. [b] **Domicile** A corporation is incorporated (has filed its ar ticles of incorporation with the

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Type of Jurisdiction	Type of Judgment	Differences Between Individual and Corporate Defendants	
		is/has been physically pr esent and intends t o remain for the time being; individuals ha ve only one domicile. [c] **Physical Presence** Def endant is ser ved b y hand while within the geographic boundaries of the state. [d]	state) and/or has its corporate headquar ters in the state. **Physical Presence** A corporation is r ecogniz ed as " doing business" in the state.
In r em			
A uthority o ver pr oper ty or status of something within the contr ol of the state. Settles ownership	Aff ects the pr oper ty or status.	The rules for individuals and corporations ar e basically the same.	

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Type of Jurisdiction	Type of Judgment	Differences Between Individual and Corporate Defendants
inter ests in pr oper ty or status for all persons. *Quasi in r em* A uthority obtained thr ough pr oper ty under the contr ol of the state. Settles issues of ownership, possession, or use of pr oper ty; or settles personal disputes unr elated t o the pr oper ty.	Aff ects the rights of specific people t o the pr oper ty.[e]	The rules for individuals and corporations ar e basically the same.

[a] This column ap plies to corporations. Other business entities ha ve diff er ent rules. F or examp le, a limited liabi lity company is domiciled in the states wher e any of its members ar e domiciled.

[b] If th e co rporation fails to register , the cour t ma y imply consent fr om the act of doing bu siness in the state. Ge nerally , implied consent is limited to cases arising fr om the actual doing of business in the state.

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[c] Some people are not capable of selecting domiciles for themselves; they have domiciles determined for them by legal rules (for example, minors).

[d] Most states will refuse to exercise jurisdiction if the defendant is brought into the state by force or enticed into the state by fraud.

[e] A successful plaintiff is limited to the value of the property.

In certain cases, more than one court may have jurisdiction. This is called *concurrent jurisdiction.* On the other hand, some subjects can be heard only by a specific court to the exclusion of other courts, which is called *exclusive jurisdiction.* Examples of exclusive jurisdiction in the federal courts are suits in which the United States is a party or suits that involve bankruptcy, copyrights, federal crimes, and patents. Most federal statutes set out whether jurisdiction under the statute is exclusive to the federal courts or concurrent with federal and state courts. Employment discrimination is an example of concurrent jurisdiction. An employee who sues based on allegations of discrimination can sue in either federal or state court. Generally, the employee can combine federal claims and state claims. Exhibit 3.3 illustrates the jurisdictional domains of federal and state courts.

Concurrent jurisdiction in multiple courts is common. When there is concurrent jurisdiction, the plaintiff and the plaintiff's attorney must choose where to file the suit. This is commonly called *forum shopping*. The plaintiff considers several things in making the decision. For example, the plaintiff may be more likely to be successful in one court compared to other courts. The parties may have to wait longer for a trial date in some forums than other courts. If the parties want a jury trial, the probable makeup of the jury is also important. The parties, attorneys, and witnesses will also be required to travel to the court, so the relative cost and convenience of traveling to the forum is also a factor. The plaintiff's attorney will only be licensed to try cases in certain courts. If the case is tried somewhere else, the plaintiff will have to hire additional lawyers, or the plaintiff's attorney will have to obtain the court's permission to appear before it. Different remedies may be available depending on the courts.

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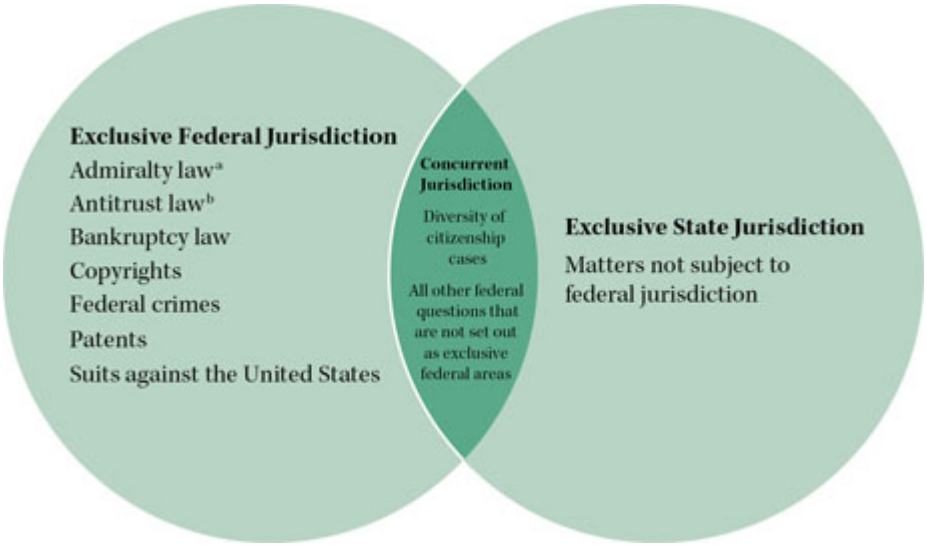
Exhibit 3.3

A Comparison of Federal and State Court Jurisdiction



[a] States have concurrent jurisdiction over some aspects of admiralty law under federal statutes.

[b] Some states have state antitrust laws.

Venue

Once a court establishes that it has proper jurisdiction over the subject matter and the defendant, it must decide whether it is the proper venue. *Venue* literally means "neighborhood." In a legal sense, however, it means the proper geographical area or district where a suit can be brought. In federal courts, the question of venue is which federal judicial district is the appropriate one. In state courts, it is usually a question of which county is appropriate. If both the plaintiff and the defendant are domiciled in the same state, *in personam* jurisdiction exists in that state's courts. But which of the state courts is best situated to hear the case? For example, venue could be proper in the county where an incident, such as an automobile accident, occurred. The court may consider the domicile of the defendant in

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determining the proper venue. More than one court may have proper venue. The laws of most states explain in great detail which courts would have venue.

Choice of Laws

Choice of laws is the selection of which jurisdiction's laws should be applied to a particular incident, that is, what laws should govern the subject before the court. Although it is also called "conflict of laws," choice of laws is the more descriptive title. The forum court will use choice of laws rules to determine the *substantive laws* (the laws that create, define, and regulate rights) that should be applied to the dispute; however, the forum will use its own procedural laws. (*Procedural laws* are the methods for enforcing rights or obtaining redress for the violation of rights.) Choice of law rules can be very complex. Since state laws can vary greatly, the forum's choice of which law to apply can often determine the outcome of the dispute. To reduce some of the uncertainty, parties to a contract often specify what law should govern the transaction, i.e., a clause that says "this contract is governed by the laws of South Carolina." Courts will usually enforce the clause if the state specified has some connection with the agreement. In addition, the parties can also select a court for any litigation; for example, "any disputes will be decided in Arizona state court."

Federal Jurisdiction

Two specific grounds exist for federal jurisdiction: (1) federal question; and (2) diversity of citizenship *plus* amount in controversy. Most federal questions do not require a particular amount to be in controversy.

Federal Question Jurisdiction Federal question jurisdiction comes directly from Article III of the Constitution. *Federal questions* are questions that pertain to the federal Constitution, statutes of the United States, regulations of federal administrative agencies, and treaties signed by the United States. For example, if Rachelle's

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Flowers, Inc. wants to file for bankruptcy protection, that will raise a federal question under the federal bankruptcy code. If Aspen Publishing brings an action asserting that another publishing company has infringed its copyright, Aspen Publishing raises a federal question because copyright is both a federal constitutional and statutory question. States do not have the authority to issue copyrights, and state courts do not have subject matter jurisdiction to decide copyright cases.

Generally, state courts are presumed to have concurrent jurisdiction over civil cases under federal statutes unless Congress clearly intended for the federal courts to have exclusive jurisdiction.[41] Litigation can occur over whether the jurisdiction is concurrent or exclusive when the statute is not clear. For example, in 2012 the U.S. Supreme Court resolved the issue of whether individual private suits filed under the Telephone Consumer Protection Act (TCPA) could be tried only in state courts or whether federal courts had concurrent jurisdiction. It decided that jurisdiction under the act was concurrent.[42] Some other examples of concurrent jurisdiction between the federal courts and state courts are in the areas of civil rights[43] and trademark cases.[44] There is also concurrent jurisdiction over some areas of admiralty law.[45] Federal courts have exclusive jurisdiction over antitrust under federal statutes,[46] bankruptcy,[47] copyright,[48] federal crimes,[49] and patents.[50] Even when there is exclusive jurisdiction in the federal courts, state courts can try related cases. For example, a state court can hear a suit for breach of contract when the contract involves the sale of a copyright or patent.

Diversity of Citizenship Jurisdiction Federal question jurisdiction is not necessary when diversity of citizenship is present. *Diversity of citizenship* exists when the plaintiff is a citizen of one state and the defendant is a citizen of another; it also exists when one party is a foreign country and the other is a citizen of a state. The primary reason underlying diversity jurisdiction is possible bias. Suppose that a citizen of Hawaii must file suit in Iowa to obtain jurisdiction over a citizen of Iowa. The Hawaiian plaintiff could worry that the Iowa court

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might favor its own citizen. If the plaintiff is worried about such potential favoritism, the plaintiff can file suit in federal court.

When federal jurisdiction is based on diversity of citizenship, a further requirement exists: a *minimum amount* in question. Federal law requires that the amount in question must exceed $75,000 in diversity cases.[51] The purpose behind the amount is to prevent federal courts from dealing with trifles and to reduce the caseload in federal courts. Many cases are highly complex, and the dollar amount is often unknown when the lawsuit is filed. Accordingly, the courts look to the amount the plaintiff, acting in good faith, claims to be in dispute. This is called the *plaintiff viewpoint rule.* In contrast, cases in which the federal courts have federal question jurisdiction generally do not require a minimum amount in controversy.

Another aspect of diversity jurisdiction is called complete diversity. *Complete diversity* requires that no plaintiff be a citizen of the same state as any of the defendants. This rule poses complex problems when there are multiple plaintiffs and/or defendants. Complete diversity also prohibits having an alien plaintiff and an alien defendant in the same suit, even when the aliens are from different countries. (An *alien* is a person or corporation that is a citizen of another country.) Courts do not permit people to create diversity by assignment of rights, the creation of trusts, or similar techniques.[52] (An *assignment* is a transfer of rights. A *trust* is a legal arrangement where a trustee manages property for other people's benefit. People can put assets in a trust for their own benefit or the benefit of others.)

Exhibit 3.4 depicts the two grounds for federal jurisdiction.

Exhibit 3.4

The Two Grounds for Federal Jurisdiction

For Federal Jurisdiction the Case Must Involve	
Either	***Or***

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For Federal Jurisdiction the Case Must Involve

Federal Question

The controlling law involves a federal statute, rule, or regulation; an issue of U.S. constitutional law; or a treaty.

The case involves a consul or ambassador as a party.

The case involves maritime or admiralty law.

The United States is a party to the action.

The case is between two or more states.

Diversity of Citizenship *

Parties on one side of the controversy are citizens of a different state than the parties on the other side.

and

A Minimum Amount in Controversy (Excluding Costs and Interest)

The plaintiff must sue for more than $75,000.

* There are special rules for cases filed under the federal Class Action Fairness Act (CAFA).

Cyber Guardian 3.3 Management/Marketing

LAWSUIT AGAINST A COMPETITOR

Cyber Guardian recently learned that Always Alert, a California firm located in Silicon Valley, is providing a service very similar to that of Cyber Guardian. Always Alert is leasing its service for several dollars less than Cyber Guardian. Customers are leaving Cyber Guardian for the lower cost alternative. Asher, Danica, and Mai believe that Always Alert has infringed their copyright and patent, and they would like to sue. However, they are concerned about the short-and long-term effects on the company's finances and reputation. They ask you what the company should do. What will you tell them? What should they consider in making their decision?

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BUSINESS CONSIDERATIONS Can Cyber Guardian sue Always Alert? In what court(s) could the suit be filed? What additional information will be necessary and why? Would filing the suit improve or harm Cyber Guardian's reputation? Why?

ETHICAL CONSIDERATIONS What should Cyber Guardian do to protect its reputation? Are there any ethical restrictions on what Cyber Guardian does to protect its reputation?

The Federal Court System

Congress has, from time to time, created courts of *limited* jurisdiction. The U.S. Court of Appeals for Veterans Claims, U.S. Court of International Trade, and the U.S. Tax Court are examples of courts with limited jurisdiction. Congress has created *federal district courts* (general trial courts in the federal court system) in every state. Each state has at least one; some states have many. Rhode Island, for example, has one district court, and Texas has four. Most federal judges are nominated by the President, confirmed by a majority of the Senate, and entitled to serve for life during good behavior.[53]

All of the district courts are grouped into 13 circuits. Each circuit has a court of appeals, which hears appeals from the trial courts. Courts of appeals do not retry the case; instead, they review the record to determine whether the trial court made errors of law. Generally, a panel of three judges from the circuit hears appeals. Decisions of the court of appeals establish precedents for all district courts in the circuit. For the most part, the decisions of these *circuit courts of appeals* are final. In a very few cases, the parties can appeal to the U.S. Supreme Court.

The 13 federal judicial circuits and their seats are: First: Boston, Massachusetts; Second: New York, New York; Third: Philadelphia, Pennsylvania; Fourth: Richmond, Virginia; Fifth: New Orleans, Louisiana; Sixth: Cincinnati, Ohio; Seventh: Chicago, Illinois; Eighth: St. Louis, Missouri; Ninth: San Francisco, California; Tenth: Denver, Colorado; Eleventh: Atlanta, Georgia; Twelfth: District of Columbia,

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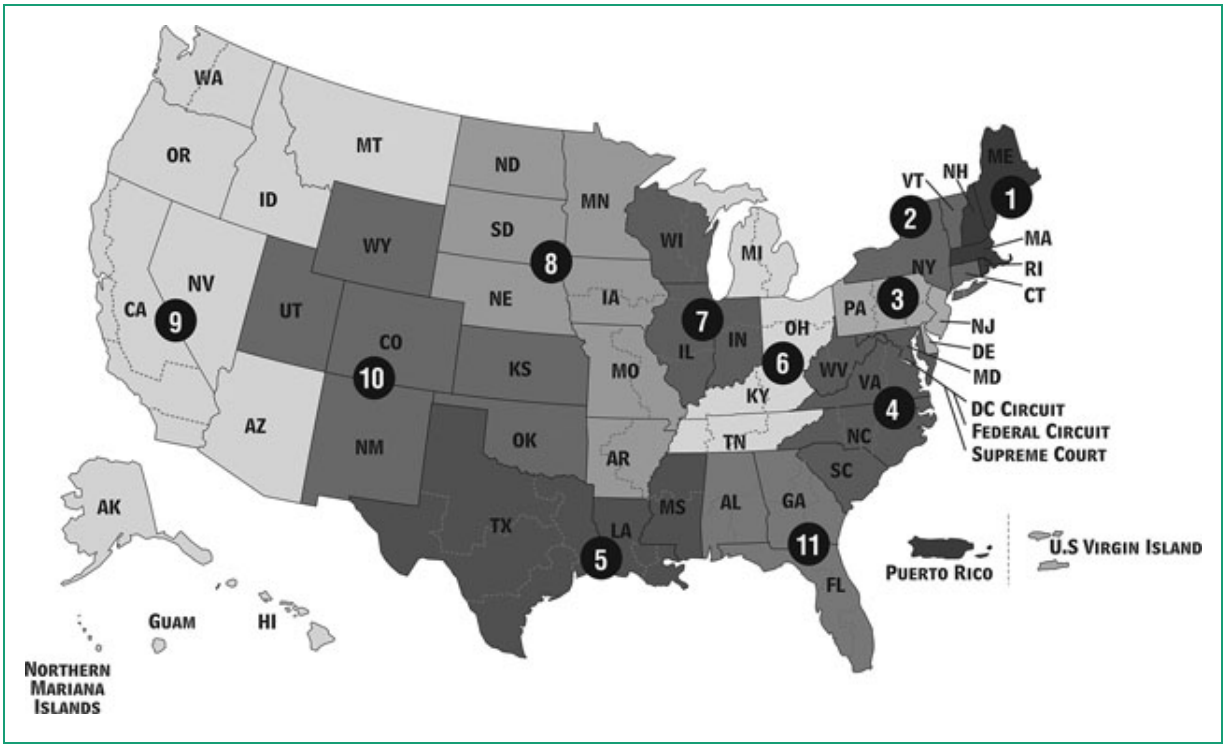
Washington, D.C.; and Thirteenth: Federal Circuit, Washington, D.C. For details on the 13 federal judicial circuits, see Exhibit 3.5.

Exhibit 3.6 describes how the federal courts are related to each other. There are three basic levels, the U.S. district courts (the trial courts in the federal system), the U.S. court of appeals, and the U.S. Supreme Court. Federal agencies are not courts; however, they often perform court-like functions, also called *quasi-judicial* functions. They are shown in Exhibit 3.6 to illustrate the appeal "path" from the agency to the court system.

Exhibit 3.5

The Thirteen Federal Judicial Circuits



Source: United States Courts, "Geographic Boundaries of United States Courts of Appeals and United States District Courts," https://www.uscourts.gov/sites/default/files/u.s._federal_courts_circuit_map_1.pdf (last visited Jun. 16, 2025).

