Business Law

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OPENSTAX, NICOLET COLLEGE, AND SAYLOR ACADEMY

This textbook has been adapted from OpenStax's Business Law I Essentials and sections of Saylor's The Legal and Ethical Environment of Business to align with Nicolet College curriculum.

Contents

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

This may all be true. However, it is really important for those in the business world to understand the legal environment in which they are operating. While you may have the best intentions and be truly diligent in your efforts to do business fairly, inevitably conflicts will arise in everyday business dealings.

The goals of this book are practical. Try to conceptualize your study of the legal environment of business as a map by which you must navigate your business dealings. We want to teach you how to read this map so that you are able to understand the law and how it affects your business and your life. Besides limiting legal liability proactively, an understanding of the law can also help you avoid serious missteps.

This book is a compilation of Open resources from several companies and has been edited by the staff at Nicolet College's Business Management team.

Indigenous Land Acknowledgement

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Nicolet College recognizes the unique, enduring relationships that exist between Indigenous peoples and their traditional lands. In doing so, Nicolet College looks to respectfully acknowledge that our institution is located on the traditional homelands of the Potawatomi (Bodwe'wdomi), Ojibwe' (Anishinaabe') and Menominee (Omaeqnomene) people and their respective nations.

Throughout modern history, the story of Native people has been suppressed, misrepresented, ignored, and in many instances, altogether erased. Confronting the past, while laying the groundwork for a shared future, we believe we can better provide a climate that is welcoming, inclusive, and respective of Native languages, history, culture, and American Indian learners.

At Nicolet, we are committed to prioritizing curriculum and access to accurate historical information, building trust and relationships among our tribal communities, implementing and validating the value indigenous knowledge and wisdom holds for today's society.

– *Land Acknowledgement was crafted by Susie Crazy Thunder- Nicolet College*

CHAPTER I

AMERICAN LAW AND THE LEGAL SYSTEM

This chapter provides an overview of the legal system. The following will be covered in this chapter:

Competency	**Explain the importance of law to society and to business. Explain the foundational concepts of law.**
Criteria	Explain the importance of law
Criteria	List and define the major sources of law in the US
Criteria	Describe the Commerce Clause

1. Basic American Legal Principles

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Background on Law

The American legal system has its roots in the **British legal system.** It was developed with the purpose of establishing standards for acceptable conduct, proscribing punishment for violations as a deterrent, establishing systems for enforcement, and peacefully resolving disputes. The ultimate goal of the American legal system is promotion of the common good.

Establishing Standards

The American legal system was developed with the goal of establishing a set of standards that outline what is to be considered minimally acceptable behavior. Broadly speaking, federal laws are those that all United States citizens are expected to follow. State and local laws may often be similar to federal laws, but they may also differ quite a bit, and only govern the state's citizens and sometimes those doing business in the state.

Figure 1.2 The American legal system is designed to establish a set of standards for acceptable behavior. (Credit: joergelman/ pixabay/ License: CC0)

Promoting Consistency

The American legal system follows the British Common Law system, which is designed to leverage past judicial reasoning, while also promoting fairness through consistency. Judges in the Common Law system help shape the law through their rulings and interpretations. This body of past decisions is known as case law. Judges use case law to inform their own rulings. Indeed, judges rely on precedent, i.e., previous court rulings on similar cases, for ruling on their own cases.

Maintaining Order

Congruent with the goal of establishing standards and promoting consistency, laws are also used to promote, provide, and maintain order.

Resolving Disputes

Conflicts are to be expected given people's varying needs, desires, objectives, values systems, and perspectives. The American legal system provides a formal means for resolving conflicts through the courts. In addition to the federal court and individual state systems, there are also several informal means for resolving disputes that are collectively called alternative dispute resolution (ADR). Examples of these are mediation and arbitration.

Protecting Liberties and Rights

The United States Constitution and state laws provide people with many liberties and rights. American laws operate with the purpose and function of protecting these liberties and rights from violations by persons, companies, governments, or other entities.

Based on the British legal system, the American legal system is divided into a federal system and a state and local system. The overall goal of both systems is to provide order and a means of dispute settlement, as well as to protect citizens' rights.

Clearly, the purposes of the American legal system are broad and well-considered.

2. Sources and Types of Law

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The American legal system is made up of many forms of law, with the United States Constitution being the pre-eminent source of American law. The Constitution establishes the boundaries of federal law, and it must be followed by all citizens, organizations, and entities. It includes Congressional acts, Senate-ratified treaties, executive regulations, and federal case law. The United States Code ("USC") compiles these laws.

For more info on the United States Code, check out:

https://uscode.house.gov

The main sources of American law are constitutional law, statutory law, administrative law, and common law.

Constitutional Law

The federal government and the states and indeed, American Indian sovereign nations, have written **constitutions t**hat set forth the general organization, powers and limits of their respective governments. The **United States Constitution** is the supreme law of the land. The U.S. Constitution created the structure of our federal government. Among other things, it sets forth the three branches—the legislative, executive, and judicial branches. The Constitution's first ten amendments are referred to as the Bill of Rights, which offers specific protections of individual liberty and justice. Additionally, the Bill of Rights restricts certain powers of government. The Constitution empowers federal law making by giving Congress the power to enact statutes for certain limited purposes, like regulating interstate commerce. The United States Code officially compiles and codifies the federal statutes.

A law in violation of the U.S. Constitution will be declared unconstitutional and will not be enforced, no matter what its source. The Founding Fathers created a federal system that would, at times, "preempt" state law through the supremacy clause, outlined in Article VI of the Constitution. In other words, since the U.S. Constitution is the "supreme law of the land;" if a state law conflicts with the U.S. Constitution, the state law is declared invalid. When the federal constitutional law prevails over the state law, it is said that the state law has been preempted. Before that determination is made, the courts try to determine if Congress intended to preempt state law in enacting the particular provision in question. If the answer is "no," then those who are asserting protections of state law may make claims under state law. If the answer is "yes," however, federal law prevails.

Figure 1.3 The U.S. Constitution is known as the supreme law of the land. (Credit: lynn0101/ pixabay/ License: CC0)

In addition to the individual constitutions established in each state, the U.S. Constitution sets out the fundamental rules and principles by which the country and individual states are governed. Constitutional law is the term used to describe the powers and limits of the federal and state governments as established in the Constitution. The political system that divides authority to govern between the state and federal governments is known as federalism, and this too is established in the Constitution. The Tenth Amendment states that any area over which the federal government is not granted authority through the Constitution is reserved for the state. This statement means that any federal legislation impacting business and commerce must be established by an expressed constitutional grant of authority.

The Tenth Amendment to the Constitution gives the states powers over areas of law not held exclusively by the federal government through the U.S. Constitution, e.g., states can make laws about how to get married, who may get married, or how to dissolve a marriage, as well as which activities are crimes and how the crimes will be punished. If the U.S. Constitution does give the federal government some power, however, then the federal government may exercise it, free from state interference. For instance, the U.S. Congress (the legislative branch of the federal government) has the power, among other things, to coin money, to create a military, to establish post offices, and to declare war. Since there is specific mention of these powers, states may not create their own currency, military, or postal service, and they may not declare war.

Statutory Federal and State Law

Laws enacted by legislative bodies at any level of the government, such as statutes passed by Congress or by state legislatures, make up the body of law referred to as **statutory law**. When a legislature passes a statute, that statute is included in the federal code of laws or the relevant state code of laws. The Constitution empowers federal law making by giving Congress the power to enact statutes for certain limited purposes, like regulating interstate commerce. Federal law preempts conflicting state and local laws.

Statutory law also includes **local ordinances** – regulations passed by municipal or county governing units to deal with matters not covered by federal or state law. Ordinances commonly have to do with city or county land use, building and safety codes.

There are certain **"Uniform Laws"** that fall under statutory law. These are laws that were developed for states to consider adopting. Each state has the option of adopting or rejecting a uniform law One of the most important Uniform Acts is the **Uniform Commercial Code (UCC)** which you will hear much about in this class. The UCC facilitates commerce among the states.

Administrative Law (Regulations)

These are the rules, orders and decisions of **administrative agencies**. An administrative agency is a federal, state, or local government agency established to perform a specific function. Laws differ from regulations in that laws are passed by either the U.S. Congress or state congresses. **Regulations**, by contrast, are standards and rules adopted by administrative agencies that govern how laws will be enforced.

Federal agencies often enjoy broad rulemaking authority when Congress acts to grant them this power. Called "regulations," these agency rules normally carry the force of law, as long as they demonstrate a reasonable interpretation of the relevant statutes. For example, the Environmental Protection Agency (EPA) has established regulations for businesses and their emission and disposal of pollutants to protect the environment. The EPA has the authority to enforce these regulations when a business violates them, and such enforcement is usually done by fining the company or by using other means.

The Administrative Procedure Act (APA) enables the adoption of regulations, which are codified and incorporated into the Code of Federal Regulations (CFR). Federal agencies frequently draft and distribute forms, manuals, policy statements, letters, and rulings. Though these may be considered as persuasive authority by the courts, they do not carry the same force as law. In other words, if a person or business questions a regulation of a government agency, saying it is unconstitutional, and that party is successful in proving it, then the regulation is not enforced and the agency will need to revise it or remove it.

Common Law

Common law is judge-made law. As discussed in the previous section, the United States follows the common law legal tradition of English law. Judges in the Common Law system help shape the law through their rulings and interpretations. This body of past decisions is known as **case law**, which is used by judges to inform their own rulings. In fact, judges rely on **precedent**, i.e., previous court rulings on similar cases, when determining the ruling in their own cases.

An example of how case law works is the case of the *State v. Wayfair Inc.* (2017 SD 56, 901 N.W.2d 754 (S.D. 2017), cert. granted, 138 S. Ct. 735 (2018)), in which the South Dakota Supreme Court held that a state law requiring internet retailers without an in-state physical presence to remit sales tax was unconstitutional. Unless this ruling is overruled by the United States Supreme Court, then it becomes part of the case law and precedent set in that state, and it will be followed by subsequent rulings when similar cases are filed.

3. Important Business Laws and Regulations

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Business law is a very expansive area of the law. Business law consists of many legal disciplines, including contracts, tax law, corporate law, intellectual property, real estate, sales, immigration law, employment law, bankruptcy, and others.

Figure 1.4 Contract law is just one type of law that businesses need to be concerned about. (Credit: edar/ pixabay/ License: CC0)

Some of the most important business law areas are disputes and dispute settlement, business ethics and social responsibility, business and the United States Constitution, criminal liability, torts, contracts, labor and employment law, Unfair Trade Practices and the Federal Trade Commission, international law, and securities regulation. Although many of these are discussed in much more depth in later chapters, the following gives a brief overview.

Disputes and Dispute Settlement

In addition to the federal court and individual state systems, there are also a variety of mechanisms that companies can use to resolve disputes. They are collectively called alternative dispute resolution ("ADR"), and they include mediation, settlement, and arbitration. Many states now require companies to resolve legal disputes using ADR before the initiation of any lawsuit to encourage speedy resolution, cost and time containment, and reduced judicial dockets. Traditional litigation remains an option in most cases if other efforts fail or are refused.

Business Ethics and Social Responsibility

In the routine course of business, employees are often required to make decisions. Business ethics outline the ethical model, or framework, that companies expect employees to follow when making these decisions, as well as the behavior that the companies deem acceptable. Sound and ethical decision making can also help companies avoid legal liability and exposure. Typically, an ethics code and/or a code of conduct details a company's requirements and guidelines, while also serving as a key corporate governance tool.

In addition to business ethics, companies must also consider their social responsibility and the laws related to it, such as consumer and investor protections, environmental ethics, marketing ethics, and ethical issues in financial management.

Business and the United States Constitution

Since the start of the 20th century, broad interpretations of the Constitution's Commerce and Spending Clauses have expanded the reach of federal law into many areas. Indeed, its reach in some areas is now so broad that it preempts virtually all state law. Thus, the Constitution's Commerce Clause has been interpreted to allow federal lawmaking and enforcement that applies to many aspects of business activity. Additionally, the Constitution's Bill of Rights extends some protections to business entities that are also constitutionally guaranteed to individuals

For example, on January 21, 2010, in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010), the U.S. Supreme Court heard the issue of whether the government can ban political spending by corporations in candidate elections. The Court ruled that corporations have the same Constitutional right to free speech as individuals, and thus lifted the restrictions on contributions.

Criminal Liability

The imposition of criminal liability is one method used to regulate companies. The extent of corporate liability found in an offensive act determines whether a company will be held liable for the acts and omissions of its employees. Criminal consequences may include penalties, such as prison, fines and/or community service. In addition to criminal liability, civil law remedies are usually available, e.g., the award of damages and injunctions, which may include penalties. Most jurisdictions apply both criminal and civil systems.

