

12th edition

# Law for Business

Barnes

Dworkin

Richards

# Law for Business

Twelfth Edition

**A. James Barnes, J.D.**

**Terry Morehead Dworkin, J.D.**

**Eric L. Richards, J.D.**

*All of Indiana University*





LAW FOR BUSINESS TWELTH EDITION

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This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 QVS/QVS 1 0 9 8 7 6 5 4

ISBN 978-0-07-802381-1

MHID 0-07-802381-5

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Compositor: *Laserwords Private Limited*  
Typeface: *10/12 Times New Roman*  
Printer: *Quad/Graphics*

**Library of Congress Cataloging-in-Publication Data**

Barnes, A. James, author.

Law for business / A. James Barnes, J.D., Terry Morehead Dworkin, J.D., Eric L. Richards, J.D., all of Indiana University.—Twelfth Edition.

pages cm

ISBN 978-0-07-802381-1 (alk. paper)

1. Commercial law—United States. 2. Trade regulation—United States. I. Dworkin, Terry Morehead, author. II. Richards, Eric L., author. III. Title.

KF889.B28 2015

346.7307—dc23

2013033985

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

# Preface

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For more than 30 years, *Law for Business* has set the standard as an easy-to-read textbook that provides students with the tools for understanding the legal environment of business. This, the 12th edition, has not strayed from that winning formula. The text goes well beyond merely identifying the current legal rules and regulations affecting business by offering insights into new developments and trends that promise to greatly affect the future of both domestic and international businesses. The result is a comprehensive, yet concise, treatment of the legal issues of fundamental importance to business students and the business profession.

We are extremely pleased with the number of institutions and instructors that continue to adopt *Law for Business*. They represent a wide range of programs in business in both two-year and four-year colleges and universities throughout the country and the world. Feedback from faculty and students alike confirms that they particularly like the clear exposition, the careful selection and editing of high-interest cases, and the text's attractive and readable design.

## What's New in the Twelfth Edition?

In preparing this latest edition of *Law for Business*, we have tried to maintain the strengths of the past editions while updating the material and cases.

The following changes have been made to the 12th edition of *Law for Business*:

### CHAPTER 1

- Replaced the chapter opener case with an abbreviated version of the *Twisdale* case
- Added three new cases: *United States v. Farinella*; *Coach v. Goodfellow*; and *Lozman v. City of Riviera Beach*
- Edited the *Lawrence v. Texas*, *Bowles v. Russell*, and *United States v. Stewart* cases for conciseness
- Removed the *Yahoo v. La Ligue Contre* and *United States v. Ressam* cases
- Edited and updated questions and problem cases

### CHAPTER 2

- Added 1 new case: *Wal-Mart Stores, Inc. v. Dukes*
- Removed the *Wong v. T-Mobile USA Inc.* case
- Edited and updated questions and problem cases

### CHAPTER 3

- Added new section on conscious capitalism
- Moved Foreign Corrupt Practices Act material to Securities Regulation chapter
- Added 3 new cases: *Hart v. Electronic Arts*; *Everson v. Michigan Department of Corrections* case; *Jane Doe v. Wal-Mart Stores*
- Removed *Virginia v. Black*; *United States v. Virginia*; *Midwest Motor Sports* cases
- Edited *Dewitt v. Proctor* case for conciseness
- Edited and updated questions and problem cases

### CHAPTER 4

- New chapter opener case
- Added new section on time, place, or manner restrictions

- Added 4 new cases: *U.S. Smokeless Tobacco Manufacturing Co. v. City of New York*; *Florida Transportation Service v. Miami-Dade County*; *R.J. Reynolds Tobacco v. Food & Drug Administration*; *McCullen v. Coakley*
- Removed *Wyeth v. Levine*; *Granholtm v. Heald*; *Gonzalez v. Raich*; *National Council of Resistance of Iran v. Albright*; *Ashcroft v. American Civil Liberties Union*; *Mainstream Marketing v. Federal Trade Commission*; *Solis v. Summit Contractors* cases
- Edited *Kelo v. City of New London* case and *Picca* case for conciseness
- Edited and updated questions and problem cases

## CHAPTER 5

- Added three new cases: *Lock v. State*; *United States v. Jones*; *United States v. Nosal*
- Removed *Chaffee v. Roger*; *Clark v. Arizona*; *United States v. Mann*; *United States v. Hong* cases
- Edited and updated questions and problem cases

## CHAPTER 6

- Added three new cases: *Roberts v. McAfee, Inc.*; *Stickdorn v. Zook*; *Kimes v. Grosser*
- Removed *Avila v. Citrus Community College*; *Amrak Productions, Inc. v. Morton*; *Gates v. Discovery Communications, Inc.*; *Stevenson v. DuPont*
- Edited and updated questions and problem cases

## CHAPTER 7

- Added three new cases: *Putnam County Sheriff v. Price*; *McDougal v. Lamm*; *Steigman v. Outrigger Enterprises, Inc.*
- Removed *Sigler v. Kobinsky*; *Izquierdo v. Ricitelli*; *Power v. Metropolitan Entertainment Co.* cases
- Edited and updated questions and problem cases

## CHAPTER 8

- New chapter opener case
- New section and learning objective on intellectual property aspects of social media
- New Ethics in Action box
- Edited text to account for the patent law changes dictated by the America Invents Act
- Removed Key Contractual Provisions material from the Licensing section
- Edited section on copyright infringement, fair use, and first sale doctrine
- Added 4 new cases: *Association for Molecular Pathology v. Myriad Genetics*; *Bowman v. Monsanto*; *Kirtsaeng v. John Wiley & Sons*; and *PhoneDog v. Kravitz*
- Edited *Schwan's v. Kraft Pizza Company* case for conciseness
- Removed *In re Stephen v. Comiskey*; *Grupo Gigante S.A. de C.V. v. Dallo & Co.*; *BMG Music v. Gonzalez*; *Perfect 10 v. Google*; *Arista Records v. Flea World*; *DuPont de Nemours & Co. v. Christopher*; and *MedImmune v. Genentech* cases
- Edited and updated questions and problem cases