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The Supr eme Cour t

The Sup reme Cour t sits at the top of the U.S. judicial system. It is the only co ur t cr eated by the Constitution. The Constitution does not specify the number of judges, called Justices, on the Supr eme Cour t. The Supr eme Cour t is led by the Chief Justice, and it has eight Associate Justices by statute. [54] The Justices, including the Chief Justice, ar e nominated by the Pr esident and confirmed by a majority of the Senate, and the y ar e entitled to ser ve for life du ring good beha vior .[55]

As pr eviously m entioned, cer tain cases ma y be appealed to the Supr eme Cour t. Howe ver, the Cour t ma y affirm a cas e routinely without permitting oral ar guments or formally considering the case. The Co ur t is mor e lik ely to h ear a case under one of the following conditions:

- Whene ver the highest state cour t declar es a federal law inv alid
- Whene ver the highest state cour t v alidates a state law that is challenged based on a f ederal law

Exhibit 3.6

The F ederal Judicial System

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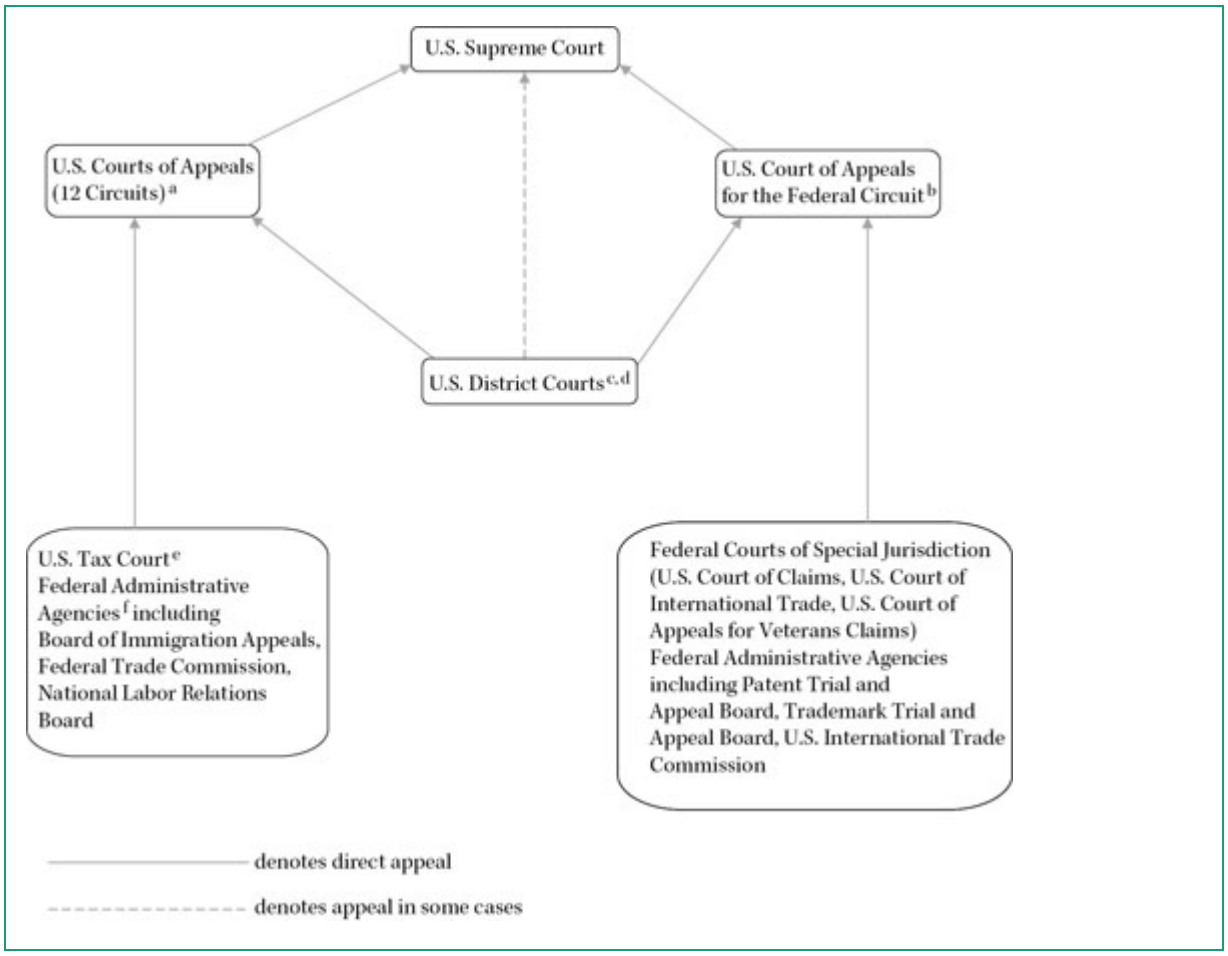

[a] Includes District of Columbia Circuit.

[b] Takes appeals from some specialized courts.

[c] Bankruptcy courts exist as units of the district courts.

[d] Appeals from some federal agencies go to the U.S. district courts.

[e] In some cases, there is Supreme Court review.

[f] Administrative agencies perform court-like functions; however, they are not courts.

- Whenever a federal court declares a federal statute unconstitutional and the government was a party to the suit
- Whenever a federal appellate court declares a state statute invalid on the grounds that it violates federal law

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- Whenever a federal three-judge court decides a civil case involving an equitable remedy

Certiorari Even when there is no right of appeal, the Supreme Court can hear cases under certiorari. *Certiorari* means "to be more fully informed." When the Supreme Court decides to grant *certiorari*, it issues a writ that orders the lower court to certify a record of the proceedings and send it to the Supreme Court. A minimum of four Justices must agree to hear the case on *certiorari.* Other than that requirement there are no hard and fast rules. However, there are certain situations in which the Supreme Court is more likely to grant *certiorari*:

- Whenever two or more circuit courts of appeals disagree with respect to the same legal issue
- Whenever the highest state court has made a decision that conflicts with prior decisions of the U.S. Supreme Court
- Whenever the highest state court has decided a question that has not yet been determined by the U.S. Supreme Court
- Whenever a circuit court of appeals has decided a state law question that appears to be in conflict with established state law
- Whenever a circuit court of appeals has decided a federal question that has not yet been decided by the U.S. Supreme Court

Original Jurisdiction The Supreme Court also has original jurisdiction in several types of cases or controversies. When the Supreme Court exercises its *original jurisdiction*, it serves as a trial court. Article III, Section 2 of the Constitution declares that the Supreme Court shall have original jurisdiction "[i]n all cases affecting ambassadors, other public ministers and consuls, and those in which a state shall be a party."

State Courts

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Like the federal system, most states have three basic levels: trial courts, courts of appeals, and a supreme court. The names of the courts vary from state to state. States also have *inferior trial courts*. These may include municipal courts, juvenile courts, domestic relations courts, traffic courts, small claims courts, probate courts, and justice courts presided over by justices of the peace. (Historically, justices of the peace were not required to be lawyers. Many states have changed their rules and now require new justices of the peace to be lawyers.) For the most part, inferior trial courts are not *courts of record*—that is, they make no record or transcript of the trial. In cases of appeals from their decisions, there is a *trial de novo*, a new trial, in a regular trial court.

Usually, the more significant cases involving matters of state law begin in *courts of general jurisdiction* (courts having unlimited or almost unlimited trial jurisdiction in civil and criminal cases). In some jurisdictions, two courts exist at this level. One court is charged with resolving all questions of law and the other with resolving all matters of equity. An example of a question of law is a suit seeking money damages. Most business law cases fall into this category. Equity suits, on the other hand, are those in which the plaintiff is seeking a special remedy, such as an *injunction* (a writ issued by the court of equity ordering a person to do or not do a specified act), because monetary damages will not make the plaintiff "whole."

Each state has at least one court of appeals. The highest court of appeals is usually called the supreme court. There are exceptions. In New York State, for example, the Court of Appeals is the highest court in the state. New York also labeled some of its trial courts as Supreme Courts and labeled some of its appeals courts as Appellate Terms of the Supreme Court.[56] Sometimes intermediate courts of appeals also exist, as in the federal system. These appellate courts review the trial court record to determine whether the lower court made any errors of law. Appellate courts do not usually review decisions of facts made by the lower court. Some appellate courts hold trials *de novo*, which are exceptions to this general rule.

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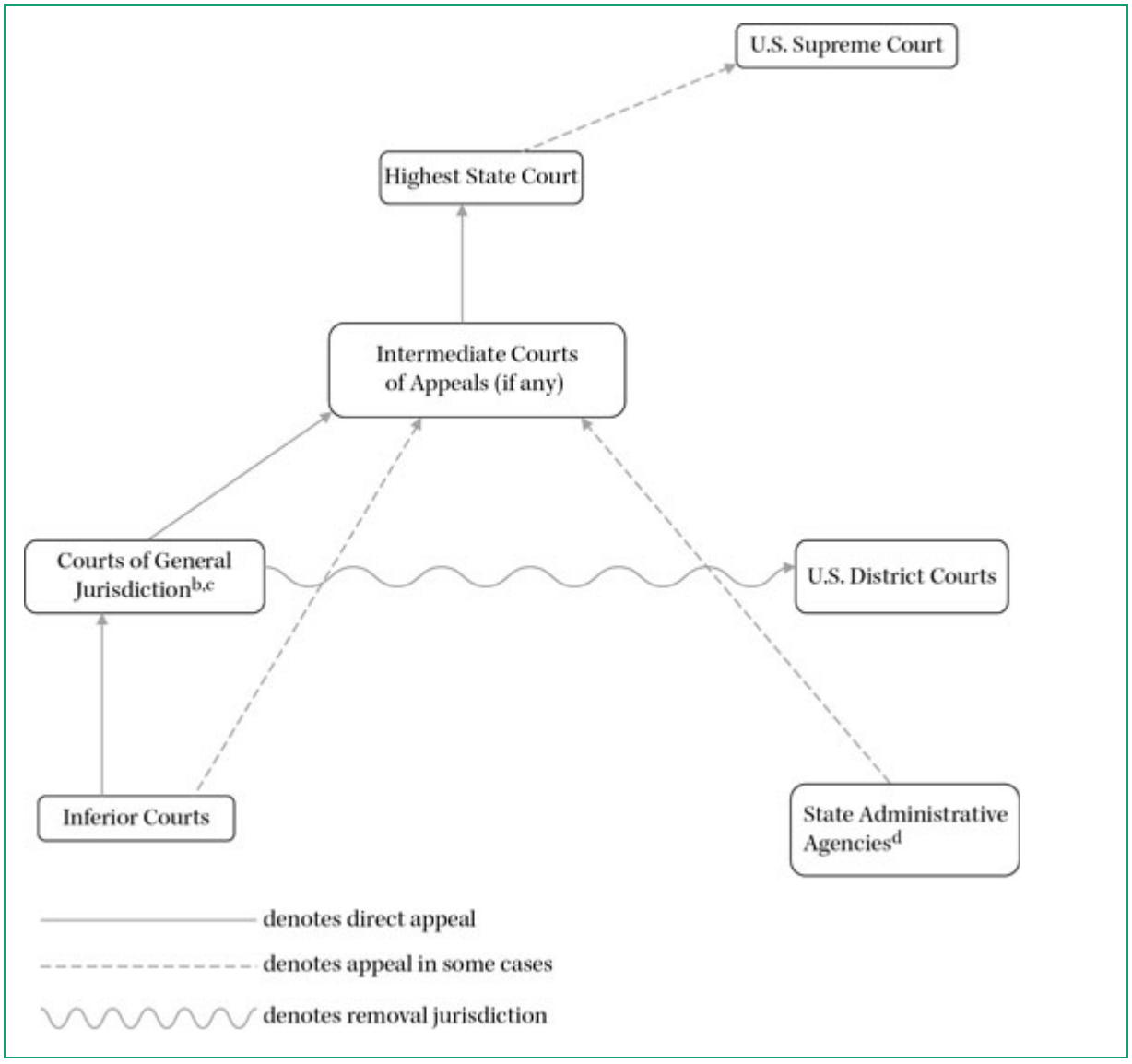
Exhibit 3.7

The T ypical State Judicial Systema



a Ther e is gr eat variation among the states. The titles of the cour ts var y fr om state t o state.

b The state trial cour ts ma y be divided int o divisions—for examp le, the civil division, the criminal division, and family cour t.

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[c] Removal jurisdiction generally is exercised when the defendant asks that a case filed in one court be moved to another court.

[d] Administrative agencies perform some court-like functions; however, they are not courts.

An example of a case history is *Bennis v. Michigan.*[57] It was originally decided by the Wayne County Circuit Court, then appealed (in this order) to the Michigan Court of Appeals, the Michigan Supreme Court, and then the U.S. Supreme Court.

Exhibit 3.7 describes a typical state system and its interrelationship with the federal system. State agencies, like federal agencies, are not courts; a person can appeal an unfavorable agency decision to the intermediate court of appeals in most states.

HOW TO FIND THE LAW

We have already referred to some legal cases in this and previous chapters. Other cases will be cited in later chapters. If you want to go to the library and read these or other cases in their entirety, you will need to know how to find the law.

Federal Court Cases

If you are looking for the Classic Case of *International Shoe Co. v. State of Washington*, 326 U.S. 310, 90 L. Ed. 95, 66 S. Ct. 154 (1945), for example, you will find it in any one of three sources. The case citation tells you where to look. The first number is the volume, the letters designate the reporter, and the second number is the page on which the opinion begins. The first citation tells you that the opinion is found in volume 326 of the *United States Reports* (published by the U.S. Government Printing Office) on page 310. The case can also be found on page 95 of volume 90 of *Lawyers Edition*, published by the Lawyers Cooperative Publishing Company, or in volume 66 of the *Supreme Court Reporter*, which is published by West Publishing Company, at page 154.

Reported cases decided by the circuit courts of appeals are found in the *Federal Reporter*, abbreviated "F." U.S. District Court cases are

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found in the *Federal Supplement Series*, abbreviated "F. Supp." Both use the same format of volume, abbreviation for the books, and page number. If the name of the book is followed by "4th," that means that it is in the fourth series. The title of the court and the year of the decision generally follow in parentheses.

State Court Cases

State court decisions are reported using the same format. States generally also have their own system for publishing cases. In addition, West Publishing Company publishes reporters for some states, and they publish reporters for different regions.

Computerized Legal Research

There are three digital databases for legal research—LexisNexis, Loislaw Libraries on Fastcase, and Westlaw. The search techniques are similar, although the particular computer commands vary. These systems allow you to indicate what material you wish to search and to enter keywords for search terms. If your search terms are not appropriate or are too broad, you may not locate the desired material. Some historical cases may not have been added to the database. Increasingly courts are publishing their own decisions online. There are also several sites on the internet that contain articles on the law, court cases, and government activity. You should be careful since websites are not generally subject to review, so their information may be incorrect or out of date.

Contemporary Case

In this Contemporary Case, the Court of Appeals is deciding whether the creation of the trust and the appointment of Nicholas Fugedi, a citizen of Michigan, as its trustee was a sham to create diversity of citizenship jurisdiction in the federal courts. The underlying dispute is

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about the ownership of real property in Texas. The defendants and the beneficiaries of the trust are residents of Texas.

FUGEDI v. INITRAM, INCORPORATED

150 F. 4th 690 (5th Cir. 2025)

FACTS Nicholas Fugedi, as trustee for the Carb Pura Vida Trust, sued to quiet title to the property in Texas. (A *quiet title action* asks the court to declare the plaintiff the owner of the property against other claimants.) In this part of the litigation, the district court decided that Fugedi had been appointed as a sham trustee in order to manufacture diversity jurisdiction in contravention of 28 U.S.C. §1359. The case is now before the federal court of appeals.

ISSUE Can a party create diversity of citizenship by creating a sham trust and appointing an out-of-state trustee?

HOLDING No. Parties cannot use sham transactions to create diversity.

REASONING Excerpts from the opinion of Judge Duncan:

We again consider this "contentious" and "convoluted" dispute over real property located . . . in Houston, Texas. . . . The main issue this time around is whether a trust can be used as a device to improperly manufacture diversity jurisdiction in violation of 28 U.S.C. §1359. . . . We review a dismissal for lack of subject matter jurisdiction *de novo*. . . . To the extent the ruling depends on the district court's resolution of disputed jurisdictional facts, we review those findings for clear error. . . .

Fugedi argues the district court erred because 28 U.S.C. §1359 does not apply to a trust. We disagree.

Section 1359 provides:

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> A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court.

"The purpose of [§1359 is] to prevent agreements whose primary aim [is] to vest the court with a jurisdiction it had not formerly enjoyed." . . . ("If federal jurisdiction could be created by assignments of [a collusive] kind . . . , then a vast quantity of ordinary contract and tort litigation could be channeled into the federal courts at the will of one of the parties. Such 'manufacture of Federal jurisdiction' was the very thing which Congress intended to prevent when it enacted §1359 and its predecessors." . . . [T]he language of §1359 does not support Fugedi's argument. It forbids manufacturing diversity jurisdiction "by assignment or otherwise." Nothing in those words excludes the use of a trust. Fugedi counters that a trust does not involve an "assignment." But, even assuming that's true, it doesn't matter. The provision says "assignment *or otherwise.*"

Nor does the nature of a trust suggest it couldn't serve as a vehicle for collusively creating diversity jurisdiction. When a trustee sues, only his citizenship matters for diversity purposes. . . . So, if someone wanted to concoct diversity in a property dispute, one way would be to create a trust to manage the property and choose a trustee with citizenship different from everyone on the other side of the *v.* That's the kind of skulldugger y §1359 is designed to prevent. . . . As the district court pointed out: "The Supreme Court has expressly contemplated that an 'allegation of sham or collusion' warrants looking beyond the trustee's citizenship." . . . Two circuit courts have done the same. . . . "[W]hile [§1359] does not ban the appointment of nonresident fiduciaries, the artificial selection of a straw representative who has no duty or function except to offer the use of his citizenship to create diversity in contemplated litigation is a violation of its provisions."

Accordingly, we reject Fugedi's argument that 28 U.S.C. §1359 cannot apply to a trust.

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Fugedi also argues that even if §1359 applies to a trust, the district court erred in finding the trust was improperly or collusively made to invoke federal jurisdiction. We disagree. The court made numerous findings supporting its conclusion that Fugedi was improperly appointed as a sham trustee to create diversity jurisdiction that would otherwise have been lacking. For instance, the court found that: Fugedi had met Elberger (the trust's beneficiary) less than two months before being appointed trustee; Fugedi does only what his attorneys tell him to do such that he seemingly does not control the trust; Fugedi has no special experience to qualify him as trustee; . . . there is no credible non-collusive reason to select an out-of-state trustee; and the suit is wholly local in nature. . . . On appeal, Fugedi makes no serious attempt to show the district court erred, clearly or otherwise, in making any of these findings.

The district court's judgment is AFFIRMED.

You Be the **Judge**

James Ethridge is a Texas resident (domiciliary). He purchased a Samsung 18650 lithium-ion battery from a Wyoming-based seller on Amazon. The record does not describe how the seller obtained the battery or delivered it to Ethridge.

Ethridge was injured when the lithium-ion battery in his e-cigarette exploded and caught fire in his pants pocket. Ethridge was in Texas when the device exploded and injured him. Ethridge sued several defendants, including the manufacturer of the battery, in Texas state court. Subsequently, the case was removed to federal court based on diversity jurisdiction. Ethridge claimed product liability, breach of warranty, and gross negligence. Samsung moved to have the case against it dismissed due to lack of personal jurisdiction over it.

Samsung SDI (Samsung) is not incorporated in Texas. It is a South Korean corporation. Its principal place of business is South

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Korea. It does not have a physical presence in the United States. It has subsidiaries and distribution companies which is uses to serve its U.S. customers. Samsung sells 18650 batteries directly to Texas companies (like Dell, HP, and Black & Decker). Samsung also sells 18650 batteries to qualified businesses in Texas; these businesses generally use them in battery packs. Samsung does not sell directly to Texas consumers.