Torts

Within the business law context, torts may involve either intentional torts or negligence. Additionally, companies involved in certain industries should consider the risk of product liability. Product liability involves a legal action against a company by a consumer for a defective product that caused loss or harm to the customer. There are several theories regarding recovery under product liability. These include contract theories that deal with the product warranty, which details the promises of the nature of the product sold to customers. The contract product warranty theories are Express Warranty, Implied Warranty of Merchantability, and Implied Warranty of Fitness. Tort theories deal with a consumer claim that the company was negligent, and therefore caused either bodily harm, emotional harm, or monetary loss to the plaintiff. The tort liability theories that can be used in this context are negligence (failure to take proper care in something), strict liability (imposition of liability without a finding of fault), and acts committed under Restatement (Third) of Torts (basic elements of the tort action for liability for accidental personal injury and property damage, as well as liability for emotional harm).

Contracts

The main function of a contract is to document promises that are enforceable by law. The key to an agreement or contract is that there must be an offer and acceptance of the terms of that offer. Sales contracts normally involve the sale of goods and include price terms, quantity and cost, how the terms of the contract will be performed, and method of delivery.

Employment and Labor Law

Employment and labor law is a very broad discipline that covers a broad array of laws and regulations involving employer/employee rights and responsibilities in the workplace. This law includes worker protection and safety laws, such as OSHA, and worker immigration laws, such as the Immigration Reform and Control Act, which imposes sanctions on employers for knowingly hiring illegal immigrants. Other notable areas of employment and labor law include, but are not limited to, the National Labor Relations Act, which deals with union and management relations, as well as Equal Opportunity in Employment laws, which provide workers with protections against discrimination in the workplace, e.g., Title VII, the Americans with Disabilities Act, Age Discrimination in Employment Act, and others.

Antitrust Law

Antitrust legislation includes both federal and state laws regulating companies' conduct and organization. The purpose of such regulation is to allow consumers to benefit from the promotion of fair competition. The main statutes implicated by antitrust law are the Sherman Act of 1890, the Clayton Act of 1914, and the Federal Trade Commission Act of 1914. These Acts discourage the restraint of trade by prohibiting the creation of cartels and other collusive practices. Additionally, they encourage competition by restricting the mergers and acquisitions of certain organizations. Finally, they prohibit the creation and abuse of monopoly power.

Actions may be brought in courts to enforce antitrust laws by the Federal Trade Commission ("FTC"), the U.S. Department of Justice, state governments, and private parties.

Unfair Trade Practices and the Federal Trade Commission

The term "unfair trade practices" is broadly used and refers to any deceptive or fraudulent business practice or act that causes injury to a consumer. Some examples include, but are not limited to, false representations of a good or service including deceptive pricing, non-compliance with manufacturing standards, and false advertising. The FTC investigates allegations of unfair trade practices raised by consumers and businesses, pre-merger notification filings, congressional inquiries, or reports in the media and may seek voluntary compliance by offending businesses through a consent order, administrative complaints, or federal litigation.

Securities Regulation

Securities regulation involves both federal and state regulation of securities and stocks by governmental regulatory agencies. At times, it may also involve the regulations of exchanges like the New York Stock Exchange, as well as the rules of self-regulatory organizations like the Financial Industry Regulatory Authority (FINRA).

The Securities and Exchange Commission (SEC) regulates securities on the federal level. Other instruments related to securities, such as futures and some derivatives, are regulated by the Commodity Futures Trading Commission (CFTC).

4. Commerce Clause

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Figure 4.2 The United States Constitution is the supreme law of the land. (Credit: 1778011/ pixabay/ License: CC0)

The main source of authority for the federal regulation of interstate and international commerce is the **commerce clause**. This clause is established in Article I, Section 8, of the Constitution. The Article grants Congress the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Thus, the commerce clause serves to simultaneously empower the federal government, while limiting state power.

So long as a federal regulation impacts **interstate commerce**, that regulation can be described as constitutional, according to the commerce clause. However, since the Constitution was first written, there have often been occasions when the judiciary system has needed to step in to interpret the meaning and implications of the commerce clause. In particular, there have been disputes over the intended meaning of the phrase "among the several States." Up until the 1930s, this phrase was interpreted in a literal way, so that activities subject to federal regulation were required to involve trade between the states. This strict interpretation actually served to limit the federal regulation of commerce.

The turning point in the interpretation of the commerce clause came with the 1937 case, *NLRB v. Jones & Laughlin Steel Corp*. The previous year, in the *Carter v. Carter Coal Co* case, the court invalidated a program, initiated under the New Deal, that had tried to regulate the labor practices of coal firms on the basis that these practices were local, and therefore had only an indirect impact on interstate commerce. In *NLRB v. Jones & Laughlin Steel Corp*, the court deviated from that decision by ruling that Congress could regulate employment practices at a steel plant because any stoppages at that plant would have a serious, detrimental impact on interstate commerce. The court concluded that since the steel industry is a networked industry that incorporates mines, plants, and factories from Minnesota to Pennsylvania, the manufacturing of steel properly falls under the jurisdiction of the commerce clause. In summing up, the court concluded that:

"Although activities may be intrastate in character when separately considered, if they have such a close and substantial relationship to interstate commerce that their control is essential or appropriate to protect that commerce from burdens or obstructions, Congress cannot be denied the power to exercise that control" (NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 1937).

Challenges to and Reinterpretations of the Commerce Clause

Ever since the *NLRB v. Jones & Laughlin Steel Corp* case, Congress has invoked the commerce clause to rule on a diverse range of business and commercial activities, as well as to support social reforms that indirectly impact state commerce. Examination of the United States Code reveals that there are more than 700 legislative provisions that explicitly refer to foreign or interstate commerce. What is perhaps most remarkable is the sheer diversity of statutory areas covered by the commerce clause. Areas covered include the regulation of sporting activities, endangered species, energy regulation, gambling, firearms control, and even terrorism.

Examples of Federal Legislation Passed by Invoking the Commerce Clause

- The Controlled Substances Act
- The Federal Mine Safety and Health Act
- The Civil Rights Act
- Americans with Disabilities Act
- The Indian Child Welfare Act

While businesses have often challenged these statutes as existing outside of the realm of congressional authority, in most cases, the courts have upheld the statutes as being valid exercises of congressional power in line with the commerce clause. An exception is the 1995 case, *United States v. Lopez*. The case centered around the legality of the Gun-Free School Zone Act, which was a federal law that outlawed the possession of guns within 1,000 feet of a school. In a landmark case, the Court ruled that the Act was outside the scope of the commerce clause, and that Congress did not have the authority to regulate in an area that had "nothing to do with commerce, or any sort of enterprise."

A recent controversy pertaining to the commerce clause relates to the passing of the Affordable Care Act, as described earlier. Protestors claimed that the individual mandate aspect of the ACA should be treated as a regulation that affects interstate commerce. According to their argument, after the Act was implemented, there would be an increase in the sale and purchase of health care insurance, such that the market for health care should be seen as being significantly impacted by the Act. However, the Chief Justice of the Supreme Court, Justice Roberts, ruled that actions that create new business activity do not affect interstate commerce.

Police Power and the Dormant Commerce Clause

The authority of the federal government to regulate interstate commerce has, at times, come into conflict with state authority over the same area of regulation. The courts have tried to resolve these conflicts with reference to the **police power of the states.**

Police power refers to the residual powers granted to each state to safeguard the welfare of their inhabitants. Examples of areas in which states tend to exercise their police power are zoning regulations, building codes, and sanitation standards for eating places. However, there are times when the states' use of police power impacts interstate commerce.

If the exercise of the power interferes with, or discriminates against, interstate commerce, then the action is generally deemed to be unconstitutional. The limitation on the authority of states to regulate in areas that impact interstate commerce is known as the **dormant commerce clause.**

In using the **dormant commerce clause** to resolve conflicts between state and federal authority, the courts consider the extent to which the state law has a legitimate purpose. If it is determined that the state law has a legitimate purpose, then the court tries to determine whether the impact on interstate commerce is in the interest of the citizens of the state, and will rule accordingly. For instance, an ordinance that banned spray paint, issued in the city of Chicago, was challenged by paint manufacturers under the dormant commerce clause, but was ultimately upheld by the U.S. Court of Appeals because the ban was intended to reduce graffiti and related crimes.

Today, Congress uses its authority to regulate commercial activity in four general areas relating to the commerce clause:

1. Regulation of the channels of interstate commerce
2. Regulation of the instrumentalities of interstate commerce
3. Regulation of intangibles and tangibles that cross state lines
4. Regulation of activities that are deemed to be both economic and to have a substantial impact on interstate commerce

Area of Regulation	Explanation	Examples
Regulation of the **channels** of interstate commerce	Channels of interstate commerce describe the passages of transportation between the states. Thus, the commerce clause authorizes Congress to regulate activities pertaining to the nation's airways, waterways, and roadways, and even where the activity itself takes place entirely in a single state.	For example, Congress can pass regulations that restrict what can be carried on airlines or on ships.
Regulation of the **instrumentalities** of interstate commerce	Instrumentalities of commerce are understood to be any resource employed in the carrying out of commerce. Examples of these resources are machines, equipment, vehicles, and personnel. Thus, Congress has the power to regulate these areas.	Congress could pass regulations mandating certain safety standards for equipment used in manufacturing plants.
Regulation of intangibles and tangibles that **cross state lines**	Any object, tangible or intangible, that crosses state lines can be regulated under the commerce clause. Tangible objects include goods purchased by consumers, as well as raw materials and equipment used in the production of goods for sale. Intangible objects include services, as well as electronic databases.	The Driver's Privacy Protection Act (DPPA) regulates the sale of information contained in the Department of Motor Vehicles' (DMV's) records.
Regulation of activities that are deemed to have a **substantial impact** on interstate commerce	Federal regulation of economic commercial activity expected to have a significant (as opposed to minor) effect on interstate commerce is constitutional, according to the commerce clause. Noneconomic commercial activity is not covered.	The courts in the United States vs. Lopez case described earlier deemed the Act to be unconstitutional because its terms have "nothing to do with 'commerce' or any sort of economic enterprise."

Table 4.1

5. Constitutional Protections

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The **Bill of Rights** is the common term given to the **first 10 amendments to the U.S. Constitution.** These are not the only set of amendments to the Constitution, but they are considered together as impacting rights because they limit the ability of the federal government to infringe upon individual freedoms. In addition, a later amendment, the Fourteenth Amendment, extends the provisions set out in the Bill of Rights to the states, in addition to federal government. The Bill of Rights has a substantial impact upon government regulation of commercial activity, and therefore, it is important to fully understand it.

A summary of the provisions of the Bill of Rights is supplied below:

Amendment	Provision
First	Ensures that U.S. citizens have the right to freedom of speech, press, religion, and peaceable assembly. Provides citizens with the right to appeal to government to redress grievances.
Second	Establishes that the government cannot infringe upon citizens' right to bear arms. Establishes the importance of a militia for national security.
Third	Establishes that the government cannot quarter soldiers in private houses during peacetime or wartime.
Fourth	States that government can only issue warrants with probable cause and protects U.S. citizens from unwarranted search and seizure.
Fifth	Establishes rights of due process. Ensures that indictment of a grand jury is necessary to put a citizen on trial and grants citizens the right not to testify against themselves.
Sixth	Provides citizens with the right to an expeditious public trial, the right to an attorney, and the right to an impartial jury.
Seventh	States that citizens have the right to a trial by jury for common lawsuits involving monetary value of $20.
Eighth	Prohibits cruel and unusual punishment, prevents the imposition of excessive fines, and states that the government cannot set bail at excessive amounts.
Ninth	States that the rights set out in the Bill of Rights do not remove any other rights granted to citizens.
Tenth	States that any area over which the federal government is not granted authority through the Constitution is reserved for the states.

Table4.2

Application of the Bill of Rights to Commercial Activity

The protections afforded the citizenry in the Bill of Rights are also extended to corporations and commercial activities. In the next sections, some applications of the various amendments in the area of business are discussed.

The First Amendment

The freedom of speech provisions in the First Amendment have application to corporations. The courts distinguish between different types of speech, and each has implications for the power of the federal government and states to regulate in these areas:

1. Corporate Political Speech. Political speech is any speech used to support political agendas or candidates. Until the 1970s, several states prevented firms from financially supporting political advertising because they feared the power of corporate assets. However, since the 1978 case First National Bank of Boston v. Bellotti, it has been established that corporate political speech is protected in the same way as citizens' free speech.
2. Unprotected Speech. The 1942 case Chaplinsky v. New Hampshire determined that certain types of speech—that which could "inflict injury or incite an immediate breach of the peace"—is not protected under the First Amendment. Therefore, obscenities, defamation, and slanderous speech are not protected.
3. Commercial Speech. This type of speech conveys information pertaining to the sale of goods and services. Ever since the 1980 case Hudson Gas & Electric Corp v. Public Service Commission of New York, a four-part test has been established to determine whether commercial speech should be regulated according to the First Amendment. This test is known as The Central Hudson Test for Commercial Speech.