## CHAPTER 9

- Added 2 new cases: *Dodd v. American Family Mutual Insurance Co.* and *Anderson v. Hannaford Brothers Co.*
- Removed *Race v. Fleetwood Retail Corp. of Washington*; *Staley v. Taylor* cases
- Edited and updated questions and problem cases

## CHAPTER 10

- Added 3 new cases: *Allen v. Clarian Health Partners*; *Permison v. Comcast Holdings Corporation*; *Alexander v. Lafayette Crime Stoppers, Inc.*
- Removed *Leonard v. Pepsico, Inc.* and *Giovo v. McDonald* cases
- Edited and updated questions and problem cases

## CHAPTER 11

- Added 2 new cases: *Trademark Properties, Inc. v. A&E Television Networks* and *Teter v. Glass Onion, Inc.*
- Removed *Basis Technology Corp. v. Amazon.com, Inc.* and *Aetna Life Insurance Co. v. Montgomery* cases
- Edited and updated questions and problem cases

## CHAPTER 12

- Added 3 new cases: *Bob Acres, LLC v. Schumacher Farms, LLC*; *Tasini v. AOL, Inc.*; *Dixon v. Wells Fargo Bank, NA*
- Removed *McBee v. Nance* and *Duncan v. Duncan* cases
- Edited and updated questions and problem cases

## CHAPTER 13

- Added 2 new cases: *Woodman v. Kera, LLC* and *Sexton v. Sexton*
- Removed *Cooper v. The Aspen Skiing Company* and *Willard v. Peak* cases
- Edited and updated questions and problem cases

## CHAPTER 14

- Added 2 new cases: *Koehlinger v. State Lottery Commission* and *Gomez-Jimenez v. New York Law School*
- Removed *Morehouse v. Behlman Pontiac-GMC Truck Service, Inc.*; *Columbia/HCA Healthcare Corp. et al v. Cottey*; and *David D. Murray v. Dianne E. Murray* cases
- Edited and updated questions and problem cases

## CHAPTER 15

- Added 3 new cases: *Grigsby v. Russell*; *Home Paramount Pest Control Companies, Inc. v. Shaffer*; and *Lhotka v. Geographic Expeditions, Inc.*
- Removed *Neiman v. Provident Life & Accident Insurance Co.*; *Central Indiana Podiatry, P.C. v. Krueger*; and *Alexander v. Anthony Int'l, L.P.* cases
- Edited and updated questions and problem cases

## CHAPTER 16

- Added 3 new cases: *East Lynn Fertilizers, Inc. v. CHS, Inc.*; *MEMC Electronic, Inc. v. BP Solar Int'l, Inc.*; and *State Automobile Mutual Insurance Company v. Flexdar, Inc.*
- Removed *Conner v. Lavaca Hospital Dist.*; *Wehry v. Daniels*; and *Knight v. Indiana Insurance Company* cases
- Edited and updated questions and problem cases

## CHAPTER 17

- Added two new cases: *Allan v. Nersesova* and *Huff v. FirstEnergy Corp.*
- Removed *Caba v. Barker* case
- Edited and updated questions and problem cases

## CHAPTER 18

- Added three new cases: *Sargon Enterprises v. University of Southern California*; *Dean v. Kruse Foundation, Inc.*; and *Equal Employment Opportunity Commission v. Dresser Rand Co.*
- Removed *Dupont Flooring Sys. v. Discovery Zone, Inc.*; *American Car Rental, Inc. v. Commissioner*; and *Manuma v. Blue Hawaii Adventures, Inc.* case
- Edited and updated questions and problem cases

## CHAPTER 19

- Replaced *Heart of Texas Dodge, Inc. v. Star Coach, LLC.* case with *Janke v. Brooks*
- Edited and updated questions and problem cases

## CHAPTER 20

- Replaced *Klein v. Sears Roebuck & Co.* case with *Ram Head Outfitters, Ltd. v. Mecham*
- Added *Baba v. Hewlett Packard Co.* case
- Deleted *Thacker v. Menard's* case
- Edited and updated questions and problem cases

## CHAPTER 21

- Replaced *Rochester Gas and Electric Corporation v. Delta Star, Inc.* case with *Vasaturo Brothers, Inc. v. Alimenta Trading-USA, LLC.*
- Edited and updated questions and problem cases

## CHAPTER 22

- Added 2 new cases: *Beer v. Bennett* and *Cahaba Disaster Recovery, LLC v. Rogers* case about the fire and explosion of the Deepwater Horizon drilling rig in the Gulf of Mexico in 2010
- Deleted *Moore v. Coachmen Industries, Inc.* and *KGM Harvesting Co. v. Fresh Network* cases
- Edited and updated questions and problem cases

## CHAPTER 23

- Added new section on moonlighting
- Added 3 new cases: *Wesco Autobody Supply v. Ernest*; *American Family Mutual Insurance v. Roth*; *AA Sales & Associates v. Coni-Seal*
- Removed *Kakides v. King Davis Agency*; *Cameco v. Gedicke*; *Pacific Aerospace & Electronics v. Taylor*; and *Christensen Sales Agency v. General Time Corporation* cases
- Edited and updated questions and problem cases