The Texas long-arm statute says the state has jurisdiction as long as jurisdiction is constitutional. Assume that this case has been filed in *your* court of appeals. How would *you* decide this case? Be certain that you explain and justify your answer. Does the State of Texas have personal jurisdiction over Samsung? Why or why not? Would the exercise of personal jurisdiction comply with the Fourteenth Amendment's conceptions of fair play and substantial justice? Why or why not? Does Texas have general personal jurisdiction or specific personal jurisdiction? [See *Ethridge v. Samsung SDI Company, Limited*, 137 F.4th 309 (5th Cir. 2025).]

Summary

- The U.S. government is divided into three distinct branches: legislative, executive, and judicial.
- Administrative agencies also play an important role.
- Federal courts cannot issue advisory opinions, decide moot cases, or decide political questions.
- Plaintiffs must have standing to sue in court.
- The doctrine of judicial review allows the federal courts to determine whether a statute passed by Congress or the action of the executive branch is constitutional.
- Courts must have subject matter jurisdiction and jurisdiction over the persons or property.
- There are three techniques to obtain jurisdiction over persons or property— *in personam, in rem*, and *quasi in rem.*
- Courts can have exclusive or concurrent jurisdiction based on whether there is only one potential forum or multiple forums.

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- A federal district court's jurisdiction can be based on either (1) a federal question or (2) diversity of citizenship, plus a minimum amount in controversy.

Discussion Questions

1. There have been several recent cases where legislators, judges, and their families have been assaulted or killed.[58] Ask AI how the United States could protect its government officials. Analyze the results from the AI. Do you think AI's suggestions would provide additional protection to these individuals? Why or why not? What are the limitations to the AI's proposals?

2. Should AI be regulated at the federal level, state level, or both? Why? Do we have any U.S. laws that inform us who is entitled to regulate AI? If so, what are they?[59]

3. Does Congress have the authority to impose a Code of Conduct on the U.S. Supreme Court Justices? Why or why not? If you were creating a Code of Conduct for the Justices (either as a member of the Senate or a member of the Court), what would you include in it? Why? What conduct by the Justices or their family members might concern the public? Why? What type of gifts might be a concern? Why?

4. Assume that you are a congressional aide. Your Senator has asked you to find out the purpose of a specific federal agency. Where would you go to discover this information? Why would that be a good source of information?

5. Courts have acknowledged that specific personal jurisdiction is not the clearest legal doctrine.[60] Do clear legal doctrines benefit businesses? Why or why not?

Case Problems and Writing Assignments

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1. Louisiana passed a statute, H.B. 71, that required public schools to permanently display a specific protestant version of the Ten Commandments [61] in every classroom in the state. Louisiana requires students to attend school. H.B. 71 was scheduled to go into effect January 1, 2025, requiring "that the Ten Commandments be displayed (1) in every public school classroom in the state (2) on a poster subject to comparable minimum size requirements (3) with context statements purporting to describe the historical basis for each display. . . ."[62] The statute did not integrate the Ten Commandments into the curriculum. There is a "minimum requirement that the Ten Commandments shall be displayed on a poster or framed document that is at least eleven inches by fourteen inches. The text of the Ten Commandments shall be the central focus of the poster or framed document and shall be printed in a large, easily readable font."[63] The posters can be financed by private donations.

"Parts of the Ten Commandments include basic principles regarding criminal conduct that are part of a civilized society, such as the prohibition against murder. However, they come from religious texts and include commandments that have clear religious import, such as requiring worship of one God and keeping the Sabbath holy. Their display in public school classrooms . . . qualifies as a religious display."[64]

"Courts are 'normally deferential to a [legislative] articulation of a secular purpose.' . . . But an alleged secular purpose 'must be sincere,' and not 'merely a sham.' . . . When "undertaking a 'sham' inquiry, . . . [the courts] consider whether the challenged action furthers the particular purposes articulated by the legislature or whether the challenged action contravenes those avowed purposes."[65] H.B. 71's legislative purpose states:

> It is the Legislature's intent to apply the decision set forth by the Supreme Court of the United States in . . . [precedents], to continue the rich tradition [of including the Ten Commandments in the education of our children] and ensure that the students in

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> our public schools may understand and appreciate the foundational documents of our state and national government. [66]

However, statements made during the legislative debate support a religious objective.[67] "It is also unclear how H.B. 71 ensures that students in Louisiana public schools 'understand and appreciate the foundational documents of [its] state and national government' when it makes displaying those 'foundational' documents optional, and does not require that they also be printed in a large, easily readable font."[68]

A group of multi-faith and non-religious Louisiana parents and students filed a lawsuit requesting an injunction. They want to stop Louisiana from implementing H.B. 71. Is this dispute ripe for a decision? A case is not ripe when it is abstract or hypothetical. Do the plaintiffs have standing to file this suit? Does H.B. 71 violate the Establishment Clause and Free Exercise Clause of the First Amendment? [See *Roake v. Brumley,* 141 F. 4th 614 (5th Cir. 2025). The court of appeals has vacated its decision, and all the eligible members of the court are going to rehear it in the future. *Roake v. Brumley,* 154 F. 4th 329 (5th Cir. 2025).]

2. The California State Legislature concluded that lesbian, gay, bisexual, transgender, queer, and questioning youth confront various forms of discrimination. Consequently, the Legislature passed Assembly Bill 1955. One of the provisions in the bill prohibits California public schools from revealing to any third party (including parents), when a child goes by a different name or gender pronoun in school without that child's permission. Plaintiffs are a group of parents and school entities that want to challenge this provision of Assembly Bill 1955. In this Case Problem, we are concerned with the Parent Plaintiffs. Parent Plaintiffs have children enrolled in California public schools. They are "devout Christians and believe that God created man and woman as distinct, immutable genders."[69] They argue that the Assembly Bill violates their First Amendment rights, because it unduly restricts parents' ability to find out about their children's gender identity or gender expression at school. The policy

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has not actually been applied to the children of Parent Plaintiffs. There is no indication that their children will fall in the group protected by this statute.

"Standing under Article III of the U.S. Constitution has three basic elements: the Plaintiff must have suffered: (1) an "injury in fact"; (2) which is fairly traceable to or caused by the defendant's offensive conduct; and (3) which is likely to be redressed by a favorable decision. "[70] Do the Parent Plaintiffs have standing under Article III so that their lawsuits can be heard in federal court? Why or why not? Be sure to explain and justify your answer. [See *Chino Valley Unified School District v. Newsom*, 2:24-cv-01941-DJC-JDP, Slip Copy, 2025 WL 1151004 (E.D. CA Apr. 17, 2025).]

3. In 2025 President Trump signed Executive Order No. 14160 (the Citizenship Order).[71] Its language limits the situations in which a person born in the United States is a U.S. citizen. The plaintiffs are individuals, organizations, and States which filed three separate lawsuits in U.S. district courts to enjoin the implementation and enforcement of the executive order. The plaintiffs claim that the executive order violates the Fourteenth Amendment's Citizenship Clause §1 and §201 of the Nationality Act of 1940. Each district court concluded the executive order is probably unlawful. Each district court granted a preliminary injunction stopping various federal officials from applying the policy to *anyone* in the country. (A *preliminary injunction* is a temporary order that bars people from taking action until the merits of the dispute can be resolved. It is granted by a court after holding a hearing. It is granted to parties who will suffer irreparable injury and who are likely to win on the underlying arguments (merits).) This is called a universal preliminary injunction (also a nationwide or national preliminary injunction), because it applies to everyone in the United States. One district court justified its universal preliminary injunction this way:

> Only a nationwide injunction will provide complete relief to the plaintiffs. ASAP [one of the groups before the court] has "over 680,000 members . . . who reside in all 50 U.S. states and several

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> U.S. territories." . . . ASAP expects that "[h]undreds or even thousands of ASAP members will give birth to children in the United States over the coming weeks and months." . . . Because ASAP's members reside in every state and hundreds of them expect to give birth soon, a nationwide injunction is the only way "to provide complete relief" to them. [72]

In each case, the executive branch appealed to the appropriate court of appeals asking those courts of appeals to stop the universal preliminary injunctions. The courts of appeals denied the executive branch's requests agreeing that the Executive Order is probably unconstitutional. [73] Then the executive branch filed three emergency applications to the Supreme Court, one for each lawsuit. The executive branch claimed that the federal courts did not have authority to prevent the executive branch officials from enforcing the President's executive order in this manner. The government asks for a partial stay of the injunctions limiting the injunctions to the parties before the District Courts. The executive branch does not raise the question of whether the executive order violates the Citizenship Clause or Nationality Act. Assume that you are sitting on the Supreme Court and you are called upon to decide this case. What is the authority of the district courts? What should be their authority? What would you decide and why? Be sure to explain your reasons. [See *Trump v. CASA, Inc.*, 606 U.S. 831 (2025). [74]]

Notes

1. Cornell Law School, Legal Information Institute, "Emergency Powers," updated Nov. 2022, https://www.law.cornell.edu/wex/emergency_powers (last visited Jun. 23, 2025). The authority of state governors also can expand during emergencies. For example, see National Conference of State Legislatures, "Legislative Oversight of Emergency Executive Powers," Sep. 22, 2023, https://www.ncsl.org/about-state-legislatures/legislative-oversight-of-emergency-executive-powers (last visited Jun. 23, 2025).
2. *Marbury v. Madison*, 5 U.S. 137 (1803). *Marbury v. Madison* is also the Classic Case in Chapter 5.
3. Citations deleted. *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-241 (1937).
4. *Black's Law Dictionary* 54 (6th ed. 1990).
5. *Id.* at 1008.

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6. *Id.* at 1045.
7. *Id.* at 1158.
8. *DeFunis v. Odegaard*, 416 U.S. 312 (1974).
9. Endangered Species Act of 1973 (ESA), 16 U.S.C. §1540(g); and *Bennett v. Spear*, 520 U.S. 154 (1997).
10. *Marbury v. Madison*, *supra* Note 2.
11. Supreme Court of the United States, "Current Members," https://www.supremecourt.gov/about/biographies.aspx (last visited Jun. 21, 2025).
12. Sheila M. Smith, "Comment: Justice Ruth Bader Ginsburg and Sexual Harassment Law: Will the Second Female Supreme Court Justice Become the Court's Women's Right Champion?," 63 U. Cin. L. Rev. 1893 (1995).
13. Lawrence Hammack, "Supreme Court Takes Closer Look at Virginia Ban on Cross Burning," *Roanoke Times*, Dec. 12, 2002.
14. *Ortiz v. Fibreboard Corporation*, 527 U.S. 815 (1999).
15. There is a lot of commentary and opinion about the proper role of judges. "Dean John Henry Wigmore . . . noted in 1917 that common-law judges were constantly making law, and 'our own Supreme Courts have long been drawing copiously and consciously from this unbounded field of public policy.' " Carol Nackenoff, "Privacy, Police Power, and the Growth of Public Power in the Early Twentieth Century: A Not So Unlikely Coexistence," 75 Md. L. Rev. 312, 322, 323 (2015). See also Richard Lavoie, "Issues Facing the Judiciary: Activist or Automaton: The Institutional Need to Reach a Middle Ground in American Jurisprudence," 68 Alb. L. Rev. 611 (2005).
16. For example, see Code of Conduct for United States Judges, Mar. 12, 2019, https://www.uscourts.gov/file/25752/download (last visited Jun. 24, 2025) and Rules of the Chief Administrative Judge, Part 100: Judicial Conduct, NYCourts.gov, https://ww2.nycourts.gov/rules/chiefadmin/100.shtml (last visited Jun. 24, 2025).
17. Supreme Court of the United States, Statement of the Court, Regarding the Code of Conduct, Nov. 13, 2023, https://www.supremecourt.gov/about/Code-of-Conduct-for-Justices_November_13_2023.pdf (last visited Jun. 24, 2025).
18. Senators reintroduced the Supreme Court Ethics, Recusal, and Transparency (SCERT) Act in the belief that the Supreme Court's Code was not adequate. Tim Kaine's Website, "Kaine, Colleagues Introduce Bill to Require Supreme Court to Adopt Binding and Enforceable Code of Ethics," May 30, 2025, https://www.kaine.senate.gov/press-releases/kaine-colleagues-introduce-bill-to-require-supreme-court-to-adopt-binding-and-enforceable-code-of-ethics (last visited Jun. 24, 2025).
19. *Black's Law Dictionary* 601 (7th ed. 1999).
20. Habeas corpus can be used in immigration detention cases. See Trina Realmuto and Kristin Macleod-Ball, "Nuts and Bolts of Habeas Corpus Petitions, Challenging Immigration Detention," Practice Advisory, Copyright ©2021, National Immigration Litigation (NILA) and Children's Immigration Law Academy of the American Bar Association (CILA), Jul. 31, 2021, https://www.immigrationlitigation.org/wp-content/uploads/2021/08/Practice-Advisory-Nuts-and-Bolts-Imm-Detention-Habeas.pdf (last visited Jun. 24, 2025).
21. *Supra* note 19.
22. *Brown v. Entertainment Merchants Association*, 564 U.S. 786 (2011).
23. *Free Speech Coalition, Inc. v. Paxton*, 606 U.S. 461 (2025). The Court used the intermediate scrutiny test which will be discussed in Chapter 5.

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24. The constitutional requirements for a jury trial under the Seventh and Fourteenth Amendments are outside the scope of this text. See *Securities and Exchange Commission v. Jarkesy*, 603 U.S. 109 (2024).
25. It is possible to explain the difference between procedure and substance. However, the Court has acknowledged that the demarcation is difficult. Recently the Supreme Court, quoting precedents, has said, "The line between procedural and substantive law is hazy." . . . Many rules "are rationally capable of classification as either." *Moore v. Harper*, 600 U.S. 1, 23-24 (2023).
26. For example, see Brandon Marc Draper, "And Justice for None: How COVID-19 Is Crippling the Criminal Jury Right," 62 B.C. L. Rev. E-Supplement I.-1 (Aug. 28, 2020); and National Association of Criminal Defense Lawyers (NACDL), "Criminal Court Reopening and Public Health in the COVID-19 Era," 44-MAY *Champion* 46 (May, 2020).
27. *City of Ontario, California v. Quon*, 560 U.S. 746, 753 (2010).
28. *Id.*
29. Choe Sang-Hun, "Mixed Emotions over Deft Imitator," *The International Herald Tribune*, Sep. 3, 2012; and Kim Tae-Jong, "Wharton Director Says Apple Claims Unreasonable," *Korea Times*, Sep. 7, 2012.
30. 36 Am. Jur. 2d Foreign Corporations §418 and 36 Am. Jur. 2d Foreign Corporations §419.
31. *International Shoe Co. v. State of Washington*, 326 U.S. 310 (1945).
32. Some states have similar statutes for nonresidents who operate aircraft in the state.
33. See *Wheelbarger v. Detroit Diesel ECM, LLC*, 978 N.W.2d 334 (Neb. Ct. App. 2022).
34. See *Skidmore v. Led Zeppelin*, 106 F. Supp. 3d 581 (E.D. Pa. 2015).
35. 62B Am. Jur. 2d *Process* §160.
36. When the courts write about passive and interactive websites, it is a legal term. It has nothing to do with how the website functions internally. 15B Am. Jur. 2d Computers and the Internet §171.
37. *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997). The sliding scale in *Zippo* has created several inconsistencies. It has been argued that the sliding scale does not provide effective notice to the public and consequently violates due process. "Without consistency in common law how can an internet user 'structure [his or her] primary conduct with some minimum assurance as to where that conduct will and will not render [him or her] liable to a suit[?]' " (citations deleted). Emily Ekland, "Comment: Scaling Back *Zippo*: The Downside to the *Zippo* Sliding Scale and Proposed Alternatives to Its Uses," 5 Alb. Gov't L. Rev. 380, 381-382 (2012). This continues to be an issue. For some recent discussions of the problem, see Justin Angotti, Comment, "Everywhere and Nowhere: Reframing Personal Jurisdiction to Meet the Realities of an Increasingly Boundaryless Society," 28 Geo. Mason L. Rev. 1513 (Summer 2021); Jenny Bagger, Note, "Dropping the Other Shoe: Personal Jurisdiction and Remote Technology in the Post-Pandemic World," 73 Hastings L.J. 861 (Apr. 2022); and Celia Kaechele, "Traditional Notions of Fair Play and Substantial Justice in the Age of Internet Interconnectivity: How Masking an IP Address Could Constitute Purposeful Availment," 21 Yale J.L. & Tech. 59 (2019).
38. 15B Am. Jur. 2d Computers and the Internet §170.
39. 15B Am. Jur. 2d Computers and the Internet §171.
40. See *Doshier v. Twitter, Inc.*, 417 F. Supp. 3d 1171 (E.D. Ark. 2019).
41. 32A Am. Jur. 2d Federal Courts §912.
42. *Mims v. Arrow Financial Services, LLC*, 565 U.S. 368 (2012).
43. 32A Am. Jur. 2d Federal Courts §912.