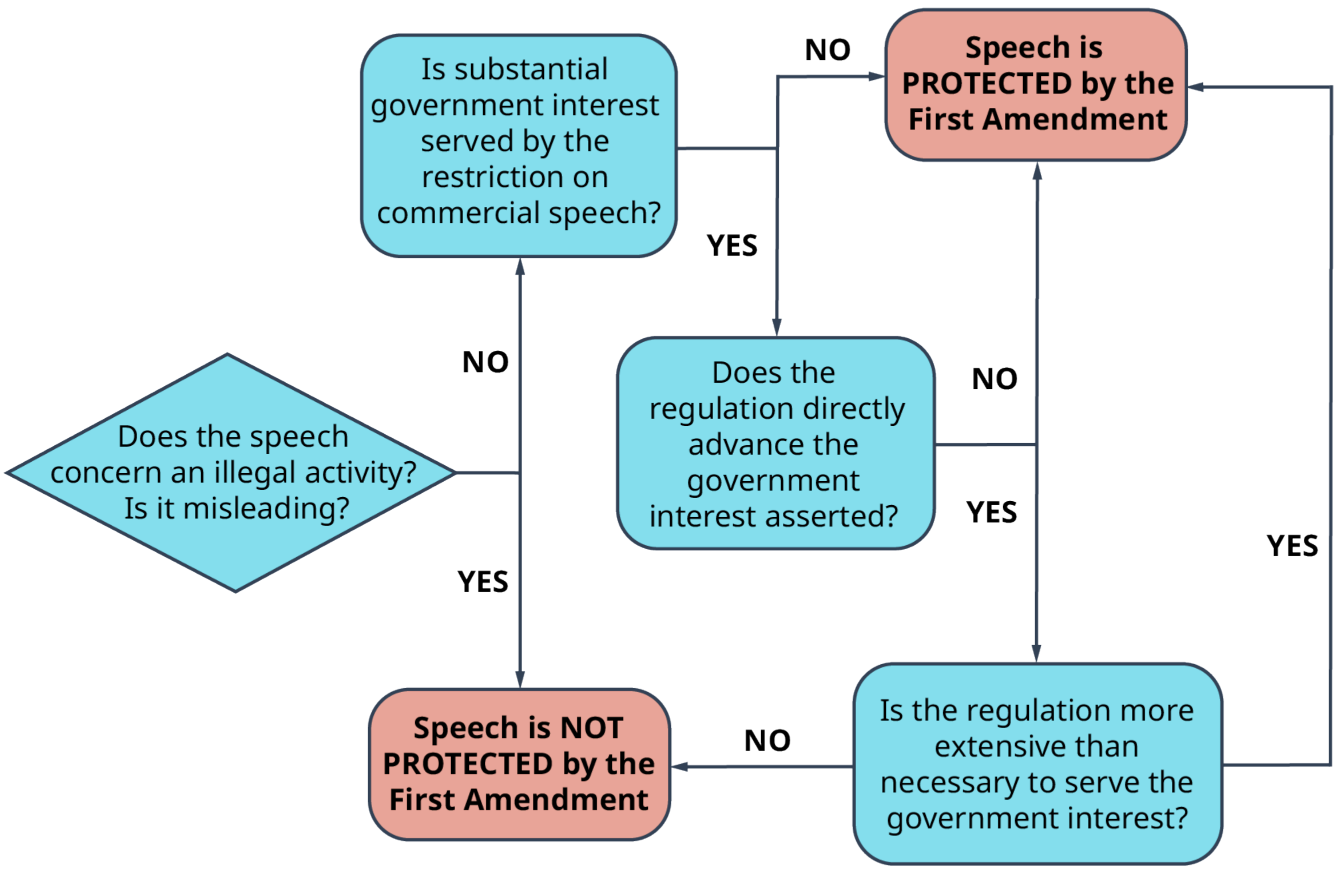

Figure 4.3 Hudson Gas & Electric Corp v. Public Service Commission of New York established a four-part test to determine whether commercial speech should be regulated according to the First Amendment. (Modification of art by BNED/pixabay Credit: CC BY NC SA)

The free exercise clause of the First Amendment states that government is prohibited from making laws that prohibit the free exercise of religion. Issues pertaining to this clause often arise in organizational settings. For example, historically, there have been a number of cases in which government employees have challenged employers' attempts to inhibit their exercise of religious practice (e.g., the wearing of religious symbols) in the workplace.

The Fourth Amendment

The Fourth Amendment guarantees that citizens are free from unreasonable searches and seizures, and requires government officials to obtain search warrants to conduct searches. However, government officials can only request a search warrant if they have probable cause to believe that criminal activity is occurring at the location of the search, or that they will locate evidence of criminal activity during the search (except where the official believes items will be removed prior to obtaining a warrant). The Fourth Amendment protects individual organizations and places of business, as well as residences. However, under the terms of the pervasive-regulation exception, administrative agencies can conduct warrantless searches of businesses attached to industries that have a long history of pervasive regulation. For example, public health agencies are allowed to conduct warrantless searches of stone quarries, as authorized by the Federal Mine Safety and Health Act of 1977.

The Fifth Amendment

For commercial enterprises and businesspeople, it is the due process clause of the Fifth Amendment that offers the most extensive protection. The clause states that the government cannot take an individual's life, liberty, or property without due process of law. Specifically, there are two types of due process:

- Substantive due process means that laws that will deprive an individual of his or her life, liberty, or property must be fair and not arbitrary. Laws passed should not affect fundamental rights, and regulations are required to meet the rational-basis test. In other words, the government must demonstrate that the law bears a rational relationship to a legitimate state interest. Many regulations affecting commercial activity, such as banking regulations, minimum wage laws, and regulations inhibiting unfair trade, have been tested against the rational-basis test.
- Procedural due process means that governments must use fair procedures when depriving an individual of his or her life, liberty, or property. This status quo does not only apply to federal criminal proceedings. For example, if a government employer discharges an employee from his job, or if the government suspends the driver's license of a worker, the employer must follow procedural due process.

Another clause contained in the Fifth Amendment that is relevant to commercial enterprises is the takings clause. According to this clause, when the government seizes private property for public use, it is required that the government pay the owner just compensation for the property. Just compensation is understood to be equivalent to the market value of the property. This clause has been broadly interpreted. For example, if environmental or safety regulations significantly impact the way in which a property owner can use his or her land for economic gain, the regulation can essentially be deemed as depriving the owner of his or her land, and the owner is entitled to compensation.

It is important to note that the privilege against self-incrimination, established under the Fifth Amendment (usually interpreted as the right to remain silent), only applies to sole proprietorships that are not legally distinct from the individual who owns them. Custodians and agents of corporations do not enjoy this privilege.

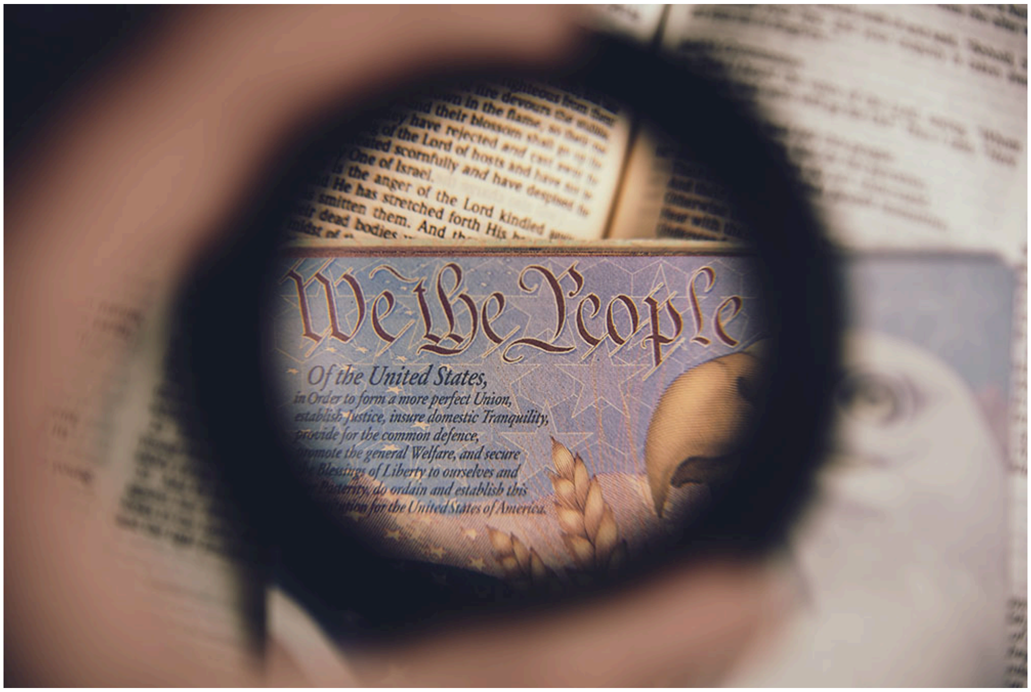

Figure 4.4 The various protections afforded the citizenry in the Bill of Rights are also extended to corporations and commercial activities. (Credit: Anthony Garand/ unsplash/ License: Unsplash License)

6. Tribal Law

ELLEN MATHEIN

In the Nicolet College district, there are three sovereign Native American nations: Lac du Flambeau band of Lake Superior Chippewa Indians, Mole Lake Sokaogon Chippewa Indians and Forest County Potawatomi Indian Community. These are independent nations within the state of Wisconsin, meaning the tribes have rights and responsibilities for self-governance.

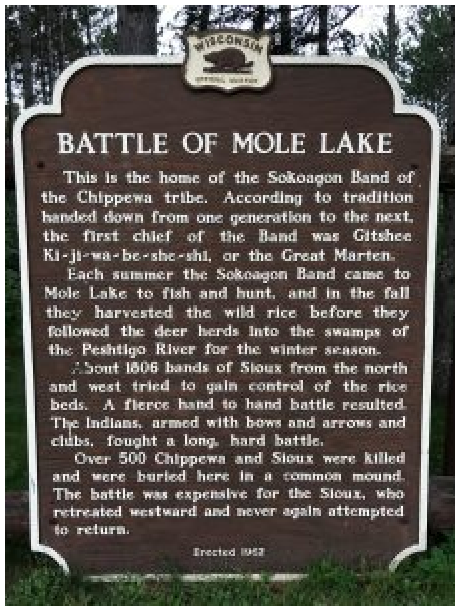

Photo by Nicolet College and Ellen Mathein

Long before the arrival of Europeans, native nations operated under successful, but varying governance systems – systems that included procedures and mechanisms for the administration of justice. An effective tribal judiciary is a major player in the process of native nation sovereignty. It upholds the nation's constitution, helps ensure the maintenance of law and order, promotes peace and resolves conflict within the community.

The native nations in our district must adhere to federal laws. However, for some criminal and many civil matters which occur on the reservation, each has a tribal court with tribal judges who adjudicate matters. The reason for this is each tribe has customs and culture which may play a role in judicial matters. Incorporation of customs and culture has proven to be a more effective way to maintain peace and order in tribal affairs.

Generally, tribal courts have civil jurisdiction over Indians and non-Indians who either reside or do business on federal Indian reservations. They also have criminal jurisdiction over violations of tribal laws committed by tribal members residing or doing business on the reservation.

Tribal courts are responsible for appointing guardians, determining competency, awarding child support, determining paternity, sanctioning adoptions, marriages, and divorces, making presumptions of death, and adjudicating claims involving trust assets.

Each tribe's constitution dictates how the tribal courts run and what jurisdiction they have.

For a deeper dive into Tribal Law, see the articles in the module and also see:

https://www.home.tlpi.org/

7. End Notes

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CHAPTER II

COURTS AND THE COURT SYSTEM

Laws are meaningless if they are not enforced. Companies have to make a barrage of decisions daily, from product development to marketing to strategies to maintain growth, but most of these are based on sound business acumen rather than legal requirements. If a company does violate a law, however, it must be held accountable. That accountability comes in the form of a lawsuit heard in court. Whether a suit is brought by a supplier, customer, employee, shareholder, or other stakeholder, litigation is a fact of life for companies. As future business professionals, being familiar with our court system will lay the foundation for your understanding of the litigation process.

The following will be covered in this chapter:

Competency	**Explain the importance of law to society and to business. Explain the foundational concepts of law.**
Criteria	Identify the Federal and state court systems
Criteria	Describe how courts establish jurisdiction
Criteria	Explain alternative dispute resolution options

8. Jurisdiction and Courts

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In many American cities, you can find both a state and a federal courthouse. These courts hear different types of cases, involving different laws, different law enforcement agencies, and different judicial systems. The rules governing the procedures used in these courts are known as civil procedure or criminal procedure.

There are actually fifty-one separate legal systems in the United States: one federal and fifty in the states. Within each legal system is a complex interplay among executive, legislative, and judicial branches of government. The foundation of each of these systems of government is a constitution. Some state constitutions are actually older than the federal Constitution, while others are relatively new.

To determine which court a case belongs in, lawyers look first to what the case is about. The rules of subject matter **jurisdiction** dictate whether a case is heard in federal or state court. Lawsuits involving state laws are generally heard in state courts. Most criminal laws, for example, are state laws. There may be wide differences among the states about what behavior constitutes criminal behavior. Speed limits, for example, are different from state to state. Even serious crimes such as murder or manslaughter, and possible defenses to those crimes, are defined differently by the states. Domestic issues such as divorce and family law are also handled at the state or tribal level. Child custody and adoption laws are state or tribal based. Property and probate laws are also based on state or tribal law. Laws related to the transfer of property (including real estate), vehicle or watercraft ownership registration, and the disposition of property after death are different depending on what state you live in. The laws surrounding contracts are also passed at the state level (although most are based on a common law called the Uniform Commercial Code [UCC]).