## CHAPTER 24

- Added 2 new cases: *Ophthalmic Surgeons v. Paychex* and *Roberts v. Danner*
- Edited the *NCP* and *TGM* cases for conciseness
- Removed *CSX Transportation v. Recovery Express* and *Freeman v. Busch* cases
- Edited and updated questions and problem cases

## CHAPTER 25

- Added two new cases: *Glatt v. Fox Searchlight Pictures, Inc.* and *Mauerhan v. Wagner Corporation*

- Removed *Media General Operations, Inc. v. National Labor Relations Board*; *Karl Knauz Motors, Inc. and Robert Becker*; *General Dynamics Land Systems, Inc. v. Cline*; *Akers v. Kindred Nursing Ctrs. Ltd. P'ship D/B/A Southwood Health* cases
- Edited and updated questions and problem cases

## CHAPTER 26

- Added three new cases: *North American Steel Connection v. Watson Metal Products*; *McCann v. McCann, Jr.*; and *Katris v. Carroll*
- Removed the *La Montagne Builders v. Bowman Brook Purchase Group*; *Brooks v. Hill*; and *Estate of Countryman v. Farmers Cooperative* cases
- Edited the *In re Garrison-Ashburn, LC* and *Boulanger v. Dunkin' Donuts* cases for conciseness
- Edited and updated questions and problem cases

## CHAPTER 27

- Added two new cases: *McGregor v. Crumley* and *In the Matter of Hardwood*
- Removed *Chen v. Wang* and *Gregg v. S. R. Investors, Ltd.* cases
- Edited the *Long v. Lopez* case for conciseness
- Edited and updated questions and problem cases

## CHAPTER 28

- Added two new cases: *Keene v. Brookhaven Academy* and *Kertesz v. Korn*
- Removed the *Bridas v. Government of Turkmenistan* and *Balsamides v. Perle* cases
- Edited and updated questions and problem cases

## CHAPTER 29

- Added two new cases: *Kirschner v. K&L Gates* and *Sarei v. Rio Tinto*
- Edited the *In re Walt Disney Derivative Litigation*; *Gantler v. Stephens*; and *SEC v. Gemstar-TV Guide International* cases for conciseness
- Removed the *MM Companies v. Liquid Audio*; *Omnicare v. NCS Healthcare*; and *Southern Management Corporation v. Taha* cases
- Edited and updated questions and problem cases

## CHAPTER 30

- Added two new cases: *Barasch v. Williams Real Estate* and *Lerner v. Immelt*
- Edited *Levco Alternative Fund Ltd. v. The Reader's Digest Association*; *Accipiter Life Sciences Fund v. Helfer*; *American Federation v. American International Group*; and *Pirelli Armstrong Tire Corporation v. Raines* cases for conciseness
- Removed *Seinfeld v. Verizon Communications*; *Lohnes v. Level 3 Communications*; and *In re Oracle Corporation Derivative Litigation* cases
- Edited and updated questions and problem cases

## CHAPTER 31

- Added learning objective and new section on Foreign Corrupt Practices Act
- Added new Ethics in Action box
- Removed the sections on Regulation of Proxy Solicitations and International Cooperation
- Added four new cases: *Gibbons v. Malone*; *Morrison v. National Australia Bank*; *Matrixx Initiatives v. Siracusano*; and *USA v. Lindsey*



- Edited the *SEC v. Charles Edwards* and *SEC v. Rocklage* cases for conciseness
- Removed the *Credit Suisse Securities v. Glen Billing*; *Roth v. Perseus L.L.C.*; *Stonridge Investment Partners v. Scientific-Atlanta*; *Greenhouse v. MCG Capital Corporation*; and *South Ferry LP #2 v. Killinger* cases
- Edited and updated questions and problem cases

#### CHAPTER 32

- Added four new cases: *Delollis v. Friedberg, Smith & Co.*; *Stephenson v. PriceWaterhouseCoopers*; *Knappe v. United States*; *Bennett v. Sprint Nextel Corporation*
- Edited the *APA Excelsior III L.P. v. Premiere Technologies* and *Arthur Anderson v. United States* cases for conciseness
- Removed the *Thabault v. Chait*; *Tricontinental Industries v. PricewaterhouseCoopers LLP*; *Ernst & Young L.L.P. v. Pacific Mutual Life Insurance Co.*; *McCurdy v. SEC*; and *United States v. Roxworthy* cases
- Edited and updated questions and problem cases

#### CHAPTER 33

- Replaced *Jasphy v. Osinsky* case with *Weissman v. City of New York*
- Edited and updated questions and problem cases

#### CHAPTER 34

- Replaced *Rothermich v. Union Planters National Bank* case with *Chevron U.S.A., Inc. v. Sheikhpour*
- Edited and updated questions and problem cases

#### CHAPTER 35

- Replaced *Hemmings v. Pelham Wood Limited Liability Limited Partnership* with *Tan v. Arnel Management Company*

#### CHAPTER 36

- Modified and expanded the Learning Objectives
- Replaced *In re Estate of Kathleen Lee Meade* case with *Estate of Abshire*
- Edited and updated questions and problem cases

#### CHAPTER 37

- Added new section on affordable health care
- Added three new cases: *Nationwide Insurance v. Central Laborers' Pension Fund*; *ISBA Mutual Insurance v. Frank M. Greenfield*; and *Kutlenios v. Correa*
- Edited the *State Farm Mutual Automobile Insurance Company v. Kastner*; *Terra Nova Insurance v. Fray-Witzer*; and *Mayo v. Hartfield Life Insurance Co.* cases for conciseness
- Removed *Medical Mutual Insurance v. Indian Harbor Insurance*; *Knight v. Indiana Insurance Company*; *Phillips v. Saratoga Harness Racing, Inc.*; *SR International Business Insurance v. World Trade Center Properties*; and *Amex Life Assurance Company v. Superior Court* cases
- Edited and updated questions and problem cases