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44. 74 Am. Jur. 2d Trademarks and Tradenames §142.
45. 32A Am. Jur. 2d Federal Courts §912.
46. States have authority to enact and enforce their own antitrust legislation when the antitrust behavior has significant local consequences. The contract, conspiracy, or monopoly may actually occur outside the state. When a combination affects interstate *and* intrastate commerce, federal control over the interstate part does not prevent state control over the intrastate aspects. See Am. Jur. 2d Monopolies, Restraints of Trade, Unfair Trade Practices §793.
47. *Id.*
48. *Id.*
49. *Id.*
50. State courts do not have jurisdiction over any cases brought under federal patent law. 60 Am. Jur. 2d Patents §816.
51. 28 U.S.C. §1332(a).
52. *Fugedi v. Initram, Incorporated,* 150 F. 4th 690 (5th Cir. 2025).
53. This applies to federal judges serving on the Supreme Court, the federal courts of appeals, the federal district courts, the U.S. Court of Claims, and the U.S. Court of International Claims. These judges are called Article III judges. Article III judges serve "during good behavior." They cannot have their salaries reduced. Federal Judicial Center, "Part 2: How the Federal Courts Are Organized," https://fjc.adobeconnect.com/p2xcfge0oq8z/ (last visited Jun. 23, 2025); Federal Judicial Center, "The U.S. Legal System: A Short Description [English Original]," Federal Judicial Center, Aug. 4, 2014, https://www.fjc.gov/content/us-legal-system-short-description-english-original (last visited Jun. 23, 2025); United States Courts, "About Federal Judges," https://www.uscourts.gov/about-federal-courts/types-federal-judges (last visited Jun. 23, 2025); and United States Courts, "FAQs: Federal Judges," https://www.uscourts.gov/about-federal-courts/about-federal-judges/types-federal-judges/faqs-federal-judges (last visited Jun. 23, 2025).
54. The number of Associate Justices is established in 28 U.S.C. §1. Cornell Law School, Legal Information Institute, "28 U.S. Code §1. Number of Justices; Quorum," https://www.law.cornell.edu/uscode/text/28/1 (last visited Jun. 23, 2025).
55. Supreme Court, "FAQs-General Questions," https://www.supremecourt.gov/about/faq_general.aspx (last visited Jun. 23, 2025).
56. New York uses "Supreme" in the labels of several of its courts. See NYCOURTS.GOV, The Courts—General Information, Structure of the Courts, updated Aug. 3, 2023, https://www.nycourts.gov/courts/structure.shtml (last visited Nov. 9, 2025).
57. *Bennis v. Michigan*, 516 U.S. 442 (1996).
58. Meg Anderson, Rachel Treisman, and Russell Lewis, "The Suspect in the Shooting of 2 Minnesota Lawmakers Had a 'Hit List' of 45 Officials," *NPR*, updated Jun. 16, 2025, https://www.npr.org/2025/06/16/nx-s1-5433748/minnesota-shooting-suspect-vance-boelter-arrested-melissa-hortman-john-hoffman (last visited Jun. 23, 2025) and Ben Kesslen, "The Attack on Judge Salas' Family Highlights Concerns Over Judicial Safety," *NBC News*, Jul. 21, 2020, https://www.nbcnews.com/news/us-news/attack-judge-salas-family-highlights-concerns-over-judicial-safety-n1234476 (last visited Jun. 23, 2025).
59. Andrew R. Lee, Jason M. Loring, and Graham H. Ryan, "US House of Representatives Advance Unprecedented 10-Year Moratorium on State AI Laws," The National Law Review, May 28, 2025, https://natlawreview.com/article/us-house-representatives-advance-unprecedented-10-year-moratorium-state-ai-laws (last visited Jun. 29, 2025) and U.S.

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Senate Committee on Commerce, Science & Transportation, Press Releases, "State Attorneys General Tell Congress: AI Moratorium Will Leave Consumers, Citizens Vulnerable to AI Fraud, Theft & Other Harms," Jun. 18, 2025, https://www.commerce.senate.gov/2025/6/state-attorneys-general-tell-congress-ai-moratorium-will-leave-consumers-citizens-vulnerable-to-ai-fraud-theft-other-harms (last visited Jun. 29, 2025).

60. *Ethridge v. Samsung SDI Company, Limited*, 137 F.4th 309, 319 (5th Cir. 2025).
61. According to the Louisiana statute H.B. 71, the text must read:

> "The Ten Commandments
> I AM the LORD thy God.
> Thou shalt have no other gods before me.
> Thou shalt not make to thyself any graven images.
> Thou shalt not take the Name of the Lord thy God in vain.
> Remember the Sabbath day, to keep it holy.
> Honor thy father and thy mother, that thy days may be long upon the land which the Lord thy God giveth thee.
> Thou shalt not kill.
> Thou shalt not commit adultery.
> Thou shalt not steal.
> Thou shalt not bear false witness against thy neighbor.
> Thou shalt not covet thy neighbor's house.
> Thou shalt not covet thy neighbor's wife, nor his manservant, nor his maidservant, nor his cattle, nor anything that is thy neighbor's." *Roake v. Brumley,* 141 F. 4th 614, 626-627 (5th Cir. 2025).

62. *Id*. at 626.
63. *Id*.
64. *Id*. at 632.
65. *Id*. at 643.
66. *Id*. at 644.
67. Some of the discussion about the bill includes:

- H.B. 71's primary author and sponsor stated during a legislative debate: "It is so important that our children learn what God says is right, and what he says is wrong, and to allow [the Ten Commandments] to be displayed in our classrooms as a visual aid, I believe, especially in this day and time is so important."
- In support of the bill, a co-author of the bill stated, "I really believe that we are lacking in direction. A lot of people, their children, are not attending churches. . . . We need to do something in the schools to bring people back to where they need to be." . . .
- H.B. 71's primary author also stated, "You know, not all children . . . are taught right from wrong. . . . But I believe when I went to school, I learned . . . to know there was a God by reciting the Ten Commandments. . . . I knew what God said was right, and what he said was wrong, . . . not all of us were taught that." . . .
- When asked how a Buddhist or Muslim student would interpret one of the Commandments, the bill's author responded, "Well I'm not Buddhist or Muslim so I'm not really worried about defining it for them. . . . [The Ten Commandments] [are] a model for what's God—it's God's law, and it's universal law." . . .

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- Another co-author and co-sponsor of H.B. 71 expressed his support for the law during debate by claiming that those who oppose it are waging an "attack on Christianity" and suggesting that it would provide a religious counterbalance to students' secular education: "My wife is a Christian and if she was a teacher she would be asked to teach evolution which is in complete contradiction with the theory of creation that we believe out of the Bible. . . . I am a parent and am asking for this [bill]." *Id.* at 644.

68. Id. at 645.
69. *Chino Valley Unified School District v. Newsom*, 2:24-cv-01941-DJC-JDP, Slip Copy, 2025 WL 1151004 (E.D. CA Apr. 17, 2025) at *2.
70. *Id.*
71. See Protecting the Meaning and Value of American Citizenship, 90 Fed. Reg. 8449 (2025).
72. ASAP is the Asylum Seeker Advocacy Project. *CASA, Inc. v. Trump*, 763 F. Supp. 3d 723, 746 (D. Md. Feb. 5, 2025).
73. *CASA, Inc. v. Trump,* No. 25-1153, 2025 WL 654902 (4th Cir., Feb. 28, 2025); *Washington v. Trump,* No. 25-807, 2025 WL 553485 (9th Cir., Feb. 19, 2025); and *New Jersey v. Trump,* 131 F.4th 27 (1st Cir. 2025).
74. In this opinion, Justice Sotomayor wrote a dissenting opinion. Justice Kagan and Justice Jackson joined in her dissent.

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4

Civil Dispute Resolution

Learning Objectives

After completing this chapter, you should be able to:

- List the stages in a typical civil lawsuit
- Identify the different types of fee arrangements clients can have with their lawyers
- Contrast the types of discovery
- Describe the role of small claims courts
- Recognize the advantages and disadvantages of using alternate dispute resolution
- Compare the different types of alternate dispute resolution

Outline

- Litigation
- Small Claims Courts
- Alternate Dispute Resolution (ADR)

Agenda

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31

Protection of Intellectual Property

Learning Objectives

After completing this chapter, you should be able to:

- Recognize the importance of intellectual property to businesses
- Discuss the advantages and disadvantages of the different types of intellectual property
- Distinguish trademarks, service marks, and trade dress
- Identify how a business can protect its intellectual property from employees and those outside the enterprise

Outline

- Introduction
- Patents
- Copyrights
- Trademarks, Service Marks, and Trade Dress
- Trade Secrets

Agenda

Cyber Guardian's success is ultimately tied to its intellectual property. The principals are concerned about their ability to patent their products and how to enforce their rights if they can obtain a patent. They would also like to get trademark protection on the brand name and the names of their products and services, but they are unsure about how to do so. Danica has expressed interest in obtaining endorsements of their products from InfraGard or the National Cybersecurity Alliance, or similar cyber security groups as a marketing tool.

These and other questions will arise as you read this chapter. Be prepared! You never know when the firm or one of its members will seek your advice.

Classic Case

The Classic Case for this chapter is a Supreme Court decision concerning the rights of Coca-Cola in its trademark. A competitor, The Koke Company, argued that the trademark should be canceled because it was a fraud, since the drink did not contain cocaine.

THE COCA-COLA COMPANY v. THE KOKE COMPANY OF AMERICA

254 U.S. 143 (1920)

FACTS Coca-Cola filed suit seeking an injunction to restrain The Koke Company of America from using the word "Koke" to describe its product. Coca-Cola alleged that the words infringed Coca-Cola's trademark and constituted unfair competition. Coca-Cola asserted that "Koke" was a trademark infringement, clearly intended to capitalize on Coca-Cola's goodwill. The Koke Company argued that Coca-Cola's trademark should be declared void because it fraudulently represented the contents and/or effects of the product.

ISSUES Did Koke infringe on the trademark of Coca-Cola? Did Koke's action constitute unfair competition? Was the Coca-Cola trademark a fraudulent representation of the product?

HOLDINGS Yes, Koke infringed on the Coca-Cola trademark. Yes, Koke was guilty of unfair competition. No, the Coca-Cola trademark was not a fraudulent representation of the product.

REASONING Excerpts from the opinion of Justice Holmes:

. . . Whatever may have been its original weakness, the mark for years has acquired a secondary significance and has indicated the plaintiff's product alone. It is found that defendant's mixture is made and sold in imitation of the plaintiff's and that the word Koke was chosen for the purpose of reaping the benefit of the advertising done by the plaintiff and of selling the imitation as . . . the plaintiff's goods. The only obstacle found by the Circuit Court of Appeals . . . was its opinion that the trade-mark [sic] . . . and the advertisements accompanying it made such fraudulent representations to the public that the plaintiff had lost its claim to any help from the Court. That is the question . . . that we shall discuss.

Of course a man is not to be protected in the use of a device the very purpose and effect of which is to swindle the public. . . . The defense relied on here should be scrutinized with a critical eye. . . . Before 1900 the beginning of the good will was more or less helped by the presence of cocaine, a drug that, like alcohol or caffeine or opium, may be described as a deadly poison or as a valuable item of the pharmacopoeia. . . . The amount seems to have been very small. . . . [A]fter the Food and Drug Act of June 30, 1906[,] . . . if not earlier, . . . it was eliminated from the plaintiff's compound. . . . It is argued that the continued use of the name imports a representation that has ceased to be true and that the representation is reinforced by a picture of coca leaves and cola nuts upon the label and by advertisements, . . . that the drink is an "ideal nerve tonic and stimulant," . . . and that . . . the very thing sought to be protected is used as a fraud.

The argument does not satisfy us. We are dealing here with a popular drink not with a medicine. . . . The name now characterizes a beverage to be had at almost any soda fountain. It means a single thing coming from a single source, and well known to the community . . . . [W]e see no reason to doubt that . . . it has acquired a secondary meaning in which perhaps the product is more emphasized than the producer but to which the producer is entitled. The coca leaves and . . . cola nut . . . may be used to justify the continuance of the name or they may affect the flavor as the plaintiff contends. . . . [B]efore this suit was brought the plaintiff had advertised to the public that it must not expect and would not find cocaine. . . . [Plaintiff] had eliminated everything tending to suggest cocaine effects except the name and the picture of the leaves and nuts, which probably conveyed little or nothing to most who saw it. . . . [I]t would be going too far to deny the plaintiff relief . . . because possibly here and there an ignorant person might call for the drink with the hope for . . . cocaine intoxication. The plaintiff's position must be judged by the facts as they were when the suit was begun, not by the facts of a different condition and an earlier time. . . .

Decree of District Court modified and affirmed.

INTRODUCTION

In this chapter, we will examine how the law protects intellectual property. Intellectual property is intangible property that is created or invented by human beings. Intellectual property law encompasses several substantive legal areas: patents, copyrights, trademarks, service marks, trade dress, and trade secrets. Computers and the internet make it easy to discover and infringe on someone's intellectual property rights. Once the information is obtained, it can be readily shared on blogs and online publications.

Article I, Section 8 of the U.S. Constitution authorizes Congress "to promote the Progress of Science and the useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their

respectiv e W ritings and Disco veries. " U.S. intellectual pr oper ty law is built on this constitutional grant of authority to Cong ress. The "ex clusiv e right" to authors is the basis of cop yright la w, and the "ex clusiv e righ t" to inv ent ors is the basis of patent law. These "ex clusiv e rights" pr o vide the holders of cop yrights and/or patents with go vernment-issued monopolies on their co ver ed works. It is hoped that these monopolies will encourage cr eativity . The "limited times" mention ed in this section ensur e that the monopoly will not last for ever, but rather will ex pir e after a reasonable time. Congr ess establishes what will be a r easonable time.

Although not specifically addr essed in the U.S. Constitution, the United States recogniz es other types of intellectual pr oper ty. The symbol, mark, or de vice that identifies a business or an o rganization (trademark, ser vice mark, cer tification mark, trade dr ess) is entitled to pr otection. Trade secr ets ar e also pr otected pr o vided the person who has the secr et tr eats it with an appr opriate le vel of confidentiality . Generally , the owner has the task of pr otecting th e owner 's intellectual pr o per ty and suing others who use that pr oper ty without permission. The Classic Cas e in this chapter is an example of the trademark owner filing suit t o " police " its trademark.

The United States has four diff er ent intellectual pr oper ty systems, each of which will be discussed in this chapter . The y ar e repr esented in Exhibit 31.1 . The column labeled Type of System describes who will generally own the intellectual pr oper ty unless ther e is a contract stating other wise.

Exhibit 31.1

Types of Intellectual Proper ty Systems in the United States

Type of Intellectual Proper ty	Type of System	Federal or State Protection	Type of Protection
P atents	First t o file* with the P atent and Trademark Office has the rights.	F ederal	Owner can sue t o pr otect the owner 's rights.
Cop yrights	First t o reduce it t o a tangible medium has the rights. The " ar tist" owns the ex clusiv e rights and can pr event use b y others.	F ederal	Owner is not requir ed t o file with the Cop yright Office of the Librar y of Congr ess unless the owner wants to r eco ver monetar y damages.
Trademarks, Ser vice Marks, and Trade Dr ess	First t o use the mark or trade dr ess in business.	F ederal and state	Owner is not requir ed t o file with the P atent and Trademark Office but the owner will ha ve better pr otection b y filing.

Type of Intellectual Property	Type of System	Federal or State Protection	Type of Protection
Trade Secrets	Must treat it as confidential and must attempt to keep it secret.	Federal and state	Owner may seek an injunction and sue for damages when others improperly acquire it. Federal and state governments may protect trade secrets under their criminal laws.

* This system began in the United States in 2013 after the effective date of the America Invents Act. It is a first-to-file system similar to that used in most other countries. However, the U.S. law provides for an administrative derivation proceeding to determine if the first person or entity to file is really an inventor.
Source: Courtesy of Lynn M. Forsythe, © 2026.

PATENTS

A *patent* is a federally authorized and issued *monopoly* (exclusive right) granted to the inventor. To obtain this legal monopoly, the inventor must file an application with the U.S. Patent and Trademark Office (PTO). The filing requires a full description of the item or design. If the patent is granted, the patent holder has the exclusive right to the item or the design for the life of the patent. The holder can use it, sell it, or license it for use by others. Once the patent protection ends, anyone can copy, make, use, or sell the product formerly

protected by the patent. Currently, the exclusive right lasts for 20 years (for a utility or a plant patent) or 15 years (for a design patent). Most inventors obtain utility patents for their creations. Plant patents protect new plants that are invented or discovered. In order to be protected, the plant must be reproduced asexually. Design patents protect unique designs of objects, such as chairs and lamps. When a patent is issued, the time period runs from the date of filing. Our discussion here will focus on utility patents.

The Standards of Patentability

To be eligible for a utility patent, the invention must be (1) new or novel; (2) useful; and (3) not obvious to persons of ordinary skill in the trade or area. All three requirements must be satisfied before a utility patent will be issued. New or novel means that the invention does not already exist and there is not something substantially similar to it. For purposes of determining what is new or novel, prior information includes all information that is publicly available before the filing date *wherever* that information exists. (In patent law, we often call inventions "art" and prior inventions or knowledge "prior art."[1]) The invention must be shown to be useful. The person requesting the utility patent needs to demonstrate that society might be able to benefit from the invention. For example, the PTO will not issue a patent for a machine that does not work as it is intended.

Finally, the invention must involve a development that is not obvious to others in the field. This is probably the most important standard. It is called either the unobvious or nonobvious requirement. If the invention is obvious, the public will not benefit by permitting the inventor to have a 20-year monopoly. An inventor is not entitled to a patent for a trivial or "obvious" improvement of prior art. The standard for determining if an improvement is "obvious" is whether it would be "obvious" on the date the patent application was filed to a person having ordinary skill in the art to which the claimed invention pertains. It is also assumed that this person has ordinary levels of creativity. The PTO and courts look at prior art in the same field of endeavor or art that deals with the same problem the inventor was attempting to

solv e.[2] The re is an assumption that if the inv ention is truly useful and it is ob vious, so meone would come for war d with the idea in due time, and the pr otections affor ded b y a patent would not benefit society .

Utility patents can be obtained for any of the following:

1. Any pr ocesses (this includes pr ocesses, ar t, or methods)
2. Machines
3. Ar ticles of manufactur e
4. Business methods [3]
5. Compositions of matter , including cer tain non-natura lly occurring plants, such as hybrids [4]
6. Any new and useful impr ovements ther eof

Ideas *per se* ar e not patentable. Neithe r ar e laws of natur e (for example, "for ever y action ther e is an equal and opposite reaction "), mathematical formulas, scientific truths or principles, and mental pr ocesses.

America Inv ents Act (AI A)

In 2011, Congr ess enacted the Leahy-Smith America Inv ents Act (AI A), which made some significant changes to U.S. patent law .[5] The AI A bec ame eff ectiv e with new patent applications filed on or after Mar ch 16, 2013. The AI A mo ved the United States closer to a first-t o-file system. The text will dis cuss patents under the AI A. Howe ver, ther e are still U.S. patents go verned by the prior rules. When competing clai mants file, under the AI A it is easier to dete rmine who owns the patent since it is a first-t o-file system. A first-t o- file system is mor e efficient for inv ent ors. In addition, since the other industrializ ed countries use a first-t o-file system, it is also easier for inv ent ors who want to patent their inv ention in mor e than one countr y. Howe ver, first-t o-file systems still var y fr om countr y to countr y.

One of the mo st significant changes in the AI A is fr om a "first to inv ent" system to a "first to file " system similar to that used by many other countries. This system rewar ds the inv ent or who files the

patent application first. Under the AIA, usually the inventor must file the application within one year of the inventor's first public disclosure of the invention. This one year is considered a grace period. Public disclosure can include many activities including (1) printed publications or websites; (2) presentations at conferences; (3) foreign patent filings; (4) the offering of the invention for sale; (5) the making of the invention available to the public; (6) statements on a radio talk show; and (7) videos on social media. AIA takes a global view of public disclosures. Consequently, a disclosure does not have to occur in the United States. Test marketing can prevent an inventor from filing a regular patent application. Test marketing should wait until after the application is filed or a provisional patent application (PPA) is filed. Even though the inventor has a one-year "grace period" between the inventor's public disclosure and the effective date of the patent application, the inventor may be at a significant risk during this time. Someone else may file during that period. Normally, the patent will be awarded to the first one who files. In addition, a number of countries do not have this one-year "grace period" in their patent law. Consequently, if the inventor discloses before filing, the inventor will be prevented from filing in those countries.