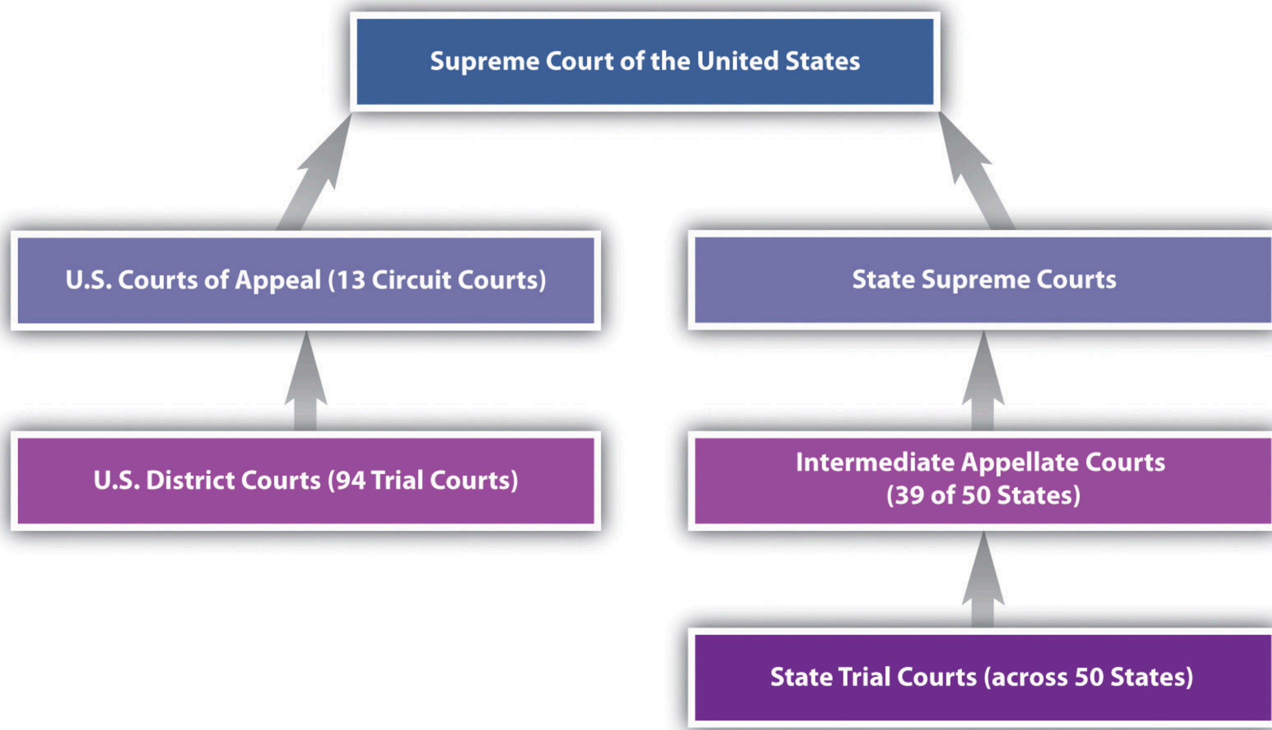
Finally, the law of **torts i**s state based. **Torts** are any civil wrong other than a breach of contract and can cover a vast array of situations in which people and businesses suffer legal injury. Some states are far friendlier toward torts than others, and the resulting patchwork of tort laws means that companies that do business across the country need to bear in mind the different standards they are held to, based on what state their customers live in.

Given the wide array of subject areas regulated by state law, it's not surprising that for most individuals and businesses, their experience with courts is with state courts. Nonetheless, cases do sometimes end up in federal court as well.

Federal court subject matter jurisdiction is generally limited to cases involving a federal question—either the federal Constitution or a federal law. Cases involving the interpretation of treaties to which the United States is a party are also subject to federal court jurisdiction. In fact, any case involving the United States as a party is properly litigated in federal court. Finally, in original jurisdiction cases (so called because the Constitution specifically grants this jurisdiction), lawsuits between states can be filed directly with the U.S. Supreme Court. Ongoing disputes between Wyoming and Montana over the use of the Tongue and Powder rivers, for example, were litigated in the Supreme Court in 2005.

Within both the federal court and the state court system, there is a hierarchy of higher and lower courts. The diagram below demonstrates this hierarchy. The U.S. Supreme Court is the highest court in the country, and all courts are bound to follow precedent established by the U.S. Supreme Court through the doctrine of **stare decisis** or precedent. Keep in mind, though, that if an issue is exclusively a state matter (such as a state court interpreting its own state's Constitution), then the U.S. Supreme Court has no jurisdiction on that matter, leaving the state supreme court as the highest court on that particular issue.

State and Federal Court Systems



Federal

On the left-hand side of the diagram is the federal court system. Cases are filed in a U.S. District Court, the trial court in the federal system. Under the court administration system, there are ninety-four judicial districts in the country. Some states with low population have only one judicial district, while more populous states have multiple judicial districts. The districts are named for their geographical location—the federal court in Manhattan, for example, is the U.S. District Court for the Southern District of New York. The U.S. Department of Justice, which acts as the prosecutor representing the federal government in both civil and criminal cases, divides its attorneys among the ninety-four judicial districts, with each district led by a U.S. attorney appointed by the president without any Senate confirmation.

As a trial court, the U.S. district courts hear civil and criminal trials. The trials may be bench trials (heard only by the judge), or they may be jury trials. At the trial, witnesses are called and their testimonies are recorded, word for word, into a trial record (transcript of what was said in the courtroom along with supporting documentation). At the conclusion of the trial, if the losing side is unhappy with the outcome, it is entitled as a matter of right to appeal its case to the U.S. Circuit Court of Appeals. There are thirteen circuit courts of appeals in the United States, also spread geographically through the states. A party losing an appeal at the circuit court level can appeal one more time to the U.S. Supreme Court for review, but given the extremely small odds of that appeal being granted, most federal litigation ends at the U.S. circuit court level.

State

On the right side of the diagram is the state court system. In all fifty states, a trial court of general jurisdiction accepts most types of civil and criminal cases. These courts are called various names such as superior court, circuit court, or district court. Confusingly, trial courts in New York State are called supreme courts. There may be other courts of limited jurisdiction at the state level, such as traffic court, juvenile court, family court, or small claims court. Increasingly, states are also experimenting with specialized drug courts to treat drug abuse (not distribution or trafficking) as a health problem rather than a criminal problem. State judges may be either appointed by the governor or elected by the public. Like their federal counterparts, state trial courts hold trials, and most preserve a trial record for review by an appellate court. In thirty-nine states, a party that loses at trial can file an appeal with an intermediate court of appeals. The remaining states are smaller and therefore don't maintain this level of appeal, in which case appeals are filed directly with the state supreme court. In states with an intermediate court of appeals, the party losing the appeal can typically file one more time with the state supreme court, although state supreme court rules vary on whether appeals are a matter of right or discretion. Finally, in certain cases that involve a federal constitutional right, a party that loses at the state supreme court level can appeal to the U.S. Supreme Court for review. These cases are typically criminal and involve the application of the Constitution to criminal procedure, evidence collection, or punishment.

Whenever an appeal is filed, the trial record is forwarded to the appellate court for review. Appellate courts do not conduct new trials and are unable to recall witnesses or call new witnesses. The trial court's duty is to figure out the facts of the case—who did what, when, why, or how. This process of fact-finding is an important part of the judicial process, and a great deal of deference is placed on the judgment of the fact finder (trier of fact). The trier of fact is typically the jury, or the judge in the case of a bench trial. On appeal, the appellate judge cannot substitute his or her interpretation of the facts for that of the trier of fact, even if the appellate judge believes the trier of fact was wrong. The issues on appeal are therefore limited to questions of law or legal errors. For example, the appellate court may disagree with the trial judge's interpretation of the meaning of a law, or it may disagree with a ruling the trial judge made about what evidence should be admitted or excluded to the trier of fact.

The deference to the trier of fact (trial court) means that, as a practical matter, appeals are rarely won. Even if a litigant is successful in persuading a court of appeals that legal error has taken place, it doesn't automatically win the case. In most cases, the best remedy a litigant can hope for is for the court of appeals to send the case back to a trial court (a process called remand) for reconsideration or perhaps a new trial.

9. Civil vs. Criminal Law

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A legal case can be **civil or criminal**. Each case has different components and requirements. Before one can understand the civil and criminal systems, it is important to understand the aspects of both civil and criminal laws. The scope, consequences, and treatments of each vary.

Constitutional Rights

It is important to understand the Constitution, which is the basis of all law. States are allowed to create and categorize crimes and punishment, as long as they do not violate rights protected by the U.S. Constitution. For example, in a fairly recent United States Supreme Court case, *Lawrence v. Texas*, the defendants asserted the unconstitutionality of a Texas law (enacted by the Texas legislature) regarding a particular act. When the United States Supreme Court ruled it unconstitutional, Texas could no longer enforce it.

Frequent issues litigated in the courts are:

- Whether evidence must be suppressed (not allowed to be introduced at trial) because it was obtained pursuant to an unreasonable search and seizure (violating the Fourth Amendment). This category might involve a sub-issue about whether officers had sufficient probable cause to conduct a warrantless search. Without a warrant, and without the suspect's consent, officers generally may only conduct searches if they have "probable cause" to do so; any evidence obtained without consent or probable cause can be objected to, and ultimately ruled inadmissible by the court in trial, if illegally obtained.
- Whether evidence must be suppressed because it was obtained while the suspect was "in custody" without advising a suspect of his rights to remain silent, to speak to an attorney, and to the appointment of an attorney if he cannot afford one (Fifth Amendment privilege against self-incrimination and Sixth Amendment right to counsel), as required by the Supreme Court in the famous *Miranda v. Arizona* case. The term often used to describe these rights is "Mirandizing," which is named after the case.
- Whether a state law or constitutional provision provides more protection than the U.S. Constitution.

Figure 5.4 Both civil and criminal convictions are based on precedent. (Credit: PactoVisual/ pixabay/ License: CC0)

Components of Crime

There are usually two components to criminal conduct that must be proven by the prosecutor. The prosecutor prosecutes the case against the accused: **mens rea (**the criminal, or guilty, or "wrongful" mind) and **actus reus** (the criminal, or guilty, or "wrongful" act).

Each statute creating a crime is supposed to include a description of:

a. the mental state (mens rea) required to establish that the suspect committed the crime, coupled with
b. a description of the conduct (actus reus) that the suspect must have done.

The statute generally also indicates the category of crime (felony/misdemeanor/gross misdemeanor).

Criminal Procedures

Generally, the first pleading filed by the prosecutor is called the information. (This step could be described as the criminal counterpart to a civil "complaint.")

The next stage is called the arraignment, where the defendant appears in court so that the court can determine or confirm his or her identity, inform the defendant of the charge the prosecutor has filed against him or her, and hear the defendant's plea.

Then, there will be discovery and trial. In criminal cases, the jury will convict only if convinced "beyond a reasonable doubt" that the defendant committed the crime, and the verdict must be unanimous. This type of case involves a higher burden of proof than in civil cases.

Criminal and Civil Law

Criminal law addresses behaviors that are offenses against the public, society, or state. Examples of criminal law offenses include assault, drunk driving, and theft. In contrast, civil laws address behavior that causes an injury to the private rights of individuals in areas such as child support, divorce, contracts, property, and the person. Examples of civil law offenses include libel, slander, or contract breaches.

Criminal and civil cases differ in who initiates the case, how the case is decided, what punishments or penalties are issued, requirements of proof, and legal protections provided.

Figure 5.5 Civil and criminal cases involve the court system. (Credit: Brett Sayles/ pexels/ License: CC0)

Initiation and Roles

Criminal and civil cases are initiated differently, and the titles of the individuals involved differ slightly. Criminal cases are only initiated by the federal or state government in response to a law being broken. The federal or state governments are known as the prosecution. The prosecution is an attorney, or group of attorneys, hired by the government to present a case against the accused. Criminal cases are usually titled something like "State v. [last name of the defendant accused of a crime]." In criminal prosecutions, the victim is not a party to the lawsuit, but might be a witness for the state at the trial.

In contrast, private parties initiate civil cases when they feel that someone has injured them. Again, civil cases stem from breach of contract, custody cases, and attacks on one's character. Private parties can include an individual, a group, or a business. The person, group, or business who initiates the case is referred to as the plaintiff or complainant. The accused is referred to as the defendant, in both criminal and civil proceedings.

Typically, there is a difference in the burden of proof for the two types of cases. In a criminal case, the defendant must be proven guilty "beyond a reasonable doubt." In a civil case, the defendant must be proven liable through a "preponderance of the evidence." In other words, the prosecution in a civil case must prove that it is more probable than not that the defendant is liable.

In criminal cases, the defendant is entitled to an attorney and may be appointed an attorney if he or she is not able to afford one. The state appoints the attorney. In contrast, all parties involved in a civil case are required to secure their own legal representation.