#### CHAPTER 38

- Rewrote chapter introduction and made other changes throughout the chapter to reflect recent changes in the law
- Replaced *Chung v. New York Racing Association* case with *Scott v. Zimmerman*
- Edited and updated questions and problem cases

## CHAPTER 39

- Added *E & G Food Corp. v. Cumberland Farms, Inc.* case
- Deleted *Griffith v. Mellon Bank, N.A.* case
- Edited and updated questions and problem cases

## CHAPTER 40

- Added new material relating to counterfeit checks
- Added new material relating to recent changes in Article 3 of the UCC.
- Replaced *Lawyers Fund for Client Protection of the State of New York v. Bank Leumi Trust Co. of New York* case with *Jones v. Wells Fargo Bank, N.A.*
- Edited and updated questions and problem cases

## CHAPTER 41

- Added *Cincinnati Insurance Company v. Wachovia Bank National Association* case
- Deleted *Union Planter's Bank, N.A. v. Rogers* case
- Made changes to text relating to Check 21 and electronic transfers
- Edited and updated questions and problem cases

## CHAPTER 42

- Added *Swift, Inc. v. Sheffey* case
- Moved *In re Borden* case to chapter 43
- Updated the text material concerning foreclosures
- Edited and updated questions and problem cases

## CHAPTER 43

- Added new material to text concerning recent amendments to Article 9 of the UCC.
- Replaced *Charter One Auto Finance v. Inkas Coffee Distributors Realty* case with *In re Borden* case moved from Chapter 42
- Edited and updated questions and problem cases

## CHAPTER 44

- Updated all the dollar values currently in use in the Bankruptcy Code to reflect recent changes in those values
- Replaced *In re Gerhardt* case with *Kreiger v. Educational Credit Management Corporation* case
- Edited and updated questions and problem cases

## CHAPTER 45

- Removed the *F. Hoffman, Bell Atlantic, Continental, Weyerhaeuser, and Illinois Tool* cases
- Edited the *Valuepest, Leegin, Texaco, and Water Craft* case for conciseness
- Added section on reverse settlement marketing agreements
- Added 2 cases: *Federal Trade Commission v. Actavis* and *In re Vitamin C Antitrust Litigation*
- Removed the paragraph on the Act of State doctrine
- Edited and updated questions and problem cases

## CHAPTER 46

- Edited section on Consumer Financial Protection Bureau
- Added 3 new cases: *Cline v. Bank of America, NA*, *Long v. Tommy Hilfiger U.S.A., Inc.*; and *Dunham v. Portfolio Recovery Associates, LLC*

- Removed *Roberts v. Fleet Bank*; *Chuway v. National Action Financial Services, Inc.*; *Cannon v. Newmar Corp.* cases
- Edited and updated questions and problem cases

## CHAPTER 47

- Made a number of changes in the text to reflect recent developments in the law
- Replaced *United States v. Dean* case with *United States v. Southern Union Co.* case

## Pedagogy

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We have employed a number of proven pedagogical devices to aid students in their comprehension and critical analysis of the often complex topics raised in any business law course.

*Chapter Openers*—Most chapters begin with high-interest vignettes that provide a context for the law in the upcoming chapter. They generally take the form of a real-life case and are followed by a list of questions or issues that introduce the reader to the concepts presented in the chapter.

*Learning Objectives*—Succinct, crisply written learning objectives follow the chapter openers at the beginning of each chapter. The numbered objectives describe what the students can expect to learn as a result of completing the chapter. Each objective is identified by a unique symbol in the margin where the material appears in the text.

*Concept Summaries*—Each chapter contains numerous outlines, figures, or drawings that reinforce important or complex legal rules, issues, or concepts.

*Visual Illustrations*—Flowcharts and other visual illustrations are inserted in each chapter to facilitate student comprehension of key topics.

## Cases

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Textual material is supplemented by recent, high-interest cases decided by state and federal courts. Cases have been selected to illustrate practical applications of the important legal concepts introduced in each chapter. Although the cases are brief, they provide sufficient facts and analysis to clearly explain the law in action. To enhance understanding of the material, each case is placed immediately after the textual point it discusses.

## E-Commerce

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Most chapters contain one or more e-commerce boxes, cases, or sections that introduce important e-commerce and Internet law topics related to the chapter material. This key feature should enable students to more accurately identify future regulatory efforts and their implications for business.

## Ethics in Action

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Ethics in Action boxes are interspersed throughout each chapter. Appearing in the form of questions or commentaries, they should assist students in recognizing the ethical issues confronting businesspeople on a daily basis. In many chapters, these features introduce and explore various features of the *Sarbanes-Oxley Act of 2002*. These supplements to the regular textual material will permit students to more fully appreciate the complex and pervasive nature of ethical issues they will encounter in their professional lives. Finally, our increased focus on ethics is demonstrated by the continued inclusion of Chapter 3—“Business Ethics and Corporate Social Responsibility.” This chapter clearly explains the predominant theories of ethical reasoning and provides guidelines for making ethical decisions.

## International Focus

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Where relevant, the authors have inserted cases and textual material introducing the legal and business risks that often attend global operations. Through this global approach, students are taught that international issues are an integral part of business.

## AACSB Standards

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McGraw-Hill Companies is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, the authors of *Law for Business* have sought to recognize the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the Test Bank to the general knowledge and skill guidelines found in the AACSB standards.