The AIA did create a new type of proceeding, called a "derivation" proceeding, to determine whether the first person to file is actually a true inventor. This proceeding does not determine if the first person to file actually invented the item first. [6]

The AIA made changes in what an inventor includes in the patent filings and who can object to patent filings. It required the PTO to establish several satellite patent offices. The Director of the PTO was granted authority to set patent fees. Another provision was reduced filing fees for small entities and micro entities. (These terms have special definitions under the AIA.) The AIA also created new procedures that anyone can use to challenge the validity of a patent after it has been issued by the PTO.

Patent Procedures

Inventors who believe they have met the patent requirements usually begin the process by filing an application with the PTO. Although it is a time-consuming process, many inventors are able to file their own patent applications. [7] One of the most important parts of the application is the specifications, which describes the invention and how it operates. It includes diagrams of the invention. The information provided in the specifications should enable any person skilled in the process to make or use the invention after the expiration of the term of the patent. Another critical part of the application is the claims. The claims inform the public of the limits of the monopoly claimed by the inventor. The claims should be as broad as possible considering the prior art. Most of the disputes involve printed material, including information "printed" on the internet. However, prior art also includes the sale of the invention, the offer to sell the invention, or the commercial use of the invention by someone other than the inventor. Throughout the application process, the inventor should be careful not to state anything that a court could use later to limit the scope of the patent.

The application will be assigned to a PTO examiner for review. The examiner will have expertise in the relevant area, such as chemical engineering. The Commissioner of Patents will issue a patent if the PTO examiner approves the application. Common grounds for rejection include (1) the finding of a prior process; (2) patent claims that are too broad; or (3) the existence of *double-patenting* (two patents for the same invention or inventions that cannot be distinguished from each other). Applicants who receive rejection notices can appeal to the PTO Patent Trial and Appeal Board and then either appeal to the U.S. Court of Appeals for the Federal Circuit or file a civil suit against the director of the PTO in the U.S. District Court for the Eastern District of Virginia. [8]

Sometimes an inventor is not quite ready to file a complete patent application. However, the inventor is concerned about a competitor filing first under the U.S. first-to-file system. The inventor can strategically file a provisional patent application (PPA). These applications are permitted only for utility patents. PPAs are not truly

applications. They are placeholders, and the patent examiners do not review them. A PPA is less detailed than a regular patent application. It does need a description of the invention, drawings, and a clear statement of the claims. Obviously, anything that is not described or claimed will not be protected. The PPA does help prove that the inventor conceived of the invention prior to filing the PPA.[9] The inventor must file a regular patent application within a year or the inventor will be considered to have abandoned the PPA.

Protection from Infringement

A patent can be an extremely valuable asset. Possession of a valid plant or utility patent gives the patent holder exclusive rights to the invention, and a 20-year head start over the holder's competitors. If another person uses the patented item without the patent holder's permission, the patent holder can file suit for infringement. Patent infringement does not require proof of an intent to infringe: A person can infringe a patent intentionally or accidentally. The issuance of a patent serves as constructive notice to the world of the patent's existence.

A person being sued for patent infringement will try to prove that the invention is sufficiently different from the patented item or that the patent is invalid because one of the conditions is absent. If the person can show either one, there is no infringement. A defendant may also argue that the patent holder has abused the patent rights, for example, by using the patent to engage in anticompetitive behavior or to extend its monopoly beyond the scope of the patent rights. If the defendant can establish that the patent holder violated antitrust laws in the use of the patent, the defendant will be found not guilty of infringement. Generally, it is not a misuse of the patent if the patent holder refuses to sell or license the patent to others,[10] or even if the holder does not use the holder's own patent.[11]

Remedies for Infringement

Remedies for patent infringement include damages and equitable relief in the form of injunctions. Courts award damages in an amount adequate to compensate the holder of the patent for the infringement, including lost profits attributable to the infringement. At a minimum, the patent owner is entitled to a reasonable royalty that represents the infringer's use of the invention. Courts have authority to triple the damages assessed.

Courts can also award an injunction under the usual, well-established principles of equity. Under these principles, a plaintiff must show "(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved [hurt] by a permanent injunction."[12] Courts are authorized to award attorney's fees to the prevailing party in exceptional cases. However, courts rarely award such fees.

International Dimensions

Patent laws vary significantly from country to country. For example, some countries do not patent drugs, computer programs, or business methods. Some countries do not perform a patent search to determine whether the invention is novel. These countries will accept the patent and allow the courts to determine later if the patent is valid. In addition, some countries do not provide for a one-year grace period after the first publication, disclosure, or commercialization of the invention by the inventor.[13] In these countries, the inventor must apply *before* disclosing, publishing, or commercializing the invention.

The disagreement between Apple and Samsung illustrates the complexity of international patent disputes. The dispute spanned ten countries, including the United States.[14] A Japanese court rejected some of Apple's patent claims. A judge in South Korea entered a split decision and a court in England ruled against Apple.[15] In their complex relationship, Samsung is both a competitor and a major supplier for Apple. However, Apple has been reducing its orders for

components from Samsung.[16] In June 2018, the parties finally settled their dispute after a seven-year legal fight. The parties did not disclose the amount of the settlement.[17]

Patents may have significant value beyond the national borders of the patent holder's country. Consequently, there are a number of international treaties. The United States is a signatory nation to the Paris Convention for the Protection of Industrial Property, administered by the World Intellectual Property Organization (WIPO). The Paris Convention currently has 181 contracting countries.[18] The Paris Convention gives anyone who files a basic application in one signatory country the benefit of the same filing date in any other member country where the inventor files a national application within one year. The inventor benefits from the earlier date, especially in first-to-file jurisdictions. The United States is also one of the 158 signatory nations to the Patent Cooperation Treaty (PCT).[19] The PCT is also administered by WIPO. Under the PCT, a U.S. resident can file a PCT application with the PTO within one year after filing a U.S. national application with the PTO. The PTO will have it searched and examined to determine patentability. The PCT application serves as a placeholder. Eventually, the inventor will have to file national applications in each country where the inventor wants patent protection. Under both treaties, when the inventor files in the individual countries, the inventor pays the costs of filing and the costs of translating the application and description into the appropriate language(s). Patent attorney David Pressman recommends that an inventor not apply for a patent in a foreign country unless (1) it is likely that there is a significant market for products using the invention in that country; (2) it is likely that there will be significant commercial production of the invention there; or (3) the inventor has located a licensee for the invention or someone else who is willing to pay for the foreign patent.[20]

Cyber Guardian 31.1 Management/Marketing

COPYRIGHT INFRINGEMENT

Danica has developed a creative idea for a commercial for Cyber Guardian products. She has described it to Asher and Mai, and they also think it could be a very successful ad. In the ad, Danica envisions a homeowner using their products to ward off "Mayhem," the character in some of the Allstate commercials. The character seems to be effective in the Allstate commercials. While Asher and Mai agree that the idea for the ad is good, they are concerned that the similarity to the Allstate commercials might infringe a copyright. The firm members ask you if this ad might infringe a copyright. What will you tell them?

BUSINESS CONSIDERATIONS Would it raise more concerns if Cyber Guardian used Dean Winters, the actor who plays the role of "Mayhem"? Why or why not? Why do businesses use the voices, names, and likenesses of famous people to sell their products? Are ads less effective if the advertiser uses unknown people to show the use of the product?

ETHICAL CONSIDERATIONS Is it ethical for a business to use computer imaging to place famous people who have died into commercials with contemporary stars or contemporary settings? Does the use of the likenesses of deceased celebrities raise any ethical concerns? Does it raise any legal concerns?

Computers

U.S. patent statutes and amendments did not specifically include computers or computer program–related inventions. After a period of uncertainty, computer programs are now considered patentable in the United States, provided that they satisfy the three requirements of novelty, utility, and nonobviousness. The European Union reached a similar position under its patent law in 2005.

COPYRIGHTS

Writers, composers, and other types of artists are protected by copyright law. We will refer to them as artists or authors. The Copyright Act protects an original work of authorship fixed in any "tangible medium of expression" from which the work can be perceived, reproduced, or otherwise communicated. A person cannot receive a copyright by thinking about or telling an original story. Nor can a person copyright a song that the individual hummed or sang in private or in public. But if the person writes down the original story or records the original music, the person is entitled to copyright protection. It is the *reduction to tangible form* (the writing or the recording) that makes the work copyrightable.

Works of authorship include, but are not limited to (1) literary works, including computer programs; (2) musical works, including any accompanying music; (3) pantomimes and choreographic works; (4) pictorial, graphic, and sculptural works; (5) motion pictures and other audio visual works; (6) sound recordings; (7) architectural works; and (8) vessel hull designs. Note that copyright laws protect only *expressions of ideas*, not the ideas themselves. To acquire protection, the artist must express the original creative idea in some tangible medium, providing proof of the artist's creation of the work.

> *In one case, Shepard Fairey created a poster of Barack Obama, commonly called the "Hope" poster. The Associated Press claimed that it owned the photograph on which the poster was based. Mannie Garcia, a freelance photographer, actually took the photograph in 2006. The Associated Press argued that it was a work for hire and that it owned the photo. The Fairey-Associated Press case was settled in January 2011. Both sides contend that they owned the image and that their view of the law is correct. However, they have agreed to work together and share the image and the right to make merchandise bearing the image. The financial terms were not released. Fairey was then found guilty of misdemeanor contempt for his intentional destruction of trial evidence and*

creation of fake trial evidence during the early stages of the dispute. [21]

Copyright protection extends much longer than does patent protection. Generally, for works created after January 1, 1978, a copyright runs for the life of the author plus 70 years. If the author is anonymous, the work is created under a pseudonym, or if it is a "work for hire," the copyright runs for the lesser of 95 years from its first publication or 120 years from its creation. Copyrights cannot be renewed. [22]

Under current U.S. law, a new artistic work is automatically entitled to copyright protection as soon as it is fixed in a tangible form. This means that a person does not need to (1) register with the Copyright Office of the Library of Congress; (2) affix the copyright symbol (©); or (3) take any other steps in order to be protected under copyright law. In order for an artist or author to acquire copyright protection, the work must simply be original, it must be at least somewhat creative or artistic, *and* it must be fixed in a tangible medium of expression. However, for the copyright holder to file suit for damages against an infringer, the copyright must be registered with the Copyright Office. If the copyright is not registered, the holder can seek other remedies (e.g., an injunction) but cannot sue for damages. [23] A copyright cannot be based on a mere recitation of facts (the listings in a telephone directory, for example); consequently, many computer databases cannot be copyrighted. An idea may not be copyrighted, but the method of expressing an idea may be. [24]

The U.S. Copyright Office (1) registers copyrights; (2) issues certificates of registration; (3) maintains records of copyright registrations, licenses, and assignments; and (4) oversees deposits of copyrighted materials. Unlike the PTO's stringent and detailed oversight of patents and trademarks, the Copyright Office merely determines whether applications involve copyrightable subject matter and have fulfilled all the registration requirements. Consequently, the registration process is relatively simple and inexpensive. The artist or author can register the copyright online for a nominal fee.

Protection from Infringement

A copyright provides a bundle of rights that enables the copyright owner—usually the author or one to whom the author has transferred rights—to exploit a work for commercial purposes. These exclusive rights include (1) reproducing the copyrighted work; (2) preparing derivative works (or adaptations) based on the copyrighted work; (3) distributing copies or audio recordings of the copyrighted work; (4) performing publicly audio visual works, motion pictures, pantomimes, and/or literary, musical, dramatic, and choreographic works; (5) displaying the works themselves or individual images of the works mentioned in number 4, as well as pictorial, graphic, or sculptural works. Public performance includes performing songs at a political campaign event.

However, members of the public can use copyright-protected work in certain ways without obtaining the permission of the copyright holder. Under the fair use provisions of the Copyright Act,[25] certain reproductions are permitted without obtaining permission from the copyright holder. In order to qualify as a "fair use," the use must be for purposes such as comment, criticism, news reporting, research, scholarship, and teaching. Section 107 of the Copyright Act sets out four factors that should be considered in deciding whether a challenged use qualifies as a fair use and is not an infringement:

1. The purpose and character of the use, including whether the use is for a commercial purpose or is for nonprofit educational purposes
2. The nature of the copyrighted work
3. The amount and substantiality of the portion used compared to the copyrighted work as a whole
4. The effect of the use upon the potential market for, or value of, the copyrighted work[26]

Because the distinction between fair use and infringement is not clear, it is preferable to seek permission and to avoid using the copyrighted material if permission is not obtained. However, if a

person believes that the use is necessary, and the person is unable to obtain permission, the user should carefully review the standards generally followed for determining whether the use will qualify as fair use. The standards are included in the U.S. Copyright Office's *Reproduction of Copyrighted Works by Educators and Librarians.* [27] The user should also document the analysis of why the use was "fair."

The fair use doctrine also covers parody to some extent. If one person creates a work that parodies and imitates another's copyrighted work, the action may be viewed as a fair use under this doctrine. While the owner of the copyrighted work may not appreciate the parody, the courts tend to allow such use, even without permission from the copyright holder.

> *For example, in 1994 the Supreme Court upheld the rap group 2 Live Crew's parody of "Oh, Pretty Woman," a song written by Roy Orbison and William Dees in 1964. (Orbison and Dees had assigned their rights in the song to Acuff-Rose Music, Inc.) When 2 Live Crew asked for permission to use the song, Acuff-Rose refused.* [28] Rather than being deterred, they used the song in their recording of "Pretty Woman." Acuff-Rose sued for infringement, but the court found for 2 Live Crew, noting that the parody was within the scope of fair use and was not an infringement. [29]

Many U.S. copyright holders of recorded music assign their rights to control public performance of their music to a performing rights organization (PRO) such as (1) American Society of Composers, Authors, and Publishers (ASCAP); (2) Broadcast Music, Inc. (BMI); or (3) the Society of European Stage Authors and Composers (SESAC) to ensure that they receive royalties when their songs are played in public. PROs collect royalties from various entities that play songs and then distribute these royalties to their signed artists on a predetermined schedule of payments. When artists assign their rights to a PRO, the artists lose some control over the use of the covered recordings.

> *In 2008 when Sarah Palin was running as the Republican vice-presidential candidate, she used "Barracuda" as her song at the convention. Ann and Nancy Wilson from the rock group Heart contended that the Republicans should have asked permission before using their song. A spokesperson for John McCain, the presidential candidate, responded that the campaign had obtained a license to use the music. The song was licensed for public performance under a blanket fee paid by the convention venue to ASCAP.*[30]

There are also *compulsory* licensing sections in the copyright act that apply to cable television systems' secondary transmissions of primary broadcasts, satellite retransmissions, electronic video game arcades, and jukeboxes.

Copyright infringement does not require intent on the part of the infringing party. A totally innocent reproduction of another's copyrighted work is still an infringement of the owner's copyright, unless the owner grants permission or the fair use exception applies. George Harrison was found to have innocently and inadvertently infringed the copyright held by Bright Tunes Music for the song "He's So Fine," recorded by The Chiffons, when he recorded "My Sweet Lord."[31] More recently Ed Sheeran was found not to have infringed Marvin Gaye's "Let's Get It On" when he co-authored "Thinking Out Loud."[32] In litigation, the copyright owner will attempt to prove that the defendant had access to the copyrighted work and that the defendant's work shows a striking similarity to the copyrighted work. If the court finds that more likely than not the similarities are the result of copying the protected work, it will find that infringement has occurred.

Remedies for Infringement

Civil remedies for infringements include injunctions, the impounding and destruction of infringing items, and damages. Monetary damages are available if the copyright is registered with the U.S. Copyright Office. Plaintiffs can request actual damages, including the

infringer's profits attributable to the infringement, or statutory damages ranging from a minimum of $750 to $30,000 for all infringements involved in the action with respect to one work. The court will award what it thinks is just under the circumstances. A court may increase the damages to $150,000 for willful infringements. Similarly, the court may lower the damages to $200 if the infringer can prove it was unaware that its actions constituted an infringement. The court in its discretion may award court costs and/or attorney's fees. [33]

Criminal penalties can involve substantial fines and/or prison sentences depending on the type of copyright infringement. [34] In addition, the No Electronic Theft Act of 1997 provides for both civil and criminal penalties for copyright infringement involving the internet. Under the Act, infringement is a crime only where it is done "willfully and for purposes of commercial advantage or private financial gain." [35]

International Dimensions

The United States became a member of the International Union for the Protection of Literary and Artistic Works (the Berne Convention) in March 1989. Under the Berne Convention, each member nation must automatically extend the protection of its laws to nationals of other signatory nations and to works originally published in a member nation's jurisdiction. The United States has taken a minimalist approach to compliance with the Berne Convention, not accepting every provision of the treaty. However, the United States has enacted into law many of the treaty's provisions. WIPO has updated the Berne Convention to reflect developments in information technology. These revisions have closed some loopholes that subjected the U.S. recording industry to international infringement.

The Universal Copyright Convention (UCC), administered by the United Nations, is another international copyright treaty. It is sometimes called "UCC Geneva." It was revised in Paris. This revision is called "UCC Paris." The United States entered the first in 1955 and the second in 1974. [36] The UCC imposes fewer substantive

requirements on copyrights than the Berne Convention does. However, some Berne Convention members also joined the UCC as a means of establishing copyright treaty relationships with UCC members who have not signed the Berne Convention.

Recent amendments to the General Agreement on Tariffs and Trade (GATT) expand the protections afforded to copyrighted works, including computer programs.

Computers

Websites and computer programs may be copyrighted if the subject matter is appropriate. For example, the programs do not include "ideas, program logic, algorithms, systems, methods, concepts, or layouts."[37]

Keep in mind that while the computer program can be copyrighted, the idea behind the program cannot be protected by copyright law. Original works can receive a copyright, but ideas—even original ideas—cannot receive copyright protection. A program that provides a word-processing function can be copyrighted, but the idea of word processing cannot be copyrighted. Copyright law does not prevent other software developers from devising competing word-processing programs. The software program for the video game Halo® can be copyrighted, but the idea behind the game is "fair game" for others to "borrow" by creating a similar game with a different program to run it.

Similarly, the audiovisual display aspects of a video game may be copyrightable, whereas the idea—for example, a crazy character that "munches" everything—behind the game, or the game *per se*, ordinarily will be ineligible for copyright protection. The same may be true in general of flowcharts, components of machines, and printed circuit boards that do not have computer programs embedded in them: These normally are not copyrightable.