Typically, civil and criminal laws use different terminology, and being found guilty or accountable in each type of case results in different consequences.

In a civil action (lawsuit), the plaintiff is the person who is alleging that he or she has actually been harmed (physically, financially, or in another manner), and the defendant is the one who is asked to pay damages or otherwise compensate the plaintiff. Outside of financial compensation, the plaintiff may be ordered to do something or refrain from doing something, which is referred to as injunctive relief.

In the *Liebeck v. McDonald's* case, a woman sued McDonald's for serving hot coffee. The woman spilled hot coffee on her lap while trying to add cream and sugar. The woman sued McDonald's for negligence in a civil suit. The issue centered on whether or not the coffee's specific temperature was unreasonably hot. McDonald's lost the lawsuit. The compensatory verdict was $160,000. McDonald's was found liable.

Conversely, if a defendant is convicted of committing a crime, the consequences are usually incarceration (jail/prison) and/or a fine (payment of money to the state).

The word used to describe the legal responsibility for harm in a civil case is liability, not guilt. Guilty is the word used to describe a person found guilty of committing a crime in a criminal case.

Businesses can be charged with criminal acts as well. In 2017, Oliver Schmidt, former manager of a Volkswagen engineering office near Detroit, was arrested. He faced years in prison for attempts to defraud the United States, wire fraud, violation of the Clean Air Act, and a charge of giving an untrue statement under the Clean Air Act. Schmidt's actions directly violated a business law and, since his actions violated an established law, he was held criminally liable. In December of 2017, Schmidt was sentenced to seven years in prison.

Professional Negligence

Professional negligence is often called malpractice. A professional's duty of care is usually a duty to exercise the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent professional of the same type in the state (or sometimes in the community). Along with attorneys and health care providers, the following professionals might be sued for malpractice: accountants, architects, engineers, surveyors, insurance brokers, real estate agents and brokers, and clergy.

For negligence, the usual kind of damages recoverable are compensatory, or money to compensate for the injuries/damages incurred to make the person whole (e.g., money for medical bills, lost wages, loss of future earning capacity, pain and suffering, emotional distress, property damage, etc.).

10. Criminal law and Business

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People rarely think about their conduct at work as being potentially illegal, or that jail time could result from poor workplace decisions. However, this fact is the reality. Organizations are fined, and executives are sentenced to jail, when business laws are broken. Many of the workplace violations are nonviolent crimes, such as fraud, property crimes, or drug- or alcohol-related infractions. Regardless of the level of violence or the employee's motivation for committing the crime, breaking the law can lead to negative consequences for the business, its employees, and its customers.

Constitutional Authority to Regulate Business

Congress is given the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Our forefathers wanted to facilitate easier trade among the states by allowing Congress to adopt rules that could be uniformly applied. The theory was that if commercial enterprises knew that they would be dealing with essentially the same rules across the nation, it would be much easier to run their businesses and keep commerce flowing more efficiently.

While federal courts initially interpreted the commerce power narrowly, over time, the federal courts have decided that the commerce clause gives the federal government broad powers to regulate commerce, not only on an interstate (between the states) level, but also on an intrastate (within each state) level, as long as some economic transaction is involved. The federal government does not usually exceed its regulatory powers.

White Collar Crime

White collar crimes are characterized by deceit, concealment, or violation of trust. They are committed by business professionals. They generally involve fraud, and the employees committing the crimes are motivated by the desire for financial gains or fear of losing business standing, money, or property. Fraud is the intentional misrepresentation of material facts for monetary gain. This type of crime is not dependent on threats or violence.

Figure 5.2 White collar crimes are committed by business professionals within businesses with the intent of gaining or maintaining status. (Credit: Rawpixel/ pexels/ License: CC0)

White collar crimes tend to violate state laws, and sometimes federal laws. The violation depends on what is involved in the crime. For instance, criminal acts involving the United States postal system or interstate commerce violate federal law.

Although white collar crimes do not need to include physical violence, these types of crimes can destroy companies, the environment, and the financial stability of clients, employees, and communities. In 2018, Jeremiah Hand and his brothers, Jehu Hand and Adam Hand, were convicted and sentenced to between 9 and 30 months in prison for their respective roles in a pump-and-dump scheme. In this scheme, they were dishonest about control over their company's stock, and even went as far as filing false forms in an effort to raise the value of the stock. Once the value of the stock was raised, they released their shares into the market.

Types of Business Crimes

Business crimes or white collar crimes are not limited to pump-and-dump schemes; they come in many different forms. Business crimes come in many different forms. As previously stated, these crimes often involve deceit, fraud, or misinformation. The types of high-profile crimes include Ponzi schemes, embezzlement, and crimes that intentionally violate environmental laws and regulations. This section will explore these three types of crimes and provide examples from the 2000s.

Ponzi Schemes

Ponzi schemes (also known as pyramid schemes) are investing scams that promise investors low-risk investment opportunities with a high rate of return. The high rates are paid to old investors with money acquired from the acquisition of new investors. The performance of the market is not a factor in the investors' rate of return.

Bernie Madoff operated a 20-year Ponzi scheme through his company. He paid high returns (above average) using the investments of new clients (investors). In 2008, investors attempted to withdraw funds, but the Madoff organization was not able to provide the reimbursement. Madoff is currently serving a more than 100-year sentence in prison.

Larceny and Embezzlement

Larceny and embezzlement are two forms of theft that can occur within a business. Larceny occurs when a person unlawfully takes the personal property of another person or a business. For example, if an employee takes another employee's computer with the intent of stealing it, he or she may be guilty of larceny. In contrast, embezzlement occurs when a person has been entrusted with an item of value and then refuses to return it or does not return the item. For example, if an employee is entrusted with the petty cash at his or her office and that person purposefully takes some of the money for himself or herself, this would be embezzlement.

One high-profile example of embezzlement occurred at Koss Corporation in Milwaukee, Wisconsin. Sujata "Sue" Sachdeva was a Vice President of Finance and Principal Accounting Officer at Koss Corporation. Sachdeva was convicted of embezzling $34 million over a 5-year period and sentenced to 11 years in federal prison, as well as restitution to Koss Corporation. Sachdeva was entrusted with the company's funds and did not utilize the funds as intended.

Environmental Crimes

Many federal statutes regulate the environment. Many of these laws carry both civil and criminal penalties for violations.

The following federal laws can carry criminal penalties:

- Clean Air Act
- Clean Water Act
- Resource Conservation and Recovery Act
- Comprehensive Environmental Response, Compensation and Liability Act
- Endangered Species Act

The International Petroleum Corporation of Delaware (IPC) is paying restitution for environmental crimes, which included a scheme to violate the Clean Water Act. From 1992 to 2012, IPC processed oil and wastewater. The company admitted to altering required water test samples so they met the limits set by their permit before releasing the waste into the city's sewer system. The company also admitted to transporting waste that contained benzene, barium, chromium, cadmium, lead, PCE, and trichloroethene for disposal in South Carolina without the required reporting of the information, which also violated environmental laws.

Figure 5.3 White collar crimes are generally motivated by the desire to maintain or gain financial status. (Credit: TheDigitalWay/ pixabay/ License: CC0)

Other Types of Business Crime

The business environment is complex, and some crimes are less common or receive less media attention. These types of crimes include those that violate antitrust laws, racketeering, bribery, money laundering, and spamming.

Violations of Antitrust Laws

Antitrust laws do not allow activities that restrain trade or promote market domination. These laws are in place to provide guidance and supervision of mergers and acquisitions of companies to prevent market abuse. The goal is to avoid monopolies, or the control of one organization over a specific market. Monopolies reduce competition and, as a result, can have a detrimental impact on consumer prices. Since the United States is founded on capitalist principles, anti-competitive business conduct is prohibited by law, and some of those laws, such as the Sherman Antitrust Act, do include provisions about criminal punishment.

Racketeering

Racketeering activities include loan-sharking, money laundering, and blackmailing. In the past, the term has been used to describe organized crime. The term is now applied to other entities, as well. RICO, or the Racketeer Influenced and Corrupt Organizations Act, is a federal law aimed at preventing and prosecuting by both businesses and organized crime syndicates. "RICO is now used against insurance companies, stock brokerages, tobacco companies, banks, and other large commercial enterprises." (Schodolski, 2018). Racketeering is no longer limited to organized crime. Health insurance companies and other legitimate businesses are being accused of pressure tactics similar to those used in organized crime racketeering. These claims involve allegations of lying about the actual cost of care, damaging the business for physicians, bullying patients, and attempting to control the doctor-patient relationship through lies and pressure tactics.

Bribery

Bribery occurs when monetary payments, goods, services, information, or anything of value is exchanged for favorable or desired actions. You can be charged with bribery for offering a bribe, or taking a bribe. Bribery is illegal within the United States and outside of it. The Foreign Corrupt Practices Act prohibits bribery payments by U.S. companies to foreign government officials with an intent to influence foreign business results. One example of bribery would be a situation in which a pharmaceutical company offers special benefits to individuals who agree to prescribe their medications.

Money Laundering

Money laundering refers to taking “dirty”money, or money obtained through criminal activities, and passing it through otherwise legitimate businesses so that it appears “clean.” The money cannot be tied back to the illegal acts. Clean money is money that was obtained through legitimate business functions.

Spamming

Sending unsolicited commercial email, or spam, is illegal. While the onus is on consumers to avail themselves of whatever programs they can to block spam, laws are in place to discourage the sending of spam. The following points are outlined in the anti-spam legislation in Washington state and are similar to other legislation:

1. Individuals may not initiate the sending or plan the sending of an email that misrepresents the sender as someone he or she is not, represents the sender as being associated with an organization that he or she has no association, or otherwise hides the identity of the sender or origin of the email. Email messages may not have false or misleading information in the subject line of the message.
2. Commercial emails must include the contact information of the sender and the receiver must be aware that the message is from a commercial source.

States like Washington are putting legislation in place to reduce spam and asking consumers to take an active role in addressing spam. In general, legislators realize that spam is a nuisance and are finding ways to hold companies liable for sending spam messages.

Conclusion

It is important to know that not all people charged with business crimes or white collar crimes are necessarily guilty.

A person must be found guilty of the crime before he or she is convicted. Regardless, business crimes and white collar crimes negatively impact the individual, the organization he or she worked for, the community, and customers.

11. Alternative Dispute Resolution

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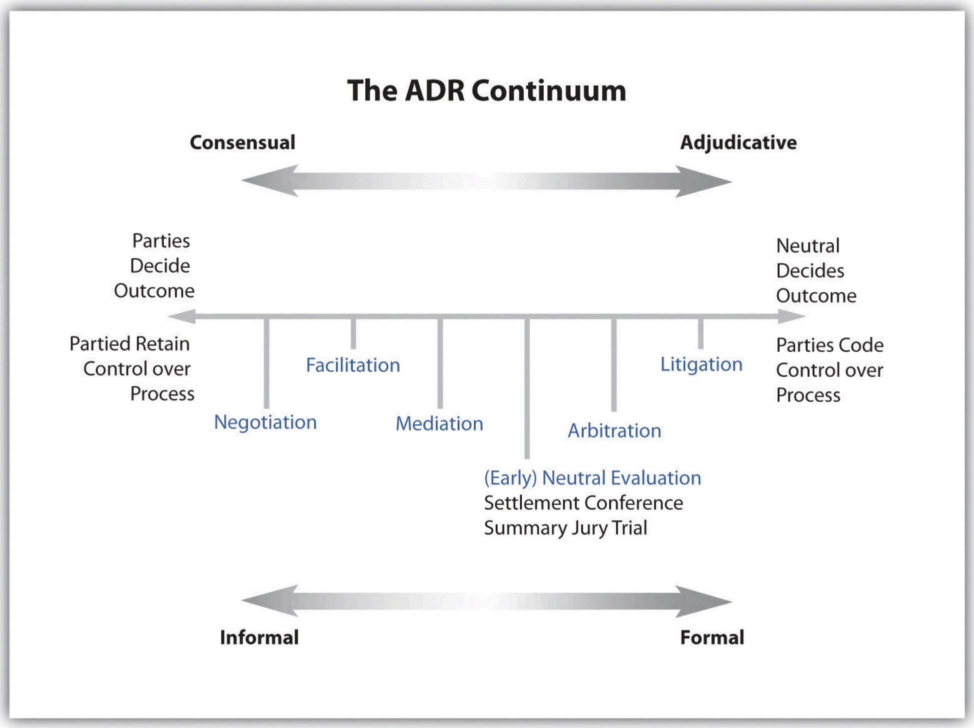
Imagine that you've been wronged by a supplier, by your employer, or by a business where you are a customer. You've correctly determined that you have an actionable legal claim. What are you going to do? You probably *won't* run to the courthouse to file a formal complaint to initiate litigation. This is because litigation is very expensive and time consuming. Besides, you may wish to continue doing business with the supplier, employer, or business. Perhaps the matter is of a private nature, and you do not want to engage in a public process to determine the outcome. You would like the dispute to be resolved, but you do not want to engage in public, time-consuming, expensive litigation to do it.