The statements contained in *Law for Business* are provided only as a guide for the users of this text. The AACSB leaves content coverage and assessment clearly within the realm and control of the individual school, the mission of the school, and the faculty. The AACSB does charge schools with the obligation of doing assessment against their own content and learning goals. While *Law for Business* and the teaching package make no claim of any specific AACSB qualification or evaluation, we have, within the book, labeled selected questions according to the six general knowledge and skill areas. The labels or tags within *Law for Business* are as indicated. There are, of course, many more within each Test Bank, the text, and the teaching package that may be used as a standard for your course.

## Online Learning Center at [www.mhhe.com/barnes12e](http://www.mhhe.com/barnes12e)

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The Online Learning Center (OLC) is a website that follows the text chapter by chapter. The 12th edition OLC contains resources for both instructors and students:

- *PowerPoint Slides.* PowerPoint slide sets for every chapter are for use in the classroom or for studying. These slides refer back to figures and concept summaries from the text as well as introduce original material not found anywhere else.
- *Instructor's Manual.* The authors of *Law for Business* have prepared an instructor's manual providing insights into the major topics introduced in each chapter. Each case is briefly summarized and accompanied by a "Points for Discussion" section that poses ideas for stimulating classroom dialogue. This manual also includes the answers to all of the Questions and Problem Cases that appear in the text, as well as references to appropriate places within the chapter to discuss particular end-of-chapter cases.
- *Test Bank.* The Test Bank consists of true/false, multiple choice, and short essay questions in each chapter. We've aligned our Test Bank with new AACSB guidelines, tagging each question according to its learning objective, knowledge, and skill areas.
- *EZ Test Online.* McGraw-Hill's EZ Test Online is a flexible and easy-to-use electronic testing program. The program allows instructors to create tests from book-specific items, accommodates a wide range of question types, and enables instructors to add their own questions. Multiple versions of the test can be created, and any test can be exported for use with course management systems such as WebCT, Blackboard, or any other course management system. EZ Test Online is accessible to busy instructors virtually anywhere via the Web, and the program eliminates the need for them to install test software. Utilizing EZ Test Online also allows instructors to create and deliver multiple-choice or true/false quiz questions using iQuiz for iPod. For more information about EZ Test Online, please see the website at [www.eztestonline.com](http://www.eztestonline.com).

- *The Business Law Newsletter, Proceedings*. We have developed this resource to help keep your classes interesting and current. One electronic newsletter is e-mailed to you per month. Instructors across the country have told us they are looking for ways to include current examples and cases, and we hope this newsletter provides you with just that. It is meant to be an easy and effective place to turn for some new discussion topics for your business law courses. Each edition includes:
  - Article abstracts with critical thinking questions
  - Video links with discussion questions and answers
  - Case hypotheticals and ethical dilemmas (with answers)
  - Teaching tips to help you incorporate this newsletter into your class
  - Chapter key that integrates all of the above with each of our McGraw-Hill Business Law texts

# Acknowledgments

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We wish to thank the many adopters of our prior editions; we have greatly profited from their suggestions. Of course, we have had to use our judgment in determining which ones to follow. Accordingly, responsibility for any shortcomings in this edition remain ours. We do solicit the comments and criticism of instructors and students who use this edition.

The following reviewers provided ideas and insights for this edition. We appreciate their contributions.

**Rodney Chrisman**

*Liberty University*

**Peter Churchill**

*Diablo Valley College*

**Richard Fountain**

*University of West Florida*

**Patrick Griffin**

*Lewis University*

**Robert Kenagy**

*Indiana University–South Bend*

**Russell Meade**

*Tidewater Community College,*

*Chesapeake*

**Susanne Ninassi**

*Marymount University*

**Kathy Seeberger**

*Kansas State University*

**John Shelapinsky**

*Westmoreland County Community*

*College*

We also acknowledge the assistance of the following individuals at Indiana University who facilitated the preparation of the manuscript: Sarah Jane Hughes and Dennis Long of the Indiana University Maurer School of Law; Desma Jones, Lori Kale, and Thomas Snider; as well as Winfield Martin of Seattle University Law School and Andy Dworkin of OHSU.

*A. James Barnes, J.D.*

*Terry Morehead Dworkin, J.D.*

*Eric L. Richards, J.D.*

# About the Authors

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## **A. James Barnes, J.D.**

Professor of Public and Environmental Affairs and Professor of Law at Indiana University, Bloomington. He previously served as Dean of the School of Public and Environmental Affairs and has taught business law at Indiana University and Georgetown University. His teaching interests include commercial law, environmental law, alternative dispute resolution, law and public policy, and ethics and the public official. He is the co-author of several leading books on business law.

From 1985 to 1988, Professor Barnes served as the deputy administrator of the U.S. Environmental Protection Agency. From 1983 to 1985, he was the EPA general counsel, and in the early 1970s served as chief of staff to the first administrator of EPA. Professor Barnes also served as a trial attorney in the U.S. Department of Justice and as general counsel of the U.S. Department of Agriculture. For six years, from 1975 to 1981, he had a commercial and environmental law practice with the firm of Beveridge and Diamond in Washington, D.C.

Professor Barnes is a member of the Department of Energy's Environmental Management Board, a Fellow in the American College of Environmental Lawyers, and a Fellow of the National Academy of Public Administration. From 1992 to 1998, he was a member of the Board of Directors of the Long Island Lighting Company (LILCO). From 2004 to 2010, he chaired the Environmental Protection Agency's Environmental Finance Advisory Board.

## **Terry Morehead Dworkin, J.D.**

The Jack R. Wentworth Emerita Professor, Business Law, Kelley School of Business, and Visiting Professor, Seattle University School of Law. She previously served as Dean of the Office of Women's Affairs, Indiana University, and as President of the Academy of Legal Studies in Business. She also served as the co-director of the I.U. Center for International Business Education and Research (CIBER) and as the Director for the Program in European Studies at the Center for European Studies, Rijksuniversiteit Limburg in Maastricht, The Netherlands.