There are some important limitations and differences in the copyright protections for computer software. While it would probably be viewed as an infringement for a customer to buy a book and then make a copy of it for the person's "archives," this copying is not an

infringement with softwar e. It is also not consider ed an infringement if a person mak es a cop y or an adaptation of a computer pr ogram when this cop y or adaptat ion is essential to pr operly use that pr ogram on the buy er's com puter . It is a violation for a person to mak e and sell a backup computer pr ogram separately fr om the original authoriz ed cop y.

The fair use d octrine also applies to softwar e. Softwar e that is pr otected by cop yright can be used in the classr oom for instruction or demonstration without obtaining permission fr om the cop yright owner and with out the need to pa y ro yalties for the use. In addition, libraries can repr oduce and distribute softwar e in some cir cumstances without infringing the cop yright.

TRADEMARKS, SER VICE MARKS, AND TRADE DRESS

Trademarks, ser vice marks , and *trade dr ess* each inv olv e a distinctiv e mark or design that identifies the pr ovider of goods or ser vices. As a business de vel ops a reputation and establishes goodwill, cust omers who see the m ark recogniz e the pr ovider and rely on tha t pr ovider 's reputation as evidence of the quality cust omers expect fr om the business. As a result, these distinctiv e marks can be quite valuable to a business.

U.S. trademark law pr otects against consumer confusion as to the origin of go ods. Early statutes wer e intended to pr ohibit "palming off," in which one pr oducer passes off its goods as the goods of a competit or by cop ying the competit or's trademark. The U.S. Constitution does not pr otect trademarks. F ederal regulation is based on the Commer ce Clause, which grants the federal go vernment authority to regulate interstate commer ce. At the federal le vel, the 1946 Lanham Act [38] pr ovides for the registration of trademarks with the PT O. When a trademark is issued, the owner of the trademark can use the ®symbol which sta nds for register ed trademark. On ce a trademark is issued, the owner of the trademark must pr otect it and enfor ce it. Many businesses ha ve established policies on the use of their trademar ks. F or example, X (formerly Twitter) has posted its policy online. [39]

State laws also protect trademarks. Over the years, an extensive body of state trademark law has developed, principally through the application of state laws governing unfair competition. Most states have their own registration provisions. [40] An owner is not required to register the trademark. Trademarks receive protection even without registration. If the owner does not register, the owner can use the ™ symbol which stands for trademark. A trademark that is not registered is commonly called a common-law trademark. Generally, the person that used the mark first in business is entitled to the trademark.

Even though the business is normally the one that must protect its marks, it may not make sense to go after all possible infringement. Generally, modern businesses should work to protect their brand names, tag lines, hashtag names, slogans, domain names, and logos. They should also protect what their customers call them. There are several techniques the owner can use including coexistence agreements, cease and desist letters, and campaigns shaming the other company. The owner may also protect the trademark through litigation. Before initiating a lawsuit, the owner should consider who is likely to win. The business would not want to start a lawsuit that might result in having its own trademark canceled.

Marks Entitled to Protection

Each of these devices is entitled to protection, but the protections can vary. This is primarily due to how a business uses the symbols and how the public perceives them.

Trademarks The Lanham Act defines a trademark as "a word, symbol, or phrase, used to identify a particular manufacturer or seller's products and distinguish them from the products of another."[41] Trademarks are used to distinguish one manufacturer's goods from those of its competitors. A mark must be distinctive in order to be registered. In determining whether any given "word, symbol, or phrase" is distinctive and deserving of protection, the courts have established four separate classifications for marks:

1. Arbitrary and fanciful
2. Suggestive
3. Descriptive
4. Generic

An *arbitrary and fanciful term* is distinctive by definition. "Exxon" and "Xerox" are arbitrary and fanciful words that had no meaning until they were created by the respective companies. The mark is identified with the product and what the product is. Exxon *is* a type of gasoline. Xerox *is* a type of copier. When a business creates a word, symbol, or phrase that did not previously exist this satisfies the test for an "arbitrary and fanciful term" and is entitled to trademark protection.

A *suggestive term* is one that conjures an image or an idea of what the product is intended to do rather than what the product is. As a result, such terms are also distinctive and entitled to trademark protection. For example, Copper tone, a sun-tanning product, suggests what the product does rather than what it is. Note that this mark embodies some degree of imagination. A "copper tone" might ordinarily have implied a color before the sun-tanning product was introduced. Now many consumers associate the term "Copper tone" with the product. With a suggestive term, the word, symbol, or phrase acquires an association in the consumer's mind that suggests a particular product to the consumer.

A *descriptive mark* is one that basically describes the business that the mark intends to portray. "Holiday Inn" is a descriptive mark, "describing" what the mark represents—an inn for people on holiday, or a hotel/motel. (Sometimes the description is less obvious, as in "Vision Center," a mark for a business that sells glasses and contact lenses. While not actually selling vision, the business is selling products that enhance one's vision.) Purely descriptive marks—adjectives such as *sweet* or *hearty*; geographic designations, like *California* or *New York* in reference to wines; and people's names, like *L.L. Bean*, used as marks—do not qualify as distinctive until they have acquired a "secondary meaning." When consumers no longer view the marks as purely descriptive terms but rather as indicative of the source of the goods or products, the marks have become distinctive.

The distinctiveness continuum is represented in Exhibit 31.2. Notice that Firefox was a word made up by Mozilla. At the other end of the exhibit, Fire Extinguishers are products made by a number of manufacturers. None of the manufacturers have an exclusive right to use the label.

Exhibit 31.2

Distinctiveness of a Mark

Source: Courtesy of Lynn M. Forsythe, © 2026.

Generic marks are not entitled to trademark protection. Generic marks describe the classification or category of the product rather than the product itself. If a computer company decided to incorporate as Computers, Inc., and to sell its product as "Computer," it would not be able to acquire a trademark on "Computer." Generic terms cannot qualify for trademark protection. In addition, some terms that were once trademarked have lost that protection because the term became generic. There are numerous examples of words that have passed into generic usage and have lost their trademark status. *Aspirin, calico, cellophane, escalator, linoleum, shredded wheat, thermos, yo-yo*, and *zipper* used to be trademarks in the United States. They are now generic terms. *Aspirin* is no longer a trademark in the United States but may still be a trademark under the laws of other nations.

Some product names are more likely to become generic than others. The first entry into a market is more exposed to this risk. If you produce the first photocopier or individual music player and then other businesses enter the field, members of the public may start calling them all by your name. For example, people commonly call

copy machines *Xeroxes* and MP3 players *iPods*, even though those labels may be inaccurate. Xerox copiers are made by Xerox and iPods are made by Apple. To avoid genericide, you should always use your trademark with the generic label, for example, Xerox copy machine. You should always capitalize your trademark, for example *Xerox* and not *xerox*. You should not use the trademark as a general noun; for example, don't call a photocopy a Xerox. You should not use the trademark as a verb, for example, "I am Xeroxing this" or "I am going to Google that." If you fail to monitor the use of your trademark, it can result in the loss of trademark protection. When you notice a potential problem with genericide, you should launch a campaign to remind people that the term is your trademark and that it should only be used properly.

Not every distinctive word, symbol, or phrase can be protected as a registered trademark. The Lanham Act prohibits the issuance of a federal trademark for marks that (1) use the name, portrait, or signature of a living person without that person's consent; (2) use the name, portrait, or signature of a deceased U.S. President during the lifetime of the President's spouse without the spouse's consent; and/or (3) so resemble an already registered mark as to be likely to cause confusion, mistake, or deception.

The Lanham Act also stated that trademarks would not be issued for marks that disparage any person (living or dead), institution, belief, or national symbol. However, in 2017, the Supreme Court declared that the prohibition against "disparaging" any person (living or dead) was unconstitutional under the First Amendment because it restricted speech based on the position or content of the speech. In that case, Simon Shiao Tam wanted to trademark "The Slants" for the name of his band. The Justices were divided on the reasoning that should be used, but they all agreed that speech could not be restricted based on viewpoint. In other words, the PTO could not discriminate against speech based on the viewpoint of the speech.[42] In 2019, the Court considered another section of the Lanham Act that stated that the PTO should not register marks that are immoral, scandalous, or offensive. In this case, Erik Brunetti created a clothing

line called FUC T. He claimed that the mark was pronounced as four letters, one after the other: F-U-C-T . Using similar reasoning, the majority concluded that this restriction also violated the First Amendment because it discriminated against speech based on the viewpoint of the speech. [43]

A trademark belongs to the first person or entity to use the mark in trade or commerce. To register the mark and gain statutory protection, the owner must demonstrate either prior use or a *bona fide* intent to use the mark in the future. An applicant submits the application with the proposed trademark to the PTO. The PTO examines the application for compliance with the statute and also to ensure that the mark is not confusingly or deceptively similar to previously registered marks . Once granted, registration ordinarily lasts for ten years and is renewable for ten-year periods so long as the mark remains in commercial use. The PTO requires periodic filings confirming that the mark is still in use.

Infringement The law protects the trademark owner from infringement when the infringer 's use will likely cause a considerable number of consumers to be confused about the source of the goods or services. The factors courts have used to determine the "likelihood of confusion " include, but are not limited to, the following: (1) similarities in the two marks' appearance, sound, connotation, meaning, and impression; (2) similarities in the customer base, sales outlets, or the character of the sale ("impulse " versus "nonimpulse " sales); (3) the strength of the mark; (4) evidence of actual confusion; and (5) the number and nature of similar marks on similar or related products and services. For example, independently , two men created radio programs and did announcing and voice work. One was using the name "Spider Harrison " and the other was using "Spyder Harrison. " The similar names caused confusion in the market. [44]

Defenses to infringement include "fair use " or abandonment of the mark. The Lanham Act expressly provides that nonuse of the mark for two consecutive years constitutes prima facie evidence of an intent to abandon the mark. Generally , people can also use their own surname in a business—even if it is the same as another famous,

trademarked name, like Campbell, Hilton, or McDonald—as long as such use does not create the likelihood of consumer confusion.

Service Marks, Trade Dress, and Certification Marks Service marks, trade dress, and certification marks are given similar treatment and protection. Each of these can also be registered with the PTO and can acquire trademark protection.

A *service mark* is a word, symbol, or phrase used to identify the provider of that service. The only significant difference between a trademark and a service mark is that a trademark is used to identify a product and a service mark is used to identify a service. In each case, the mark is intended to call to the mind of potential customers a particular company. The value of a service mark lies in the goodwill and the reputation of the business using the mark.

Trade dress is the use of a specific design, including shape or color, to identify a business, its goods, or its services. Some examples include the *shape* of a product (e.g., the iconic Coca-Cola bottle) and the *color* of the product (e.g., the pink of Owens-Corning fiber glass insulation). However, a product's shape cannot be protected by trade dress if that shape would provide a competitive advantage, such as making the product easier to stack on store shelves. Courts have extended trade dress to include floor plans, color schemes, and even some restaurant menu designs.

Certification marks are used (1) to identify the specific geographic region from which a product comes (e.g., the Real California Cheese seal); (2) to certify that the goods or services meet certain standards in relation to quality, materials, or mode of manufacture (e.g., the Good Housekeeping Seal of Approval or the Better Business Bureau logo); (3) to certify that the work or labor on the products or services was performed by a member of a union or other organization; or (4) to certify that the performer meets certain standards (e.g., ISO 9000 certified). Note that a certification mark is not used by the owner of the mark, nor does it identify the provider of the goods or services. It merely certifies that the goods or services possess certain traits or characteristics often identified with quality.

Cyber Guardian 31.2 Management/Marketing

TRADEMARK INFRINGEMENT

A new business in the online security industry recently unveiled its logo, which is very similar to the trademark Cyber Guardian has been using since it started. Danica wants Cyber Guardian to file a trademark infringement suit against this firm. Asher and Mai point out that while Cyber Guardian does have a relatively distinctive name, its symbol has not yet acquired widespread recognition. While the other business has a very similar symbol for its logo, there is little likelihood that any customers of either that firm or Cyber Guardian will be confused about the provider of the goods being sold. All three principals fear that if they do not act, Cyber Guardian will lose its right to the trademark protection it has acquired since it will no longer be unique. The firm members ask for your advice. What will you tell them? Would your answer be different if Cyber Guardian had a registered trademark or a common-law trademark?

BUSINESS CONSIDERATIONS How can a business protect its trademark so that the trademark does not become a generic term for the type of product? Should a business consider changing its logo periodically to make the logo appear "fresh" and "new" to the public? Why or why not?

ETHICAL CONSIDERATIONS What ethical concerns stem from a firm's apparent copying of the logo of a more successful rival? Is a firm that attempts to prevent any competitors from using a trademarked logo even remotely similar to its own behaving in an ethical manner or is it acting as a trademark bully?

Remedies for Infringement

The Lanham Act sets out certain statutory remedies for trademark infringement, including the equitable remedies of an injunction or an accounting to recover the profits the defendant unfairly obtained from infringing. In addition, the plaintiff may recover actual damages. The court can use its discretion and triple these damages if the circumstances justify it (for example, the infringer acts willfully or in bad faith). If the defendant used a counterfeit mark, the court will usually award treble damages, attorney's fees, and prejudgment interest.

International Dimensions

Trademark laws vary by country. Some countries require use of the mark. In other countries, ownership is based on registration and use can follow later. Some countries do not protect service marks. In others, the business may be required to register its trademark to import its goods into the country.[45] A business must make a strategic decision about where it should register. It would be too expensive and time consuming to register everywhere. The business should probably register (1) where it currently sells its products or services, (2) where it is planning to expand in the near future, (3) where the goods are being produced, and (4) where it is going to have franchisees or licensees.

The Madrid Protocol, administered by WIPO, allows for simultaneous registration in more than one member country. There are currently 115 contracting countries, including the United States.[46] Under the Madrid Protocol, a U.S. business first registers with the PTO. This registration is called the basic application or the basic registration. The business selects the other countries in which it wants protection. This is referred to as countries in which it wants "extension of protection." These other countries then decide whether to accept the trademark, using their own criteria. If one country rejects the mark, it will not affect registration in the other countries. However, if the United States registration is declared invalid, it will affect the "extension."[47]

If the firm is going to do business in European Community (EC) countries, it might consider applying for a Community Trademark (CTM). After applying, if even one member country rejects the trademark, the business will not receive a CTM. It can then apply in other individual member countries. If the business receives a CTM, it can enforce its trademark by filing one lawsuit instead of filing suits in each individual country where the infringement is occurring.[48]

The Paris Convention also applies to trademarks. Under the Paris Convention, a signatory nation grants "outside" trademark holders the same rights as it grants native trademark holders. Since the United States is a signatory country, once a U.S. trademark holder registers with the PTO, the holder's registration date will be the effective date in all Paris Convention countries as long as the holder registers in those countries within six months of filing with the PTO.[49]

TRADE SECRETS

Protection of Trade Secrets

Patents offer significant protection to a successful applicant. However, not all applications are approved. Even if an application is approved, the information concerning the patent becomes available to the public and increases the risk that a competitor may use that information to compete with the holder of the patent. Some people would prefer to treat their intellectual property as a secret, avoiding the need to reveal how something is done. When a business makes this choice, the business is treating its method as a trade secret and relying on its ability to keep the information confidential. The business is also relying to a much greater extent on state law to provide legal protection, although some federal protections also exist. In determining whether given information is a trade secret, courts generally consider the following:

1. The extent to which the information is known outside the owner's business

2. The extent to which it is known by employees and others involved in the business
3. The extent of measures taken by the owner to guard the secrecy of the information
4. The value of the information to the owner and to its competitors
5. The amount of effort or money expended by the owner in developing the information
6. The ease or difficulty with which others could properly acquire or duplicate the information

To qualify as a trade secret, the know-how, manufacturing processes, customer lists, or other proprietary information must be used continuously in the business. In addition, the owner must show that it has taken steps to protect and to ensure that the information is handled in a confidential manner. This is likely to require a showing that (1) steps were taken to ensure the physical security of the information; (2) disclosure of the information was limited to only those who actually need the information to complete their jobs; and (3) the firm gave notice to those who had access to the information that the firm expects them to keep it in confidence. At a practical level, the business may (1) require employees to sign confidentiality agreements and covenants not to compete (where they are legal); (2) review papers that employees will present in public; (3) conduct exit interviews with departing employees; and so on. The business only needs to take reasonable precautions to guard and/or prevent access to the proprietary information.

Liability for Misappropriation

Courts base liability for misappropriation of a trade secret on two principal theories: (1) breach of contractual or confidential relations; and (2) acquisition of the information through improper means. Under the first line of reasoning, courts will prohibit persons in an agency relationship (including employment) and/or a fiduciary relationship from disclosing or using information acquired in the course of the

relationship. Sometimes an employee expressly promises not to compete with the employer for a given period of time in a specified geographical area if the employee leaves this job. (Note that some states will not enforce covenants not to compete between employees and their former employers.) In the absence of such an express agreement, courts generally will not imply such a restrictive covenant. But in some circumstances—for example, where a third party learns of confidential information from the employee—the law *will* imply a confidential relationship between the third party and the owner of the trade secret. In such circumstances, the third party's disclosure or use of the information will be actionable as misappropriation.

The law also imposes liability for acquiring the trade secret improperly. The law will not tolerate conduct that falls below generally accepted standards of commercial ethics. If a competitor of a firm induces that firm's key engineer to disclose proprietary information, the competitor will have acquired the information through improper means. Liability can be based on the acquisition of information through bribery, commercial espionage, fraud, theft, and trespass. However, it is probably lawful to obtain information through reverse engineering, independent discovery, or the owner's failure to take reasonable precautions to protect it.

Civil and Criminal Remedies

Remedies for misappropriation of a trade secret include injunctions and damage awards. Such damages may include the plaintiff's lost profits, the profits made by the defendant, or the royalty amount a reasonable person would have agreed to pay. State criminal laws may apply to misappropriations of trade secrets as well.

On the federal level, the Economic Espionage Act of 1996 (EEA) seeks to punish a broad range of activities that interfere with an owner's proprietary rights in commercial trade secrets. The EEA addresses (1) economic espionage, including activities on behalf of foreign instrumentalities; and (2) theft of trade secrets, resulting from certain domestic commercial endeavors. Prohibited activities include misappropriating, concealing, procuring by fraud or deception,

possessing, altering or destroying, copying, downloading or uploading, or conveying trade secrets without permission. The sanctions that can be imposed for prohibited activities include fines, imprisonment, and criminal forfeiture. The penalties are more severe for individuals or organizations that are acting in concert with or on behalf of foreign instrumentalities. The criminal forfeiture provision permits the seizure and forfeiture of the property used to facilitate the misappropriation or impermissible possession of a trade secret.

Cyber Guardian 31.3 Management

PATENT, COPYRIGHT, OR TRADE SECRET?