A common method of dispute resolution that avoids many of the challenges associated with litigation is **alternative dispute resolution.** Alternative dispute resolution (ADR) is a term that encompasses many different methods of dispute resolution *other than* litigation. ADR involves resolving disputes outside of the judicial process, though the judiciary can require parties to participate in specific types of ADR, such as arbitration, for some types of conflicts. Moreover, some ADR methods vest power to resolve the dispute in a neutral party, while other strategies vest that power in the parties themselves. See the figure below for a continuum of different ADR methods based on where power to solve the dispute is vested. Today, more than 90% of cases aer settled before trial though some form of ADR.

A Continuum of Different ADR Methods



Source: Adapted from New York State Unified Court System, http://www.nycourts.gov/ip/adr/images/continuum2.jpg.

Common methods of ADR include **negotiation, mediation, and arbitration.** Lesser used methods of ADR include minitrials, hybrid forms of mediation-arbitration (with elements of both), and collaborative goal-oriented processes. ADR is often used to resolve disputes among businesses, employers and employees, and businesses and consumers. ADR can also be used in many other types of conflicts. For instance, ADR strategies can be used in domestic law cases, such as divorce, or in international legal issues, such as issues relating to transboundary pollution. This chapter limits its focus to the use of ADR methods in business. Particularly, we will examine the common methods of ADR, including the benefits and drawbacks to each. We will also examine potential consequences to parties that have unequal bargaining power. Additionally, we will examine the use of ADR methods in situations where ADR may not be the most appropriate method of dispute resolution, such as civil rights violations.

ADR methods are used outside of the courtroom, but that does not mean that they are outside of the interests of our legal system. Participation in ADR has important legal consequences. For instance, parties that have agreed by contract to be subject to binding arbitration give up their constitutional right to bring their complaint to court. The Federal Arbitration Act (FAA) is a federal statute under which parties are required to participate in arbitration when they have agreed by contract to do so, even in state court matters. Indeed, the FAA is a national policy favoring arbitration.[1] The *Southland Corp.* Court said that "in enacting…[the FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." This is an example of federal preemption exercised through the Supremacy Clause in the U.S. Constitution.

There is a very good chance that you will—or already have—signed a contract that contains a mandatory arbitration clause. This means that if a dispute arises under that contract, then you will be required to arbitrate your claim rather than going straight to court. Under a binding arbitration clause, you will have waived your constitutional rights to go to court. Even if you have never signed such a contract and never will, there is still a good likelihood that you will be involved in a commercial dispute at some point in your life. Because of this, it's important to understand the ADR process, situations in which litigation is a better choice than ADR, and special issues that arise when parties have unequal bargaining power.

1. *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

12. Negotiation

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We frequently engage in **negotiations** as we go about our daily activities, often without being consciously aware that we are doing so. Negotiation can be simple, e.g., two friends deciding on a place to eat dinner, or complex, e.g., governments of several nations trying to establish import and export quotas across multiple industries. When a formal proceeding is started in the court system, **alternative dispute resolution (ADR),** or ways of solving an issue with the intent to avoid litigation, may be employed. Negotiation is often the first step used in ADR. While there are other forms of alternative dispute resolution, negotiation is considered to be the simplest because it does not require outside parties. An article in the Organization Behavior and Human Decision Processes defined negotiation as the "process by which parties with nonidentical preferences allocate resources through interpersonal activity and joint decision making." Analyzing the various components of this definition is helpful in understanding the theories and practices involved in negotiation as a form of dispute settlement.

Negotiation Types and Objectives

Per the above definition, negotiation becomes necessary when two parties hold "non-identical" preferences. This statement seems fairly obvious, since 100% agreement would indicate that there is not any need for negotiation. From this basic starting point, there are several ways of thinking about negotiation, including how many parties are involved. For example, if two small business owners find themselves in a disagreement over property lines, they will frequently engage in dyadic negotiation. Put simply, dyadic negotiation involves two individuals interacting with one another in an attempt to resolve a dispute. If a third neighbor overhears the dispute and believes one or both of them are wrong with regard to the property line, then group negotiation could ensue. Group negotiation involves more than two individuals or parties, and by its very nature, it is often more complex, time-consuming, and challenging to resolve.

While dyadic and group negotiations may involve different dynamics, one of the most important aspects of any negotiation, regardless of the quantity of negotiators, is the objective. Negotiation experts recognize two major goals of negotiation: relational and outcome. Relational goals are focused on building, maintaining, or repairing a partnership, connection, or rapport with another party. Outcome goals, on the other hand, concentrate on achieving certain end results. The goal of any negotiation is influenced by numerous factors, such as whether or not there will be contact with the other party in the future. For example, when a business negotiates with a supply company that it intends to do business with in the foreseeable future, it will try to focus on "win-win" solutions that provide the most value for each party. In contrast, if an interaction is of a one-time nature, that same company might approach a supplier with a "win-lose" mentality, viewing its objective as maximizing its own value at the expense of the other party's value. This approach is referred to as zero-sum negotiation, and it is considered to be a "hard" negotiating style. Zero-sum negotiation is based on the notion that there is a "fixed pie," and the larger the slice that one party receives, the smaller the slice the other party will receive. Win-win approaches to negotiation are sometimes referred to as integrative, while win-lose approaches are called distributive.

Figure 2.2 Certain negotiation styles adopt a mindset in which the extent of one's win is proportional to the other's loss. (Credit: Sebastian Voortman/ pexels/ License: CC0)

Negotiation Style

Everyone has a different way of approaching negotiation, depending on the circumstance and the person's personality. However, the Thomas-Kilmann Conflict Mode Instrument (TKI) is a questionnaire that provides a systematic framework for categorizing five broad negotiation styles. It is closely associated with work done by conflict resolution experts Dean Pruitt and Jeffrey Rubin. These styles are often considered in terms of the level of self-interest, instead of how other negotiators feel. These five general negotiation styles include:

- Forcing. If a party has high concern for itself, and low concern for the other party, it may adopt a competitive approach that only takes into account the outcomes it desires. This negotiation style is most prone to zero-sum thinking. For example, a car dealership that tries to give each customer as little as possible for his or her trade-in vehicle would be applying a forcing negotiation approach. While the party using the forcing approach is only considering its own self-interests, this negotiating style often undermines the party's long-term success. For example, in the car dealership example, if a customer feels she has not received a fair trade-in value after the sale, she may leave negative reviews and will not refer her friends and family to that dealership and will not return to it when the time comes to buy another car.
- Collaborating. If a party has high concern and care for both itself and the other party, it will often employ a collaborative negotiation that seeks to maximum the gain for both. In this negotiating style, parties recognize that acting in their mutual interests may create greater value and synergies.
- Compromising. A compromising approach to negotiation will take place when parties share some concerns for both themselves and the other party. While it is not always possible to collaborate, parties can often find certain points that are more important to one versus the other, and in that way, find ways to isolate what is most important to each party.
- Avoiding. When a party has low concern for itself and for the other party, it will often try to avoid negotiation completely.
- Yielding. Finally, when a party has low self-concern for itself and high concern for the other party, it will yield to demands that may not be in its own best interest. As with avoidance techniques, it is important to ask why the party has low self-concern. It may be due to an unfair power differential between the two parties that has caused the weaker party to feel it is futile to represent its own interests. This example illustrates why negotiation is often fraught with ethical issues.

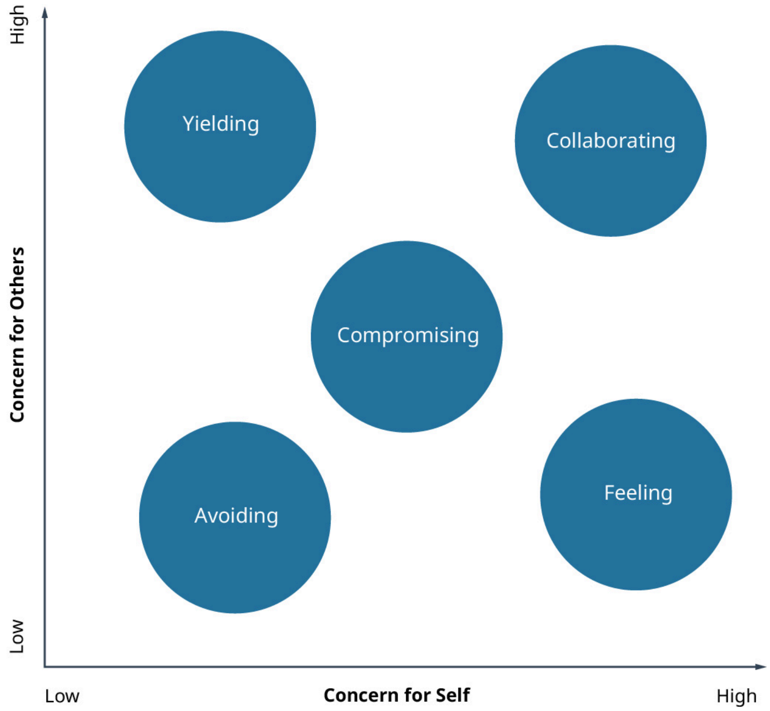

Figure 2.3 Concern for self vs. others leads to the differences in negotiating styles. (Modification of art by BNED/Rubin Credit: CC BY NC SA)

Negotiation Styles in Practice

Apple's response to its treatment of warranties in China, i.e., giving one-year warranties instead of two-year warranties as required by law, serves as an example of how negotiation may be used. While Apple products continued to be successful and popular in China, the issue rankled its customers, and Chinese celebrities joined the movement to address the concern. Chinese consumers felt that Apple was arrogant and didn't value its customers or the customers' feedback. In response, Tim Cook issued a public apology in which he expressed regret over the misunderstanding, saying, "We are aware that insufficient communications during this process has led to the perception that Apple is arrogant and disregards, or pays little attention to, consumer feedback. We express our sincere apologies for any concern or misunderstanding arising therefrom." Apple then listed four ways it intended to resolve the matter. By exhibiting humility and concern for its customers, Apple was able to diffuse a contentious situation that might have resulted in costly litigation.

Negotiation Laws

Negotiations are covered by a medley of federal and state laws, such as the Federal Arbitration Act and Uniform Arbitration Act. The Federal Arbitration Act (FAA) is a national policy that favors arbitration and enforces situations in which parties have contractually agreed to participate in arbitration. Parties who have decided to be subject to binding arbitration relinquish their constitutional right to settle their dispute in court. It is the FAA that allows parties to confirm their awards, as will be discussed in the following chapters. When considering negotiation laws, it is important to keep in mind that each state has laws with their own definitions and nuances. While the purpose of the Uniform Arbitration Act in the United States was to provide a uniform approach to the way states handle arbitration, it has only been adopted in some form by about 35 states.

13. Mediation

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Court or Agency-Connected Mediation

Mediation is a method of dispute resolution that relies on an impartial third-party decision-maker, known as a **mediator,** to settle a dispute. While requirements vary by state, a mediator is someone who has been trained in conflict resolution, though often, he or she does not have any expertise in the subject matter that is being disputed. Mediation is another form of alternative dispute resolution. It is often used in attempts to resolve a dispute because it can help disagreeing parties avoid the time-consuming and expensive procedures involved in court litigation. Courts will often recommend that a plaintiff, or the party initiating a lawsuit, and a defendant, or the party that is accused of wrongdoing, attempt mediation before proceeding to trial. This recommendation is especially true for issues that are filed in small claims courts, where judges attempt to streamline dispute resolution. Not all mediators are associated with public court systems. There are many agency-connected and private mediation services that disputing parties can hire to help them potentially resolve their dispute. The American Bar Association suggests that, in addition to training courses, one of the best ways to start a private mediation business is to volunteer as a mediator. Research has shown that experience is an important factor for mediators who are seeking to cultivate sensitivity and hone their conflict resolution skills.

For businesses, the savings associated with mediation can be substantial. For example, the energy corporation Chevron implemented an internal mediation program. In one instance, it cost $25,000 to resolve a dispute using this internal mediation program, far less than the estimated $700,000 it would have incurred through the use of outside legal services. Even more impressive is the amount it saved by not going to court, which would have cost an estimated $2.5 million.

Mediation is distinguished by its focus on solutions. Instead of focusing on discoveries, testimonies, and expert witnesses to assess what has happened in the past, it is future-oriented. Mediators focus on discovering ways to solve the dispute in a way that will appease both parties.

Other Benefits of Mediation

- Confidentiality. Since court proceedings become a matter of public record, it can be advantageous to use mediation to preserve anonymity. This aspect can be especially important when dealing with sensitive matters, where one or both parties feels it is best to keep the situation private.
- Creativity. Mediators are trained to find ways to resolve disputes and may apply outside-the-box thinking to suggest a resolution that the parties had not considered. Since disagreeing parties can be feeling emotionally contentious toward one another, they may not be able to consider other solutions. In addition, a skilled mediator may be able to recognize cultural differences between the parties that are influencing the parties' ability to reach a compromise, and thus leverage this awareness to create a novel solution.
- Control. When a case goes to trial, both parties give up a certain degree of control over the outcome. A judge may come up with a solution to which neither party is in favor. In contrast, mediation gives the disputing parties opportunities to find common ground on their own terms, before relinquishing control to outside forces.