Professor Dworkin's primary research interests focus on employment and women's issues, particularly discrimination, whistleblowing, privacy, and leadership. She is the author of numerous articles on employment law, corporate compliance, and product liability law, and of books on business law and whistleblowing. Several of her publications have an international focus.

Professor Dworkin has significant international experience, including invited lectures on international ethics and management in various countries, teaching in Germany and The Netherlands, being a scholar at the Institute for Advanced Legal Studies in England, and presenting a workshop at the UN/NGO Forum on Women in Beijing. In 2010, she was a Fulbright Senior Specialist in Australia. She has also presented papers at a variety of international conferences.

## **Eric L. Richards, J.D.**

Professor of Business Law at Indiana University's Kelley School of Business and Chair of Kelley Direct, the Kelley School's online graduate business program. He also has served

as the Resident Director for the Program in European Studies at the Center for European Studies, Rijksuniversiteit Limburg in Maastricht, The Netherlands.

Professor Richards teaches a wide variety of law courses at both the graduate and undergraduate levels, including personal law, international business law, the legal environment of business, commercial law, and business ethics. His research interests have resulted in scholarly publications exploring antitrust law, the First Amendment and campaign finance law, international trade law, and environmental issues. For the past 30 years, he has been on the faculty of the Kelley School of Business at Indiana University. Prior to that, he was on the faculty of the Kansas University School of Business for two years.

During his academic career, Professor Richards has been awarded numerous school, university, and national awards for both his teaching and his research. He also is a martial arts grand master who has taught martial arts for more than 35 years.



# Contents in Brief

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Part

1

# Introduction to the Law

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1. Law, Legal Reasoning, and the Legal Profession
2. Dispute Settlement
3. Business Ethics and Corporate Social Responsibility
4. Business and the Constitution
5. Crimes
6. Intentional Torts
7. Negligence and Strict Liability
8. Licensing and Intellectual Property



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# Chapter 1

## Law, Legal Reasoning, and the Legal Profession



### Learning Objectives

*After you have studied this chapter, you should be able to:*

1. Identify the basic functions of law.
2. List the various sources of law.
3. Analyze a case using the four steps in the process of legal interpretation.
4. Make a legal decision by applying the three-step, *stare decisis* process.
5. Explain how law is able to change despite *stare decisis*.
6. Read a judicial decision and identify which school of legal jurisprudence the judge has followed.
7. Explain when the attorney–client privilege and work product privilege arise and when they are lost.



When a female employee complained of discrimination, her supervisor, James Twisdale, participated in the investigation by giving information to the investigating officials. Twisdale told them that he was skeptical of the woman’s claim. After the complaint was resolved in her favor, Twisdale claims that the employer retaliated against him by reducing his responsibilities. He sued the employer under *Title VII of the Civil Rights Act of 1964*. That federal statute outlaws various forms of employment discrimination and makes it unlawful to retaliate against an employee who “has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under” the statute. *Twisdale v. Snow*, 325 F.3d 950 (7th Cir. 2003).

- Which of the basic functions of law are furthered by this federal statute?
- How will the court determine if Twisdale is protected by this law?
- Is Twisdale protected by the statute?

## Introduction

---

What is law? What roles does it play in our lives? These are important questions to consider as you read this first chapter. People view law in many different ways. Some think of the police, while others think of any rules governing day-to-day behavior. Each perception is partially correct. To truly comprehend law and a legal system, one must understand the nature of the underlying society. Law is a reflection of the people, organizations, and values it simultaneously serves and controls. Never lose sight of the dynamic nature of any legal system. To survive and effectively guide, it must draw from the past, reflect the present, and pave the way for the future.

### Law in Business

Effective managers and employees must develop knowledge of both law and business because people involved in business also are involved in, and greatly affected by, the law concerning business. With each passing day, this link between law and business grows even stronger.

### Chapter Overview

This introductory chapter begins by investigating the essential features of law and the U.S. legal system. Then, after consideration of several fundamental classifications of law, attention turns to the constitutional underpinnings of the legal system. This discussion is followed by an introduction to the primary sources of law and legal reasoning (how courts decide cases). Next, there is a discussion of the important concept called *stare decisis*, which promotes orderly change within the legal system. The chapter then provides a brief look at the predominant schools of legal philosophy (legal jurisprudence) that provide a context for legal decision making. Then, after looking at the role of the legal profession, the chapter closes by introducing students to the importance of practicing preventive law.

## The Nature of Law

---

Law is much more than a set of rules. Our legal system involves processes for social control. It consists of institutions such as legislatures and government agencies for the creation of rules of behavior. It also includes police forces and courts to enforce the rules and resolve disputes. In short, the U.S. legal system encompasses a process and structure for creating, enforcing, and interpreting those rules. This section looks at the idea of rules, the reasons for having rules, and the structure that manages them.

### Legal Rules

At its most basic level, law can be seen as rules that limit people's freedom of action. These rules may be called "laws," "statutes," or "ordinances." The label doesn't really matter. The important thing they have in common is that they require people to conform their behavior to some particular standard. This concept of law may be viewed as a **set of principles** that

1. Have **general application** to society.
2. Were developed by a **legitimate authority** within society.
3. May threaten **sanctions** against those who fail to comply with the principles.

## Functions of Law

The basic functions of law are



1. Keeping the peace.
2. Enforcing to maintain order.
3. Facilitating planning.
4. Promoting social justice.

For instance, laws against underage consumption of alcoholic beverages establish certain standards of conduct in an attempt to maintain order and, perhaps, keep the peace. Those functions—*keeping the peace* and *enforcing standards of conduct to maintain order*—help further another function of law that is especially important: *facilitating planning*. Contract law is an example of this function. In making the courts available to enforce contracts, the legal system ensures that parties to contracts either carry out their promises or pay for the damages they cause. For example, through contracts, a manufacturing company can count on either receiving the raw materials and machinery it has ordered or else getting money from the contracting supplier to cover the extra expense of buying substitutes.