Cyber Guardian has invested a great deal of time, energy, and money in the development of its products and services. Cyber Guardian wants to derive as much protection as the law allows. A key feature is the software that drives the products and services. Mai believes the firm will receive the greatest protection by applying for a copyright on the basic software that operates the product(s) and then applying for additional copyrights on each new version as it is developed. Asher prefers to treat the software as a trade secret, treating the information as confidential and restricting access to the information to the smallest number of people possible. All three principals ask for your advice. What will you tell them?

BUSINESS CONSIDERATIONS What factors should the principals consider in deciding whether to obtain a copyright on software? What factors should an inventor consider before deciding to seek a patent? What drawbacks should be considered before one seeks a patent? What should Cyber Guardian do if it decides to treat the software as a trade secret?

ETHICAL CONSIDERATIONS Is it ethical for a competitor to copy a patented item and then hope that it can prevail in any

patent litigation? Is it ethical for a firm to attempt to enforce questionable patents and to use the expense of litigation to deter competitors from using its patents?

Computers

To protect trade secrets involving hardware or software an employer should create confidentiality, nondisclosure, and noncompetition agreements with employees, where these agreements are legal. Employers also should limit physical access to areas where privately owned software is developed and/or stored. All software and documents containing trade secrets should have proprietary labels. To ensure the security of the information, the software should use encrypted code so that only those who have the key for unscrambling it can read the program. Employers should (1) provide regular reminders to employees about their obligations to maintain secrecy, and (2) conduct exit interviews with departing employees where they remind the employees about their obligations regarding proprietary information.

If the owner of the trade secret will be licensing the software, the owner will need to take special care. Besides restricting disclosures by the licensee, the licensor/owner should limit the rights the licensee obtains in the software under the license. The licensor should specifically prohibit copying except for use or archival purposes. The licensor should (1) formulate special coding techniques to identify misappropriated software; (2) distribute the software in object code as opposed to source code; and (3) stipulate that the breach of any confidentiality provision will result in the immediate termination of the licensing agreement.

Trade secrets may be lost through another party's independent discovery of the secret or any other legitimate means, such as reverse engineering or the public dissemination of the knowledge underlying the trade secret through either a failure to keep the information secret or weaknesses in the security methods the owner has used. Mass distribution of software copies to those with whom

the soft war e owner has a confidential relationship by itself generally does not eliminate trade secr et pr otection.

Exhibit 31.3 compar es the diff er ent types of intellectual pr oper ty discussed in this chapter .

Exhibit 31.3

Types of Intellectual Proper ty

Type of Intellectual Property	What is protected?	What is not protected?	Does it have to be registered?*	Where is it registered?	How long does the protection last?
Patent	• Invention must be new, useful, and nonobvious • Invention that is a process, machine, article of manufacture, or composition of matter, or invention that is a new and useful improvement of one of these 4 categories	• Ideas • Laws of nature • Mathematical formulas • Scientific truths • Mental processes	• Yes	• U.S. Patent and Trademark Office	• 20 years for a utility or a plant patent • 15 years for a design patent • Patents are not renewable

Type of Intellectual Property	What is protected?	What is not protected?	Does it have to be registered?*	Where is it registered?	How long does the protection last?
Copyright	• Original works of art/authorship that have been fixed in a tangible medium Includes: • Architecture • Computer software • Movies • Music • Novels • Paintings • Photographs • Poetry • Songs	• Facts • Ideas • Inventions • Methods of operation • Systems • It may protect how these things are expressed	• No • You do have to register if you wish to file a U.S. lawsuit for monetary damages	• U.S. Copyright Office	• Life of author/ creator plus 70 years • If the work is "created" by or for a business entity, the shorter of 95 years from first publication or 120 years from creation • Copyrights are not renewable
Trademark Service Mark Certification Mark	• Word, term, or mark used to identify a product, service, or group	• Purely descriptive terms • Generic terms • Marks that are deceptive • Marks that use a person's name or likeness without permission • Official symbols of the United States or any state	• No	• U.S. Patent and Trademark Office	• Registered trademark is valid for 10 years • Registered trademarks are renewable for 10-year periods • There are no limits on the number of renewals as long as the mark remains in use
Trade Dress	• Unique design, color, shape, sound, or other decorative aspect of a product that is used to identify a product or producer	• Trade dress that is functional, for example, a square package that stacks well on store shelves	• No	• U.S. Patent and Trademark Office	• Registered trade dress is valid for 10 years • Registered trade dress is renewable for 10-year periods • There are no limits on the number of renewals as long as the trade dress remains in use

Type of Intellectual Property	What is protected?	What is not protected?	Does it have to be registered?*	Where is it registered?	How long does the protection last?
Trade Secret	• Method of doing business that has value because it is not known to the competition • The owner treats it as a secret	• Information the owner fails to keep secret • Independent discovery of the secret by others • Information that is public • Legal reverse engineering	• No	• N.A.	• Indefinite period

* If registration is not required, the owner may still benefit by registering. For example, by registering the owner may be permitted to sue in federal courts or obtain assistance of the U.S. Customs Office. State registration may also be required or recommended.

Source: Courtesy of Lynn M. Forsythe, © 2026.

Cyber Guardian 31.4 Management

CLASS PROJECTS

Asher is completing his final semester of course work. He is enrolled in the capstone class in his bachelor's degree program. His professor has asked the students to bring in an idea for a business, which they will use for a class project. Since the principals have launched Cyber Guardian, Asher would like to use it for his class project. Asher feels that he might get some good ideas on how to develop and expand their business. Danica and Mai are a little concerned that this might expose them to a risk that the professor, other students, or the university might claim an interest in the business or might launch a competing business. Mai points out that the professor and the university have more funds and could launch a

business and expand more quickly than the principals can. The firm members ask you whether Asher should use Cyber Guardian for his course project. What will you tell them?

BUSINESS CONSIDERATIONS What do most universities say about the ownership of intellectual property created by students, faculty, and staff? Do the rules vary depending on who creates the intellectual property? Is the answer affected by the type of intellectual property created, i.e., copyright, patent, trademark? Do most business entities claim ownership over the intellectual property created by their workers? What methods do they use to "stake their claim"? What interests are universities and businesses trying to protect?

ETHICAL CONSIDERATIONS Is it ethical for universities and businesses to claim ownership of intellectual property created by students or employees? Why or why not?

Contemporary Case

In this Contemporary Case, the federal court of appeals examined Yuga Lab's rights in Bored Ape Yacht Club, a collection of non-fungible tokens (NFTs) Yuga Labs created and sold. NFTs are relatively new and we do not have a lot of court decisions interpreting the rights of creators in their NFTs. A short description of NFTs is included in the court's opinion.

Yuga Labs, Inc. v. Ripps

144 F.4th 1137 (9th Cir. 2025)

FACTS[50] Yuga Labs, Inc. created the Bored Ape Yacht Club (BAYC), which is a collection of 10,000 NFTs. Each NFT has a unique Bored Ape cartoon. A purchaser of an NFT gets the rights to the ape art and

can use it personally and commercially. The purchaser also gets membership in a "strange combination of gated online community, stock-shareholding group, and art-appreciation society." Purchasers, called Ape holders, can join online and offline social activities. These NFTs developed a celebrity following and million-dollar merchandise. Yuga sold their entire collection in about a month. Defendants, Ryder Ripps and Jeremy Cahen, created an NFT collection called "Ryder Ripps Bored Ape Yacht Club" (RR/BAYC). The RR stands for his name, Ryder Ripps. The defendants' collection is associated with the same Bored Ape cartoons as the plaintiff's. It also uses the same ID number as the BAYC. Defendants also sold out their collection. Both sets of NFTs are selling on the secondary market.

ISSUES Are NFTs "goods" under the Lanham Act? Was the defendants' use fair use? Are defendants liable for trademark infringement?

HOLDINGS Yes. NFTs are "goods" under the Lanham Act. No. Defendants' use was not fair use. No. Defendants are not liable for trademark infringement as a matter of law. The plaintiff must meet its burden of proof and convince a jury of the relevant elements.

REASONING Excerpts from the opinion of Judge Forrest:

. . . [W]e must first address whether NFTs can be trademarked. . . . Grappling with this nascent technology, we hold that Yuga's NFTs . . . can be trademarked. . . . Simply stated, . . . an NFT is an intangible, fully virtual, authenticating software code that is associated with separate digital or physical content. . . . Like other non-fungible assets, each NFT is unique. And the association of an NFT with otherwise fungible digital content transforms that content into a unique asset. . . . This is called "tokenizing." . . .

By way of analogy, consider an autographed baseball. If the ball was mass-produced, many people could have the exact same ball. But when one of the balls is signed by a Major League player, the

signature transforms it into a unique good with greater value than the other identical-but-unsigned balls. NFTs work this way in cyberspace. The autograph on the ball is like the authenticating software code on the digital art file. The digital file may be replicable, allowing many people to access the same piece of art. But attaching the software code to the digital file makes something that is otherwise commonplace, unique. And that uniqueness can confer value.

"NFTs can tokenize anything, such as digital art, avatars, video game wearables, digital fashion accessories, and music." . . . But they are primarily used for selling digital art because they "provide a way to create artificial scarcity in the digital art market." . . . [T]he underlying digital artwork or other content tokenized by an NFT may or may not, *by itself*, be exclusive, copyrightable, or subject to any ownership interest at all. But the pairing of authenticating software code with digital content can create a unique asset with proprietary value. . . . ("Individuals do not purchase NFTs to own a 'digital deed' divorced from any other asset: they buy them precisely so that they can exclusively own the content associated with the NFT.")

The process by which NFT creators tokenize content is called "minting." . . . When an NFT is minted, it is stored on a "blockchain." . . . A block chain is a public digital ledger "that keeps track of who owns what." . . . "The block is a list of recorded transactions; the chain is transactions recorded with a hash that chains[,] or links, preceding blocks with new blocks." . . . Think of real property deed records maintained by county recorders' offices. Just like with recorded land transactions, a block chain records the creation and initial conveyance of the NFT and all subsequent conveyances of that NFT.

Block chains allow "ownership of the NFT to be transferred and authenticated electronically without the need for a physical item or a trusted third party, such as a bank." . . . So long as the computers have "the appropriate software," . . . the block chain "ledger is maintained across the computers of all block chain users through a peer-to-peer network." . . . For example, when one person transfers an

NFT to another, a record of the transaction becomes permanently stored on the block chain. . . . In this way, a block chain is a transparent cyberspace ledger between transacting parties.

The minting, storage, and transfer of NFTs on a blockchain are accomplished through a "smart contract." . . . A smart contract is *not* a contract in the legal sense; it is an "automatically executing computer code." . . . [S]mart contracts can be used to automate agreements between parties according to the instructions written into their code. . . .

The Lanham Act "creates a comprehensive framework for regulating the use of trademarks and protecting them against infringement, dilution, and unfair competition." . . . Section 43(a) prohibits a person from using "in commerce any word, term, name, symbol, or device . . . which . . . is likely to cause confusion . . . as to the origin . . . of his or her goods." . . .

To prevail on any trademark-infringement claim, the plaintiff must have a valid and enforceable trademark. . . . [T]he Lanham Act protects marks used with "any goods or services." . . . But the Lanham Act does not define what constitutes a "good" or a "service." . . . However, the U.S. Patent and Trademark Office (PTO) has concluded that NFTs are goods covered by the Lanham Act. In one of its most recent reports on NFTs, the PTO explained:

> Trademarks perform the same functions in NFT markets as they do in other markets: They identify the source of goods and services and distinguish the goods and services of one party from those of others. For example, trademarks can be used to indicate the source of underlying assets associated with NFTs, such as digital art, video clips of iconic sports moments, or physical shoes. Trademarks can also indicate the source of services, such as unique entertainment experiences or club memberships, access to which is represented by NFTs.

. . . Although not binding, the PTO's position is instructive given Congress's silence. . . .

Customers experience the BAYC NFTs as more than a digital deed or authentication of artwork. BAYC NFTs also function as membership passes, providing "Ape holders" with exclusive access to online and offline social clubs, branded merchandise, interactive digital spaces, and celebrity events. Thus, we conclude that Yuga's NFTs are "goods" under the Lanham Act.

"A party claiming trademark ownership must establish that it was the first to use the mark in the sale of goods or services". . . . There is no dispute that Yuga was the first to use the BAYC Marks in commerce. . . . There is a limitation on the general rule that the first to use a mark in commerce establishes trademark priority: "only *lawful* use in commerce can give rise to trademark priority." . . . There are two narrowing principles that apply to the unlawful-use limitation. First, "unlawful conduct [does] not preclude trademark protection if it was 'immaterial.'" . . . And second, trademark protection may not be withheld if the unlawful conduct is collateral to the use of the mark. . . . There must be a sufficient "nexus between the unlawful behavior and the use of the mark in commerce." . . .

Defendants contend that "there is a genuine dispute whether Yuga used [its] marks *legally*" because there is "evidence showing that Yuga sold the Bored Apes NFTs as unregistered securities." Defendants point to Yuga's marketing of BAYC NFTs as "investment contracts" coupled with its grant of cryptocurrency to NFT holders. . . . [W]e conclude that there is an insufficient nexus between Yuga's use of the BAYC Marks and its purported securities violations to withhold trademark protection. . . .

To prevail on its trademark-infringement claim, Yuga must show a likelihood of consumer confusion between the Defendants' allegedly infringing marks and Yuga's marks. . . . Under our "likelihood-of-confusion test," we "ask 'whether a "reasonably prudent consumer" in

the marketplace is likely to be confused as to the origin of the good or service bearing one of the marks.'" . . . But there is no need to reach this inquiry if the defendant's use of the protected mark constitutes nominative fair use. . . .

Nominative fair use does not implicate the source-identification function of trademark. . . . By definition, if the defendant *uses the plaintiff's mark to refer to the plaintiff's product*, the source is correctly identified. . . . [We consider the following factors:]

> First, the product or service in question must be one not readily identifiable without use of the trademark; second, only so much of the mark or marks may be used as is reasonably necessary to identify the product or service; and third, the user must do nothing that would, in conjunction with the mark, suggest sponsorship or endorsement by the trademark holder.

These factors are "designed to address the risk that nominative use of the mark will inspire a mistaken belief on the part of consumers that the speaker is sponsored or endorsed by the trademark holder." . . . Here, Defendants cannot make the required initial showing because they did not use the BAYC Marks merely to describe or otherwise reference Yuga's NFTs. They used the marks *as marks*. . . . Defendants embedded the "Bored Ape Yacht Club" and "BAYC" marks into their RR/BAYC NFTs by using them for their NFT collection name and symbol. . . . Defendants used Yuga's marks not just as descriptors or comparators, but to "capitalize on consumer confusion [and] appropriate the cachet of" BAYC NFTs to sell their own product. . . .

[W]e turn to the merits of Yuga's infringement claim and analyze "whether a 'reasonably prudent consumer' in the marketplace is likely to be confused as to the origin of" Defendants' NFTs. . . . [W]e consider . . .: '(1) strength of the mark; (2) proximity of the goods; (3) similarity of the marks; (4) evidence of actual confusion; (5) marketing channels used; (6) type of goods and the degree of care

likely to be exercised by the purchaser; (7) defendant's intent in selecting the mark; and (8) likelihood of expansion of the product lines.'" . . . These "factors (1) are non-exhaustive, and (2) should be applied flexibly, *particularly in the context of Internet commerce.*" . . . The first factor is the "strength of the [plaintiff's] mark." . . . "The more likely a mark is to be remembered and associated in the public mind with the mark's owner, the greater protection the mark is accorded by trademark laws." . . . The BAYC Marks are all conceptually strong. Far from describing an NFT, they are arbitrary, if not entirely fanciful. There is no obvious conceptual link between NFTs and Apes, Bored Apes, or Yacht Clubs. Combining these terms creates a conceptually strong mark based on anthropomorphized apes. . . . Similarly, the BAYC marks are commercially strong. Yuga has used the BAYC Marks for years to promote its website, events, and products, including its BAYC NFT collection. . . .

Second, we consider the "proximity of the goods." . . . That is, how similar or related Defendant's goods are to Yuga's goods . . . . Both parties sell NFTs. But given the complexity, idiosyncrasies, and nascence of NFTs, it would be reductive to suggest that all NFTs are the same. . . . That is why the precise design and functionality of the parties' actual products matter.

But the complexity and elasticity of NFTs does not reduce the proximity of the RR/BAYC and BAYC NFTs, particularly where they are linked . . . to the exact same Bored Ape images and corresponding Ape ID numbers. In that sense, the two products are nearly identical. There are, of course, differences in the underlying code of each NFT because NFTs are inherently "one-of-a-kind." . . . But there is also evidence suggesting that Defendants' choice to copy Yuga's contract name and symbol for their RR/BAYC NFT collection has caused actors in the NFT marketto misidentify RR/BAYC NFTs as BAYC NFTs despite the differences in the embedded code. Thus, a reasonable factfinder could also conclude that this factor favors Yuga's claim of infringement.

Third, we consider the "similarity of the marks." . . . This factor is "critical" to any likelihood-of-confusion analysis because "[o]bviously, the greater the similarity between the two marks at issue, the greater the likelihood of confusion." . . . And for internet-based goods in particular, mark similarity is one of the "most important" factors. . . . Despite the similarities between the marks at issue, the differences . . . are sufficient for a reasonable juror to conclude that these marks are not similar . . . .

The fourth factor is whether there is "evidence of actual confusion." . . . "[A]ctual confusion is not necessary to a finding of likelihood of confusion under the Lanham Act. . . . Yuga provided evidence of actual confusion, including consumer-survey evidence and examples of NFT market actors and television hosts confusing the two brands. But other evidence suggests that those interested in the Bored Apes knew that BAYC and RR/BAYC were different. . . .

Next, we consider the "marketing channels used." . . . "When examining the marketing channels used by . . . competing companies, we consider where the goods or services are sold, the sales and marketing methods employed, and the class of purchasers exposed to the [companies'] marketing efforts." . . . [The evidence is not clear on this point.]

Next, we consider the "type of goods and the degree of care likely to be exercised by the purchaser.". . . The degree-of-care analysis concerns whether . . . "a 'reasonably prudent consumer' would take the time to distinguish between the two product lines." . . . "When the buyer has expertise in the field, a higher standard is proper though it will not preclude a finding that confusion is likely. Similarly, when the goods are expensive, the buyer can be expected to exercise greater care in his purchases; again, though, confusion may still be likely." . . . Given the nature of NFTs, their relative novelty, and that they remain a mystery to most consumers, they are inherently sophisticated goods. . . . They can also be expensive goods, particularly given that they are non-essential and virtual. Because Yuga sold its entire BAYC

NFT collection before the RR/BAYC collection launched, a reasonably prudent customer would only encounter BAYC NFTs for sale in the secondary market. The BAYC NFTs have sold for steep prices in the secondary market, including some as high as $24.4 million. On the other hand, Defendants originally sold the RR/BAYC NFTs for between $100 to $200, and they sold for significantly less than BAYC NFTs on the secondary market. This extreme price differential would likely alert a consumer that there may be a substantive difference between the two NFT collections, undercutting the likelihood of confusion. . . .