Role of the Mediator

Successful mediators work to immediately establish personal rapport with the disputing parties. They often have a short period of time to interact with the parties and work to position themselves as a trustworthy advisor. The Harvard Law School Program on Negotiation reports a study by mediator Peter Adler in which mediation participants remembered the mediators as "opening the room, making coffee, and getting everyone introduced." This quote underscores the need for mediators to play a role beyond mere administrative functions. The mediator's conflict resolution skills are critical in guiding the parties toward reaching a resolution.

Steps of Mediation

As explained by nolo.com, mediation, while not being as formal as a court trial, involves the following six steps:

- Mediator's Opening Statement: During the opening statement, the mediator introduces himself or herself and explains the goals of mediation.
- Opening Statements of Plaintiff and Defendant: Both parties are given the opportunity to speak, without interruption. During this opening statement, both parties are afforded the opportunity to describe the nature of the dispute and their desired solution.
- Joint Discussion: The mediator will try to get the two disagreeing parties to speak to one another and will guide the discussion toward a mutually amicable solution. This part of the mediation process usually identifies which issues need to be resolved and explores ways to address the issues.
- Private Caucus: During this stage, each party has the ability to meet and speak privately with the mediator. Typically, the mediator will use this time to learn more about what is most important to each party and to brainstorm ways to find a resolution. The mediator may ask the parties to try to put aside their emotional responses and resentments to work toward an agreement.
- Joint Negotiation: After the private caucuses, the parties are joined again in the same room, and the mediator presents any newly discovered insight to guide them toward an agreement.
- Closure: During this final stage, an agreement is reached, or it is determined that the parties cannot agree. Either way, the mediator will review the positions of each party and ask them if they would like to meet again or explore escalating options, such as moving the dispute to court.

Ethical Issues

Both the disputants themselves, and those who attempt to facilitate dispute resolutions, i.e., mediators and attorneys, must navigate a myriad of ethical issues, such as deciding whether they should tell the entire truth, or only offer a partial disclosure. This conflict has long roots in history and has often been considered in terms of consequentialist and deontological ethical theories. Consequentialist ethics, sometimes known as situational ethics, is a way of looking at difficult decisions by considering their implications. Someone who follows consequentialist ethics in mediation or arbitration would consider the impact of his or her decision on the parties in light of their unique circumstances. In contrast, deontologist ethics bases its decision on whether the action itself is right or wrong, regardless of its consequences.

Imagine a situation in which a professional accountant holds a consequentialist ethical viewpoint and believes that there are certain scenarios in which the disclosure of only part of the truth is a commendable course of action. For example, if an accountant is interviewed regarding how the company handled a certain transaction in its retirement account, he might choose to withhold certain information because he is afraid it will harm the retirees' ability to retain the full benefits of their pensions. In this case, the accountant is utilizing "the ends justify the means" logic because he feels that the omission of truth will result in more benefit than its revelation. A mediator or arbitrator who also follows a consequentialist viewpoint would consider the accountant's motivation and the circumstances, in addition to his or her actions.

Ethical situations like these are not only part of dispute mediation in business law scenarios, but also happen in daily life. Consider the case of a parent who is on his way home from work when he receives a call from the babysitter, telling him that his child's forehead feels hot and that she is complaining of not feeling well. Sitting in traffic, the parent remembers that he does not know the whereabouts of the digital thermometer, so he decides to stop and purchase one. The parking lot at the store is extremely busy, so the parent decides to park in a handicapped spot, even though he does not have any mobility challenges. These types of situations have been addressed by philosophers such as Immanuel Kant, who spoke of the categorical imperative, which he defined as, "Act only according to that maxim whereby you can, at the same time, will that it should become a universal law." In other words, one's action should be considered in light of what would happen if everyone were to engage in the same action. While it might not seem like a harmful infraction, if everyone were to do it, then it would cause a true inconvenience and possible suffering for mobility-impaired individuals, for whom those spaces were designated. A deontological ethical viewpoint would determine that it is always wrong to park in the handicapped space, regardless of the situation. In real life, it is very difficult to adopt a 100% deontological viewpoint for dispute resolution. Often, the reason the dispute has arisen in the first place is because of some ambiguity inherent in the situation. In these cases, mediators must apply their best judgment to help the disagreeing parties see one another's viewpoints and to guide them toward a mutually amicable solution.

Figure 2.4 Sometimes ethical issues have no clear-cut answers and mediators must rely upon their best judgement. (Credit: George Becker/ pexels/ License: CC0)

Future Directions in Mediation

As technology continues to change the ways we interact with one another, it is likely that we will see advances in mediation techniques. For example, there are companies that offer online mediation services, known as e-mediation.

E-mediation can be useful in situations where the parties are geographically far apart, or the transaction in dispute took place online. Ebay uses e-mediation to handle the sheer volume of misunderstandings between parties. Research has shown that one of the benefits of e-mediation is that it allows people the time needed to "cool down" when they have to explain their feelings in an email, as opposed to speaking to others in person.

In addition to technological advancements, new findings in psychology are influencing how disputes are resolved, such as the rising interest in canine-assisted mediation (CAM), in which the presence of dogs is posited to have an impact on human emotional health. Since the presence of dogs has a positive impact on many of the neurophysiological stress markers in humans, researchers are beginning to explore the use of therapy animals to assist in dispute resolution.

Figure 2.5 Mediation experts are considering the benefits of therapy dogs for canine-assisted mediation. (Credit: Garfield Besa/ pexels/ License: CC0)

14. Arbitration

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The American Bar Association (ABA) defines **arbitration** as the "private process where disputing parties agree that one or several individuals can make a decision about the dispute after receiving evidence and hearing arguments." Arbitration is overseen by a neutral arbitrator, or an individual who is responsible for making a decision on how to resolve a dispute and who has the ability to decide on an award, or a course of action that the arbiter believes is fair, given the situation. An award can be a monetary payment that one party must pay to the other; however, awards need not always be financial in nature. An award may require that one business stop engaging in a certain practice that is deemed unfair to the other business. As distinguished from mediation, in which the mediator simply serves as a facilitator who is attempting to help the disagreeing parties reach an agreement, and arbitrator acts more like a judge in a court trial and often has legal expertise, although he or she may or may not have subject matter expertise. Many arbitrators are current or retired lawyers and judges.

Types of Arbitration Agreements

Parties can enter into either **voluntary or involuntary arbitration.** In voluntary arbitration, the disputing parties have decided, of their own accord, to seek arbitration as a way to potentially settle their dispute. Depending on the state's laws and the nature of the dispute, disagreeing parties may have to attempt arbitration before resorting to litigation; this requirement is known as involuntary arbitration because it is forced upon them by an outside party.

Arbitration can be either **binding or non-binding.** In binding arbitration, the decision of the arbitrator(s) is final, and except in rare circumstances, neither party can appeal the decision through the court system. In non-binding arbitration, the arbitrator's award can be thought of as a recommendation; it is only finalized if both parties agree that it is an acceptable solution. This fact is why non-binding arbitration can be useful for what the American Arbitration Association describes as "disputes where the parties may be too far apart in their viewpoints to mediate or are in need of an objective evaluation of their respective positions." Having a neutral party assess the situation may help disputants to rethink and reassess their positions and reach a future compromise.

Issues Covered by Arbitration Agreements

There are many instances in which arbitration agreements may prove helpful as a form of alternative dispute resolution. While arbitration can be useful for resolving family law matters, such as divorce, custody, and child support issues, in the domain of business law, it has three major applications:

- Labor. Arbitration has often been used to resolve labor disputes through interest arbitration and grievance arbitration. Interest arbitration addresses disagreements about the terms to be included in a new contract, e.g., workers of a union want their break time increased from 15 to 25 minutes. In contrast, grievance arbitration covers disputes about the implementation of existing agreements. In the example previously given, if the workers felt they were being forced to work through their 15-minute break, they might engage in this type of arbitration to resolve the matter.
- Business Transactions. Whenever two parties conduct business transactions, there is potential for

misunderstandings and mistakes. Both business-to-business transactions and business-to-consumer transactions can potentially be solved through arbitration. Any individual or business who is unhappy with a business transaction can attempt arbitration. Jessica Simpson recently won an arbitration case in which she disputed the release of a fitness video she had made because she felt the editor took too long to release it.
- Property Disputes. Business can have various types of property disputes. These might include disagreements over physical property, e.g., deciding where one property ends and another begins, or intellectual property, e.g., trade secrets, inventions, and artistic works.

Typically, civil disputes, as opposed to criminal matters, attempt to use arbitration as a means of dispute resolution. While definitions can vary between municipalities, states, and countries, a civil matter is generally one that is brought when on party has a grievance against another party and seeks monetary damages. In contrast, in a criminal matter, a government pursues an individual or group for violating laws meant to establish the best interests of the public. While the word crime often invokes the idea of violence, there are many crimes, such as embezzlement, in which the harm caused is not physical, but rather monetary.

Ethics of Commercial Arbitration Clauses

As previously discussed, going to court to solve a dispute is a costly endeavor, and for large companies, it is possible to incur millions of dollars in legal expenses. While arbitration is meant to be a form of dispute resolution that helps disagreeing parties find a low-cost, time-efficient solution, it has become increasingly important to question *whose* expenses are being lowered, and to what effect. Many consumer advocates are fighting against what are known as forced-arbitration clauses, in which consumers agree to settle all disputes through arbitration, effectively waiving their right to sue a company in court. Some of these forced arbitration clauses cause the other party to forfeit their right to appeal an arbitration decision or participate in any kind of class action lawsuit, in which individuals who have a similar issue sue as one collective group. For example, in 2006, Enron investors initiated a class action lawsuit against executives who hid the company's losses and were awarded $7.2 billion dollars. While this example represents a case where the company being sued was clearly in the wrong, it is important for large companies to be ethical in their use of arbitration clauses. They should not be used as a way to keep wrongdoings "quiet" or to limit consumers' abilities to obtain rightful retribution for products and services that do not perform as promised.

Arbitration Procedures

When parties enter into arbitration, certain procedures are followed. First, the number of arbitrators is decided, along with how they will be chosen. Parties that enter into willing arbitration may have more control over this decision, while those that do so unwillingly may have a limited pool of arbitrators from which to choose. In the case of willing arbitration, parties may decide to have three arbitrators, one chosen by each of the disputants and the third chosen by the elected arbitrators.

Next, a timeline is established, and evidence is presented by both parties. Since arbitration is less formal than court proceedings, the evidence phase typically goes faster than it would in a courtroom setting. Finally, the arbitrator will make a decision and usually makes one or more awards.

Not all arbitration agreements have the same procedures. It depends on the types of agreements made in advance by the disputing parties. Consider the following scenario: the owner of a large commercial office building uses a lease agreement, which stipulates that arbitration will be used to settle the renewal terms of a lease. For example, the lease may state that, at the end of year one, the second year's lease payment will be at current market value, and if the tenants cannot agree on that value, they will then allow an arbitrator to decide. If the building owner feels that the renewal rate should be $40/square foot and the tenant feels it should be $20/square foot, an arbiter who may not be an expert in local real estate values might decide to resolve the dispute by using a rule of thumb, such as "splitting the difference." In this case, the arbiter might decide that $30/square foot represents a fair lease renewal rate.

Figure 2.6 Various types of arbitration can be employed depending on what the parties think is best for their situation. (Credit: Tim Eiden/ pexels/ License: CC0)

To overcome this shortcoming, the building owner could write a lease agreement that stipulates that the parties use **binding baseball arbitration** and use subject matter experts as arbitrators. In this case, that might include real estate attorneys or commercial real estate investors. In baseball arbitration, each party would submit a lease renewal figure to an arbitrator. For example, imagine that the renewing tenant submits an offer of $10/per square foot, which is very much under market value, while the building owner submits an offer of $35/square foot. In this scenario, the arbitrator chooses one offer or the other, without modification. This type of arbitration incentivizes both parties to be fair in their dealings with one another because to do otherwise would be to their own detriment.

Arbitration Awards

An arbiter can issue either a **"bare bones" or a reasoned award.** A bare bones award refers to one in which the arbitrator simply states his or her decision, while a reasoned award lists the rationale behind the decision and award amount. The decision of the arbitrator is often converted to a judgement, or legal tool that allows the winning party to pursue collection action on the award. The process of converting an award to a judgement is known as confirmation.

Judicial Enforcement of Arbitration Awards

While it might seem that the party that is awarded a settlement by an arbitrator has reason to be relieved that the matter is resolved, sometimes this decision represents just one more step toward actually receiving the award. While a party may honor the award and voluntarily comply, this outcome is not always the case. In cases where the other party does not comply, the next step is to petition the court to enforce the arbitrator's decision. This task can be accomplished by numerous mechanisms, depending on the governing laws. These include writs of execution, garnishment, and liens.