While all societies use law to keep peace and maintain order, societies such as ours also use the law to achieve additional goals. The tax laws, for example, seek not only to raise revenue for government expenditure but also to redistribute wealth by imposing higher inheritance and income taxes on wealthy people. The government also may tax certain activities in order to discourage them. Taxes on tobacco products have this intent. The anti-trust laws seek to prevent certain practices that might reduce competition and thus increase prices. The Civil Rights Act is designed to promote social justice.

### Concept Summary: The Nature of Law



#### Definition

A set of principles, rules, and standards of conduct that

1. Have general application in the society
2. Have been developed by an authority for that society
3. Have an associated penalty imposed upon violations

#### Functions of Law

Keeping the peace  
Enforcing standards of conduct to maintain order  
Facilitating planning  
Promoting social justice

The function of these statutes is to *promote social justice* by protecting the disadvantaged. Courts, in applying the law, also seem to be seeking to balance the scales to benefit the “little guy” in dealing with big business, big labor, and big government. Helping the ordinary citizen to deal with a very complex and quite impersonal economy also is the objective of federal legislation establishing social security, welfare, housing, and medical programs.

## Classifications of Law

There are many ways to subdivide the law. One is to distinguish between substantive law and procedural law. Another important distinction is between criminal and civil law. This section examines these legal classifications.

## Substantive versus Procedural Law

**Substantive law** sets out the rights and duties governing people as they act in society. *Duties* tend to take the form of a command: “Do this!” or “Don’t do that!” An example is the Civil Rights Act of 1964. It tells employers that they must not discriminate among people in hiring and employment on the basis of race, color, religion, sex, or national origin.

Substantive law also establishes *rights and privileges*. An example is the freedom of speech granted by the U.S. Constitution. Another is the right you have to defend yourself if physically attacked—the so-called right of self-defense. A slightly different example is the privilege of receiving food stamps if you meet the qualifications set up by the government.

**Procedural law** establishes the rules under which the substantive rules of law are enforced. Rules as to what cases a court can decide, how a trial is conducted, and how a judgment by a court is to be enforced are all part of procedural law.

### Ethics in Action



Can you think of an example of a duty imposed by substantive law that might violate some moral or ethical belief of an individual? How should such conflicts be resolved? Consider the following case: Two clinics operated in Fargo, North Dakota. One performed abortions while the other provided only pregnancy tests and antiabortion counseling services. However, the antiabortion clinic used a name similar to that of the abortion clinic in order to confuse the public into mistakenly contacting the wrong clinic. Further, it misled the public into believing that it performed abortions, and then, when women seeking abortions arrived, they were given antiabortion materials. After the antiabortion clinic started these tactics, there was a considerable decline in the abortion clinic’s business. The jury found that the antiabortion clinic violated the state’s false advertising statute.<sup>1</sup>

## Criminal versus Civil Law

**Criminal law** defines breaches of duty to society at large. It is society, through government employees called *prosecutors* (such as district attorneys), that brings court action against violators. If you are found guilty of a crime such as theft, you will be punished by imprisonment or a fine. When a fine is paid, the money generally goes to the state, not to the victim of the crime. A criminal conviction generally is not possible unless it can be shown that an individual violated the terms of a published statute. This is because it is not believed to be fair to punish people unless they should have known that their behavior was illegal. Consider the next case which involves an unsuccessful criminal prosecution.

Private duties owed by one person (including corporations) to another are established by **civil law**. For example, we have a duty to carry out our contractual promises. Tort law defines a host of duties people owe to each other. One of the most common is a duty to exercise reasonable care with regard to others. Failure to do so is the tort of negligence.

<sup>1</sup> *Fargo Women’s Health Organization v. FM Women’s Help and Caring Connection*, 444 N.W.2d 683 (N.D. Sup. Ct. 1989).

# United States v. Farinella

558 F.3d 695 (7th Cir. 2009)

## FACTS

Farinella bought 1.6 million bottles of “Henri’s Salad Dressing” produced by Unilever. The label on each bottle said “best when purchased by” followed by a date that had been picked by Unilever. Because the “best when purchased by” date was approaching, Farinella pasted on each bottle a new label that displayed a later date. He then resold the salad dressing to discount stores. As a result, he was charged with the crime of introducing into interstate commerce misbranded food with the intent to mislead. Selling salad dressing after the “best when purchased by” date does not endanger human health. Henri’s Salad Dressing is edible a decade or more after it is manufactured. There also is no evidence of any regulation by any government body that defines “best purchased by” or forbids a wholesaler or retailer to change the date. However, at the trial an official from the Food and Drug Administration (FDA) testified that FDA approval is necessary to change labels and that no such approval was given to Farinella.

## ISSUE

Should Farinella be convicted of the crime of misbranding food?

## DECISION

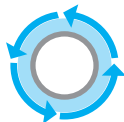
No. The testimony by the FDA official should not have been admitted into evidence. If there is a requirement that the FDA’s approval must be obtained before a “best when purchased by” date may be changed, it would, to be a lawful predicate of a criminal conviction, have to be found in some statute or regulation, or at least in some written interpretive guideline or opinion, and not just in the oral testimony of an agency employee. It is a denial of due process of law to convict a person of a crime because he violated some bureaucrat’s secret understanding of the law. The idea of secret laws is repugnant. People cannot comply with laws the existence of which is concealed. We do not suggest that a novel fraud can never be punished as a crime. But to prove a person guilty of having made a fraudulent representation, a jury must be given evidence about the meaning (unless obvious) of the representation claimed to be fraudulent, and that was not done here.