The seventh factor is the defendant's "intent in selecting the mark." . . . The relevant inquiry is the defendant's "intent to infringe." . . . While Defendants claim that they only intended to "undermine" Yuga's reputation through satire, not to trade on its goodwill, the record is replete with evidence that they knew that Yuga was using the BAYC marks in commerce, acknowledged the similarities between the BAYC and RR/BAYC NFTs and that people made "mistakes" distinguishing the two products, and admittedly designed their product to replicate Yuga's product to "satir[ize] . . . the NFT craze" and "show that NFTs do not convey rights in accompanying images." . . . Defendants posted a disclaimer on rrbayc.com, their primary market channel for selling RR/BAYC NFTs, stating in part: RR/BAYC NFTs are "a new mint of BAYC imagery, recontextualizing it for educational purposes, as protest and satirical commentary." . . . [T]he record demonstrates that Defendants could have been fueled by dual motives. Their intent to criticize and satirize Yuga is not incompatible with an intent to confuse consumers. . . .

In this case, the district court failed to thoroughly consider all the relevant variables that inform whether a likelihood of consumer confusion was created by Defendants' use of Yuga's marks. . . . [W]e cannot conclude as a matter of law that "a 'reasonably prudent consumer' in the marketplace is likely to be confused as to the origin of the good or service bearing one of [Yuga's] marks." . . . Yuga may

ultimately prove this element of infringement, but it must do so before a factfinder . . . .

You Be the **Judge**

Jana Romano va is a professional photographer . Her primary source of income is licensing fees from the online and print publication of her photos. She took a photograph (the Work) of a Russian woman with her two pet snakes. One snake is wrapped around the woman 's left hand and the other snake is crawling up her torso. It is an artistic Work. Romano va licensed the Work to National Geographic Magazine to publish it one time in an article entitled "Intimate Photos of People and Their Beloved Pet Snakes." The magazine issue was published on September 29, 2017. A couple weeks later Romano va registered the Work with the United States Copyright Office.

Amilus Inc. owns the website at "www .ai-ap.com ." On December 31, 2017, Amilus copied the photo from the National Geographic publication and published it in its online article on pets. Romano va's photo was one of ten in the article. Apparently all the photographs came from the internet. To access the website, viewers have to subscribe to Amilus and pay a monthly fee. Romano va did not consent to the publication of her photo.

Assume that Romano va sued Amilus and she has appealed the decision to *your* court. If *you* were the judge, how would you decide this dispute? Is Amilus' s use of the photograph fair use? Why or why not? [See *Romano va v. Amilus Inc.* , 138 F .4th 104 (2d Cir . 2025).]

Summary

- Intellectual property includes : patents, copyrights, trademarks, and trade secrets.
- Patent law grants to inventors the exclusive right to their discoveries. The subject matter must be patentable.

- To be patentable, an invention must be new, useful, and nonobvious. Ideas *per se* are not patentable.
- Utility patents last for 20 years and design patents last for 15 years.
- When the patent is over, others can produce, sell, and otherwise use the items formerly protected by the patent.
- Applying for a patent involves detailed disclosures to the Patent and Trademark Office (PTO).
- Copyright laws protect original works of authorship.
- To be copyrightable, works of authorship must show originality and the works must be fixed in a tangible medium of expression. Ideas are not copyrightable.
- A copyright consists of a bundle of exclusive rights that enables the copyright owner to exploit a work for commercial purposes.
- Violations of the copyright owner's exclusive rights constitute infringement. The most common defense against charges of copyright infringement is the fair use doctrine.
- Civil remedies for infringement include injunctions, the impounding and destruction of infringing items, and damages. Criminal penalties also are available.
- There is an extensive body of state trademark law. Most of it has developed through state common law relating to unfair competition.
- The most important federal protection of trademarks is in the Lanham Act. It defines a trademark as any word, name, symbol, device, or any combination used to identify and distinguish the goods or services of one person from the goods or services of others.
- A trademark must be used in a commercial activity. The term "trademark" is often used as a label to include trademarks, service marks, and trade dress. Trade dress may cover an array of things, including the distinctive features of the product such as the product's shape, the product's packaging, the logo, or artwork on the product.
- To obtain protection, the trademark must be distinctive; generic terms do not qualify for trademark protection. Purely descriptive

marks do not qualify as distinctive until they have acquired a "secondary meaning."

- The law protects the trademark owner from infringements that will result in a likelihood of confusion concerning the source of the goods.
- Defenses to trademark infringement include "fair use" and abandonment of the mark.
- The owner has certain advantages if the mark is registered with the PTO.
- Trade secret law protects proprietary information that gives the owner an advantage over the owner's competitors. To qualify as a trade secret, the information must be treated as confidential and it must be used continuously in the business.
- The law does not protect information that is either common knowledge or is easily acquired from reverse engineering.
- Misappropriation of a trade secret can occur through breach of contractual or confidential relations or the use of improper means to acquire the secret. Remedies include injunctions and damages.
- Several international treaties regulate intellectual property.

Discussion Questions

1. Ask the AI to draft a confidentiality agreement for you to use with a new software engineer that you are about to hire. Analyze the agreement that the AI provided. Do you think it will be enforceable in your state? Why or why not?

2. Raya is an independent songwriter and musician. She releases her albums through her website. She uses Craiyon to generate artwork for the covers of her albums. Craiyon uses artificial intelligence (AI) to generate artwork from word prompts. Who owns the artwork that Raya generates and why? Who should own the copyright to it? Why?

3. Taco John's obtained a registered trademark for "Taco Tuesday" by filing with the PTO in 1989. The trademark was granted even though there was evidence that other businesses had used "Taco Tuesday." In 2023 Taco Bell filed an appeal with the PTO Trademark Trial and Appeal Board to have the trademark "Taco Tuesday" canceled. Taco Bell is calling on celebrities and its fans to join its efforts to "liberate" "Taco Tuesday" so that everyone can use the phrase. [51] Should the PTO cancel the trademark to "Taco Tuesday"? Why or why not?

4. Charles James designs homes. He registered copyrights in the design and its derivatives with the Copyright Office. Real estate agents made copies of the floor plans of his homes which they included when they listed homes designed by James for resale. The agents did not use James' drawings in creating the ones they used for their online listings. [52] Are the agents entitled to use the floor plans they made? Is their use fair use? Why or why not?

5. Ken Biberaj, a political commentator, hosts a live event and podcast called "Coffee with Ken." He usually gets about 20,000 viewers per episode. Mattel owns the trademark to the Ken doll. Mattel has filed a complaint with the U.S. Patent and Trademark Office's Trademark Trial and Appeal Board (TTAB) against Coffee with Ken LLC. Mattel is complaining that the podcast will be confused with their discontinued Ken Barista doll. [53] Should Mattel be successful? Why or why not?

Case Problems and Writing Assignments

1. Sun Microsystems created the Java SE language. Oracle acquired Sun Microsystems in 2010, including its rights to the computer code.

In 2005, Google acquired Android, Inc. Google hoped to develop a software platform for mobile devices like smart phones. A platform is the infrastructure for programmers to create programs and applications. Google envisioned a free and open platform that programmers could use free of charge. The more programmers that

wrote Android apps, the more popular Android smart phones would be. Google's goal would require a large number of skilled programmers.

At the time, about six million programmers knew how to use the Java language, including Sun's popular Java SE platform. Google entered into negotiations with Sun about licensing the entire Java platform. The negotiations broke down. Google then built its own platform, but it copied approximately 11,500 lines of code from the Java SE program. These copied lines were part of the Application Programming Interface (API). An API is a tool which permits programmers to call upon prewritten computing tasks for use in their own programs instead of writing their own code for these tasks. The programmer using an API does not need to learn the implementing code. The programmer only needs to know how to call up the function. Google copied the API, but it wrote its own instructions for how the computer would perform the task. Approximately one hundred Google engineers worked for more than three years to create Google's Android platform software. They wrote millions of lines of new code.

Who should win in the copyright dispute between Google and Sun (now Oracle)? Is Google's use of the Java API fair use even if the API is copyrightable? [See *Google LLC v. Oracle America, Inc.*, 593 U.S. 1 (2021).]

2. Professor David A. Berkovitz was teaching business law online in spring 2021 at Chapman University due to the COVID-19 pandemic. So, he administered his exams online. He told his students that they were not permitted to use outside sources for the midterm and the final exam. Only current students had access to the exam questions. Later he discovered that his exam questions were posted on the Course Hero website. On the website students also asked for assistance answering the questions. Allegedly there were also sample answers. Berkovitz asked the website administrators for the identities of the posters. Course Hero informed him that they would not reveal the identities without a subpoena. Berkovitz registered his exams with the U.S. Copyright Office. His attorney then filed a

cop yright infringement suit against fiv e unnamed def endants who did the posting. In other wor ds, the y wer e listed on the lawsuit as John Does. Accor ding to the complaint, "Def endants infringed Berko vitz' s ex clusiv e right to repr oduce, mak e copies, distribute, or cr eate deriv ativ e works by publishin g the Midterm Exam and Final Exam on the Course Her o W ebsite without Berko vitz' s permiss ion."[54] His att orne y then pr epar ed subpoenas t o learn the identity of the posters.

Should Berko vitz be success ful in his suit? Why or why not? Be cer tain that you explain and justify your answer . What types of rights does Be rko vitz ha ve in his ex am questions? Is he requir ed to file with the U.S. Cop yright Office? W hy or why not? [See Minyv onne Burk e, "California College Pr of essor Sues Students after Midterm and Final Exams Ar e P osted Online," *U.S. News* , Mar . 17, 2022, https:/ /www .nbcnews.com/news/us-news/california-college-pr of essor-sues-students-midterm%20-final-exams-ar e-pos-rcna20492?f eatur eFlag=true (last visited Dec. 8, 2025); Michael Le venson, "Hoping to Identify Cheaters, a Pr of essor Sue s His Own Students," *The New York Times* , Ma r. 17, 2022, https:/ /www .nytimes.com/2022/03/17/us/chapman-law-cheating-pr of essor .html (last visited Aug. 16, 2025); and Jaclin P eiser , "A Pr of essor F ound His Exam Questions P osted Online. He 's Suing the Students Responsible for Cop yright Infringement," *The W ashingt on P ost* , Mar . 17, 2022, https:/ /www .washingt onpost.com/nation/2022/03/17/chapman-univ ersipr of essor-lawsuit-cop yright-cheating/ (last visited Aug. 16, 2025).]

3. Lynn Goldsmith is a pr of essional phot ographer who specializ es in taking pictur es of celebrities, including por traits and concer t phot os of rock and rol l musicians. Goldsmith took a number of phot ographs of th e musician Prince in her studio. Goldsmith owned the cop yrights to the phot os.

Goldsmith founded Lynn Goldsmith, Ltd. (L GL), the first agency to focus on celebrity phot ograph s. LGL repr esents the work of over 200 phot ographers including Goldsmith. Goldsmith transf err ed the rights to her phot os of Prince t o L ynn Goldsmith, Ltd.

LGL licensed one of the photographs to *Vanity Fair* magazine for use as an artist reference. A witness at trial testified that an "artist reference" meant that an artist "would create a work of art based on [the] image reference."[55] The license permitted the magazine to publish two illustrations based on the photograph in one issue. The magazine was required to print an acknowledgment to Goldsmith. Goldsmith herself did not participate in the agreement. *Vanity Fair*, in turn, commissioned Andy Warhol to create an image of Prince for its November 1984 issue. Goldsmith did not know that the artist was going to be Warhol. She also did not know that Warhol continued to use the photograph after he created the work for *Vanity Fair*. Warhol created 15 more works, which together became known as the Prince Series. The Prince Series was created in a typical Warhol style. In other words, people familiar with art would recognize the prints and drawings in the Prince Series as Warhol's work.

The Andy Warhol Foundation for the Visual Arts, Inc. (AWF) was created after Warhol's death. The Foundation is the current copyright owner of many works by Andy Warhol. AWF kept the copyright in the Prince Series images. Through the Artist Rights Society (a third-party organization that serves as AWF's agent), AWF licenses the images for editorial, commercial, and museum usage to monetize them. There is overlap in the licensing markets for the Prince Series and Goldsmith's photograph. They may compete for magazine covers, posters, coffee mugs, and other items featuring the late musician.

The day after Prince died, Condé Nast, *Vanity Fair*'s parent company, contacted AWF to determine the availability of a Prince image to use in a magazine issue commemorating Prince's life. Condé Nast obtained a commercial license from AWF for the cover of the planned tribute magazine. This image was attributed to AWF.

Goldsmith found out about the Prince Series after Prince died in 2016. She notified AWF of her infringement claims. AWF sued Goldsmith and LGL. AWF wants a declaration that the Prince Series does not infringe or that Warhol made fair use of Goldsmith's photograph.

Did Warhol make fair use of Goldsmith's photograph? Does the original Prince Series violate Goldsmith's copyright? Does the licensing of the images by AWF violate her copyright? Be certain that you explain and justify your answer. [See *Andy Warhol Foundation for Visual Arts, Inc. v. Goldsmith*, 11 F.4th 26 (2d Cir. 2021), *cert. granted* by *Andy Warhol Foundation for Visual Arts, Inc. v. Goldsmith*, 142 S. Ct. 1412 (2022). The Supreme Court opinion is reported at *Andy Warhol Foundation for the Visual Arts, Inc. v. Goldsmith,* 598 U.S. 508 (2023).]

Notes

1. For more information on art and prior art, see Fenn Mathew, "Understanding Prior Art and Its Use in Determining Patentability," Patent and Trademark Office, Office of Innovation Development, www.uspto.gov/sites/default/files/documents/May Info Chat slides (003).pdf (last visited Aug. 23, 2025). For information on doing a patent search, see USPTO—Office of Patents Stakeholder Experience Pro Se Assistance Center, "Patent Searching and Search Resources—An Introduction," https://www.uspto.gov/sites/default/files/documents/Basics-of-Prior-Art-Searching.pdf (last visited Aug. 16, 2025).
2. For a detailed discussion of what is obvious, see Brent A. Olson, Cal. Bus. Law Deskbook §29:14.
3. Business method patents can be granted in areas such as: advertising, incentive programs, and coupons; banking; cost/price, reservations, shipping, and transportation; cryptography and business data security; electronic shopping; finance; healthcare; insurance; inventory, point of sale, and accounting; and operations research. See Patent and Trademark Office, "Business Methods," https://www.uspto.gov/patents/basics/essentials/business-methods (last visited Aug. 16, 2025).
4. *J. E. M. Ag Supply, Inc. v. Pioneer High-Bred International, Inc.*, 534 U.S. 124 (2001).
5. Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284. The AIA became effective in 2013. One of the significant changes is that the patent process is more transparent and accessible to members of the public, who now have multiple opportunities to argue against granting the patent before the PTO. See Robert A. Armitage, "Understanding the America Invents Act and Its Implications for Patenting," 40:1 AIPLA Q.J. 1 (2012).
6. 60 Am. Jur. 2d Patents §548.
7. David Pressman and David E. Blau, *Patent It Yourself*, 19th ed. (Berkeley, CA: Nolo Press, 2018), at 191-193.
8. *Id.* at 428.
9. There are detailed rules about filing a regular patent application after a PPA. The inventor must pay close attention to get the filing date the inventor desires. See *id.* at 62-65.
10. 54 Am. Jur. 2d Monopolies and Restraints of Trade §121.
11. *Id.*; 60 Am. Jur. 2d Patents §791.

12. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006).
13. Pressman and Blau, *supra* note 7, at 12. For an excellent discussion of international patent law, see Chapter 12, "Going Abroad."
14. Choe Sang-Hun, "Mixed Emotions Over Deft Imitator," *The International Herald Tribune*, Sep. 3, 2012, Finance section, at 16.
15. Harriet Alexander, Shane Richmond, and Harry Wilson, "Battle of the Giants; The Feuding over Patents Between Hi-Tech Heavyweights Apple and Samsung May End in a US Court, Says Harriet Alexander, But It Will Define the Future of the Mobile Phone Across the Globe," *The Sunday Telegraph* (*London*), Aug. 26, 2012, Sport section, at 21.
16. Reuters, "Apple Cuts Orders from Samsung for iPhone Chips," *The New York Times*, Sep. 8, 2012; Sang-Hun, *supra* note 14. "Samsung estimates that it provides about a quarter of all the components inside the iPhone and the iPad, including the much talked-about retina display and the processor and memory chips. Apple is also Samsung's single biggest customer. Neither can walk away from this relationship quickly, however nasty the court battle gets. . . ." Jennifer Hughes and Stuart Kirk, "Samsung: Not a World Leader Yet," *The Straits Times* (*Singapore*), Aug. 23, 2012, Opinion section.
17. Jack Nicas, "After 7 Years, Apple and Samsung Settle Conflict over Smartphone Patents," *The New York Times* (*New York edition*), Jun. 28, 2018, at B2.
18. World Intellectual Property Organization, WIPO, "States Party to the PCT and the Paris Convention and Members of the World Trade Organization," https://www.wipo.int/en/web/pct-system/paris_wto_pct (last visited Aug. 16, 2025).
19. *Id.* Information about the Patent Cooperation Treaty can also be found at the following websites, among others: World Intellectual Property Organization, "Patent Cooperation Treaty (PCT) (1970)," https://www.wipo.int/treaties/en/registration/pct/summary_pct.html (last visited Aug. 16, 2025); World Intellectual Property Organization, WIPO/PCT, "PCT—The International Patent System," https://www.wipo.int/en/web/pct-system (last visited Aug. 16, 2025); and Patent and Trademark Office, "Patent Cooperation Treaty," https://www.uspto.gov/patents/basics/international-protection/patent-cooperation-treaty (last visited Aug. 16, 2025).
20. Pressman and Blau, *supra* note 7, at 348.
21. Tristin Hopper, "Running Out of Hope; Creator of Iconic Obama Poster Facing Prison, Millions in Fines," *National Post* (f/k/a *The Financial Post*) (*Canada*), Sep. 7, 2012, at A3; Compiled by Dave Itzkoff, "Judge Urges Resolution in Use of Obama Photo," *The New York Times*, May 29, 2010, at C2; and Randy Kennedy, "Shepard Fairey and the A.P. Settle Legal Dispute," *The New York Times*, Jan. 13, 2011, at C2.
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