Suit for the breach of a civil duty must be brought by the person wronged. Generally, the court does not seek to punish the wrongdoer but rather to make the wronged party whole through a money award called *damages*. For example, if someone carelessly runs a car into yours, that person has committed the civil wrong (tort) of negligence. If you have suffered a broken leg, you will be able to recover damages from the driver (or his or her insurance company). The damages will be an amount of money sufficient to repair your auto, to pay your medical bills, to pay for wages you have lost, and to give you something for any permanent disability such as a limp. Damages for “pain and suffering” also may be awarded.

Although the civil law generally does not aim to punish, there is an exception. If the behavior of someone who commits a tort is outrageous, that person can be made to pay *punitive damages* (also called *exemplary damages*). Unlike a fine paid in a criminal case, punitive damages go to the injured party. (Some states require that a portion of a punitive damage award be placed in a public fund to assist various social causes.)

Sometimes, the same behavior can violate both the civil law and the criminal law. For instance, a person whose drunken driving causes the death of another may face both a criminal prosecution by the state and a civil suit for damages by the survivors of the victim. If both suits are successful, the driver would pay back society for the harm done with a criminal fine and/or prison sentence and compensate the survivors with the payment of money damages.

## Concept Summary: Criminal versus Civil Law



	Criminal Case	Civil Case
<b>Elements</b>	Intentional violation of a statute	Harm to another person or property (tort) or breach of a contract
<b>Actors</b>	Prosecutor v. Defendant (government) (accused)	Plaintiff v. Defendant (wronged party) (party causing harm)
<b>Punishment</b>	Fines, imprisonment, execution	Defendant may have to pay the plaintiff compensatory and punitive damages

## Constitutional Foundations

Although law is made and enforced by the government, it also defines and organizes the government. To understand the American legal system, you need to be familiar with the constitutional foundation of American government. A very brief review is presented here.

### Checks and Balances

The original 13 colonies became sovereign (independent) nations after they won independence from England. Although people in each state were fearful their state might be dominated by other states with different interests, they came to realize the federal government needed more power than had been given to the Continental Congress. So, the founders set up a system of **checks and balances** between the powers of the states and those of the federal government. However, they also wrote the *supremacy clause* into the Constitution. It declares that where state laws conflict with legitimate federal laws, federal law shall prevail.

The founders also devised a system of checks and balances within the federal government. They established three equal branches of government—the legislative, executive, and judicial branches—which have different but complementary functions. As a check on the passage of statutes that might be ill advised, proposals will not become law unless the president and both houses of Congress approve them. A two-thirds majority is required in each house to override a veto by the president. Furthermore, Congress itself cannot enforce a statute; that is left to the executive and judicial branches. The initiative for enforcement must be taken by the executive branch—originally the attorney general.

Today, regulatory agencies take the lead in enforcing certain statutes. However, the executive must go to the judicial branch to punish violations of a statute. Also, it is this branch—the judicial—that interprets statutes and other sources of law.

### Constitutional Powers

Under the Constitution, laws enacted by Congress are invalid if the Constitution does not give Congress the power to pass that kind of legislation or if the Constitution prohibits such a law. These restraints are also a part of the system of checks and balances.

Most federal regulations are based on power given to Congress under the Constitution's **Commerce Clause**, which permits Congress to regulate interstate and foreign commerce. Supreme Court decisions since the 1930s generally have interpreted that power very broadly. For example, the Civil Rights Acts were passed under the Commerce Clause power; so was the Clean Air Act.

The federal **taxing power** has been used to regulate business activities. For example, high import duties can be used to shut off the importation of certain foreign goods. In addition, the income tax laws (the Internal Revenue Code) are used to regulate behavior. When the government wishes to encourage certain kinds of investments, it offers tax credits.

## Constitutional Limitations

Many prohibitions against government regulation are contained in the **Bill of Rights** (the first 10 amendments to the Constitution). These amendments guarantee certain rights to the people, including the familiar rights of free speech, freedom of religion, and the privilege against unreasonable search and seizure.

Judicial interpretations of the protections offered by the Constitution have varied throughout history. At one time the **Due Process Clause** of the Fourteenth Amendment was construed to prohibit many types of business regulation by state governments. Its statement that a person's liberty shall not be taken without due process was interpreted to be a guaranty of almost total freedom of contract. Under this approach, judges regularly held state and federal regulations unconstitutional. Interpretations of the law change over time, however, and today few statutes regulating business activity are found to violate the Due Process Clause.

## Federalism

Under the notion of **federalism**, the United States is composed of 51 different legal systems. The Constitution established a federal government with limited powers rather than a national government. This variety of legal systems is part of the concept of checks and balances. There is a federal legal system, and each state has its own system. However, as noted earlier, when there is conflict between the two systems, the federal rules prevail. This, of course, assumes the federal government is acting under one of the powers granted to it by the Constitution.

## Sources of Law

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There are numerous sources of law within each of the 51 systems. The primary sources are



1. Constitutions
2. Treaties
3. Statutes
4. Administrative rules and decisions
5. Executive orders
6. Judicial decisions
7. Private law

## Constitutions

The U.S. Constitution is the highest source of law in the United States. Every other form of law must be consistent with the Constitution or it will be struck down by the courts. Each state also has a constitution that is similar to the U.S. Constitution in the design of the government it provides. However, many of them are much more specific and detailed. As a result, they are not as adaptable to changing conditions as the U.S. Constitution, and many have been completely rewritten one or more times. The U.S. Constitution, on the