- Writ of Execution. Cornell Law School defines a writ of execution as "A court order that directs law enforcement personnel to take action in an attempt to satisfy a judgment won by the plaintiff."
- Garnishment. A garnishment refers to a court order that seizes the money, typically wages, to satisfy a debt. A myriad of laws apply to wage garnishment, e.g., certain types of income, such as Social Security Disability Income (SSDI), cannot be garnished. In addition, depending on state laws, sometimes only debtors who make over a certain amount, e.g. $1,600 gross/month, are subject to wage garnishment.
- Liens. A lien gives the entitled party in a judgement the right to seize the property of another to satisfy a debt. Commonly, liens can be placed on real estate and personal property, such as automobiles and boats. Property that has a lien cannot be sold because the title is encumbered and often cannot be legally transferred until the lien is satisfied, or paid. Depending on state laws, only certain property is subject to a lien. For example, the winning party in an arbitration case may only be able to place a lien on the other party's vehicle if it has a market value of over $7,500.

The enforcement of arbitration awards is governed by a number of laws, such as Federal Arbitration Act and Uniform Arbitration Act.

Summary

Negotiation, mediation, and arbitration are alternatives form of dispute resolution that attempt to help disagreeing parties avoid the time and expense of court litigation. While negotiation is involved in all three forms, mediation and arbitration involve a neutral third party to help the parties find a solution. Frameworks that consider self-interest, as opposed to interest in the other party, can help negotiators craft successful negotiation approaches. Mediators, arbitrators, and groups of arbitrators all follow certain steps and play in important role in trying to help parties reach common ground and avoid court proceedings. Mediators who establish rapport with disputing parties can facilitate dispute resolution, as mediation is very much solution-focused. Arbitrators must often decide upon awards when parties cannot reach an agreement. Even when an aggrieved party attains an arbitration award, it may still have to pursue the other party by using a variety of legal techniques to enforce the payment or practice stipulated by the award. Staying current with federal and state laws associated with negotiation proceedings is essential for businesses looking to maximize their relational and outcome goals.

15. Going to Court

If other alternative actions have not worked, the case may go to court. Here are the steps that are involved with that process.

Pre-trial Procedures

In civil cases, litigation begins with the filing of a **complaint** by the plaintiff. The complaint is a simple document setting forth who the parties are, the facts of the case, and what specific laws the defendant has violated. (Each of these is a claim.) The complaint is filed with the clerk of the court where the suit is to be heard. Every court has a clerk's office to handle administrative matters relating to litigation.

The clerk will next issue a **summons** to the defendant, along with a copy of the complaint. The summons is sent to a process server to effect service on the defendant. When the defendant is served, it is very important for the defendant to respond to the complaint in a timely manner. The defendant must file an answer to the complaint within a specified period of time, typically thirty days. The answer is a paragraph-by-paragraph response to the complaint, admitting certain paragraphs and denying others. The answer may also contain an affirmative defense (self-defense in an assault charge, for example) the defendant wishes to pursue. Taken together, the complaint and answer are known as the pleadings.

After pleadings are filed, the litigation moves into the **discovery** phase. Discovery is a process in which each side finds out information about the other's case. Discovery is designed to prevent trial by surprise, where either side may suddenly produce a damning piece of evidence that allows it to win the trial. Discovery can take the form of a **deposition**. A deposition is a sworn oral statement, in response to questions, given by a potential witness in a trial to the attorneys in the case.

During or after discovery, parties typically make a **motion for summary judgment**. This motion is designed to cut the trial short by asking the judge to decide based on the information discovered so far in the case. In essence, the party making the motion is saying, "Why have a trial?" since the evidence would lead any reasonable jury to the same and inevitable conclusion.

After discovery is finally completed, and assuming that neither side has been successful in short-circuiting litigation through motions, the case is finally scheduled for a trial. In civil litigation, this is a most unusual development, for well over 90 percent of cases filed are resolved or settled before a trial.

The Trial

If a case actually goes to trial, it means there are genuine issues of fact that the parties cannot resolve, and both sides are determined to see their side win. Remember that a trial is a fact-finding process, through which the trier of fact (the jury in most cases or the judge in a bench trial) attempts to determine what happened.

At any given day in a courthouse, several citizens may be called by a judge as potential jurors in a case. If a jury needs twelve members, it's not unusual for a judge to begin with a pool of more than fifty or sixty potential jurors to narrow down to a dozen. The process of selecting a petit jury is called **voir dire.**

After a jury has been selected and sworn in, the trial begins. The plaintiff or prosecution begins by delivering an **opening statement.**

After opening statements, the trial moves into the **examination phase.** Jurors are presented with witnesses, called by each side, to give evidence. The plaintiff begins by calling its **witnesses.** The attorney will guide the witness in delivering testimony by a series of short open-ended questions during the **direct examination.**

After direct examination, the other side has the right to conduct a **cross-examination.** During the cross-examination, the attorney will try to discredit the witness to convince the jury that the witness is not credible.

Once the prosecution or plaintiff has called all its witnesses, and the witnesses have undergone direct and cross-examination, then the prosecution or plaintiff will **rest its case.** The defendant may make a motion for a directed verdict, arguing that no reasonable juror could possibly find in favor of the prosecution or plaintiff after hearing the evidence presented so far.

After the defense has rested its case, the attorneys once again address the jury in **closing arguments.** After closing arguments are made, the judge in the case charges the jury by giving the jury its instructions. The instructions acquaint the jury with the relevant law. The jury then retires to **deliberate.** Central to the jury's deliberations is the **burden of proof** applicable to the case. In criminal trials, the prosecution always carries the burden of proof. That burden is to prove the defendant committed all the elements required in the crime **beyond a reasonable doubt.** In civil cases the burden of proof is **preponderance of the evidence.** This standard requires the scales of justice to tilt ever so slightly toward one party to declare that party the winner.

Once the jury delivers its verdict, the losing side typically makes a **motion for judgment** notwithstanding the verdict. In this motion, the party is arguing that the jury arrived at the wrong verdict and that no reasonable jury could have arrived at that verdict. If the judge denies the motion for judgment notwithstanding the verdict, then the judge enters the jury's verdict as a **judgment.** After that, the losing party has the right to file an **appeal**. Remember that on appeal, the appellate court is only reviewing the record for legal error and cannot call new witnesses or substitute its judgment on the facts for the jury's.

Once all appeals are exhausted, the winner in litigation can finally collect whatever **damages** it is entitled to. This process is called **execution**. If the loser is unable or unwilling to pay the judgment, the winner can petition the court to use its full legal resources, including asking the sheriff to seize the loser's assets for sale, to satisfy the judgment.

16. End Notes

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CHAPTER III

THE TORT SYSTEM

Whenever a company or individual acts unreasonably and causes injury, that person or company may be liable for committing a tort. In some cases it doesn't matter how careful or reasonable the company or individual is—they may be liable for any injury resulting from their actions. Torts are an integral part of our civil law, and in this chapter, we will cover:

Competency	**Explain torts**
Criteria	Differentiate between intentional torts and negligence
Criteria	Explain the four elements of negligence
Criteria	Define strict liability
Criteria	Define product liability

17. Torts

OPENSTAX

Civil suits arise from damages suffered by one or more persons or entities at the hands of another person or entity. The damage can happen in a variety of circumstances, and may be intentional or unintentional. Unlike criminal cases, civil suits seek to provide some form of remedy for the loss suffered by an injured party. Civil suits are decided by judges and juries based on the specific situation, especially when violation of statutes, or laws, is not in question.

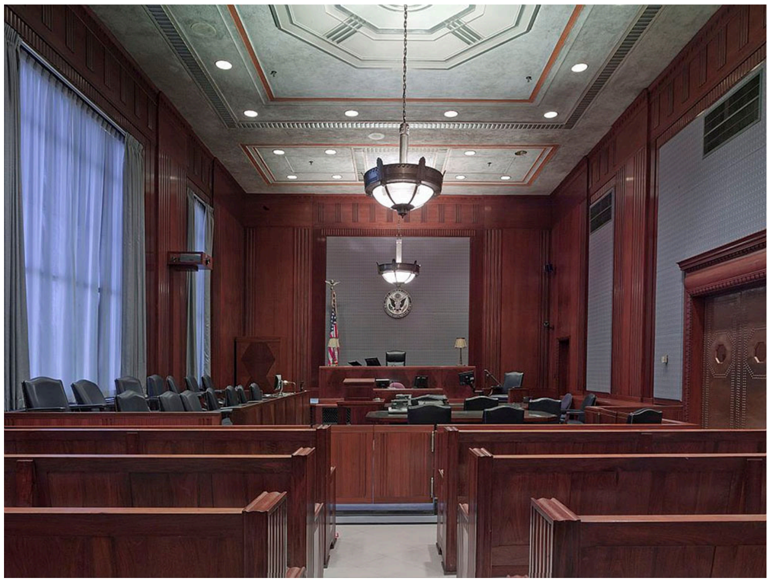

Figure 6.2 Civil suits are decided in court by judges and juries. (Credit: Coffee/ pixabay/ License: CC0)

Torts

Civil suits involve different causes of action, and they are included in one general classification: **torts**. The word **"tort"** means "wrong" in French. Thus, torts are wrongs committed against others who suffer some form of damage as a result. While these damages could also be the result of criminal action, the criminal element of the matter is not tried in a civil lawsuit. The standard of proof is lower for civil suits, and a finding of liability in a tort case does not necessarily translate to guilt in a criminal case.

The actor of the wrongs has historically been called a **"tortfeasor".** When a wrong is committed by a tortfeasor, damage is done to another. Tort law seeks to address this damage based on the circumstances of the issue, which is based on fault. Civil lawsuits are used by the injured parties to seek redress for the loss associated with the tort. Unlike criminal proceedings, redress is often provided in the form of money as opposed to incarceration. As such, the burden of proof of fault is lower. The offender, or tortfeasor, who commits the act is the accused in a civil suit. The **plaintiff**, who is the injured party, files the lawsuit on which the civil court will make a decision. The offender ultimately becomes the defendant, who must respond to the accusations of the plaintiff in a civil suit.

During tort litigation, the judge and jury have certain separate functions (Kionka, 2013):

Functions During a Tort Litigation

The Judge Decides Issues of Law	The Jury Decides Questions of Fact
The duty of the defendant to the plaintiff, if any	What happened
The elements of the defense	Legal consequences of what happened
Application of legal rules	The damages suffered by the plaintiff

Table6.1

Harm

Two types of torts are **intentional torts and negligence**. Intentional torts occur as the result of a conscious and purposeful act. Negligence occurs when an individual does not exercise duty of care. Torts are acts or omissions that result in injury or harm to an individual in such a way that it leads to a civil wrong that occurs as liability (WEX, n.d.). In tort law, harm can be defined as a loss or disadvantage suffered as a result of the actions or omissions of another (WEX, n.d.). This loss can be physical harm, such as slipping and falling on a wet floor, or personal property harm, such as allowing water to ruin furniture. The damage is the result of what someone else did, or did not do, either intentionally or based on a lack of reasonable care.

There are two basic elements to torts: **damages and compensation** (Laws, tort.laws.com). Tort law acts to compensate persons who have suffered damages at the hands of another (Baime, 2018). Tort law determines the legal responsibility of the defendant and the value of the harm. Different types of torts look at different types of circumstances.

18. Intentional Torts

OPENSTAX

Intentional Torts

Intentional torts are committed by an offender who understands that he or she is committing a tort. Intent does not always equate to directly causing an end result. In some cases, the intent may be something else, such as the possession of knowledge that some harm may occur. The harm may result from intentional action, or due to some circumstance that the offender feels will be excusable (Kionka, 2013).

Some circumstances that could allow the defendant to argue that the action is excusable would include: permission by the injured party, or defense of property, self, or another person (Kionka, 2013). If the injured party agrees to allow the defendant to juggle knives and one slips and causes harm, the action might be excusable to some extent. If a defendant caused harm to the plaintiff's car while trying to avoid being hit by the car, it would likely be excusable.

Different types of intentional torts are based on different circumstances and face different remedies, or means of recovering losses (Baime, 2018):

- Assault is an intentional tort that occurs when an individual has a reasonable apprehension of an intentional act that is designed to cause harm to himself or herself, or to another person.
- Malicious prosecution occurs when an individual files groundless complaints to initiate a criminal matter against another.
- Defamation occurs when an individual intentionally creates and promotes malicious falsehoods about another. Defamation can occur in two ways: slander and libel. Slander is, in effect, when falsehoods are spoken. Libel occurs when falsehoods are expressed in written or other recorded forums.
- Invasion of privacy involves unwanted production of negative public information. Different standards apply to invasion of privacy based on the status of the individual as a public figure.

Intentional Torts in Business

Category	Type	Definition	Compensatory Damages Usually Awarded
Against persons	Assault	Threatening immediate harm or offensive contact	For medical bills, lost wages, and pain and suffering
	Battery	Making unauthorized harmful or offensive contact with another person	
	Defamation	Communicating to a third party information that's harmful to someone's reputation	For measurable financial losses
	Invasion of privacy	Violating someone's right to live his or her life without unwarranted or undesired publicity	For resulting economic loss or pain and suffering
	False imprisonment	Restraining or confining a person against his or her will and without justification	For treatment of physical injuries and lost time at work
	Intentional infliction of emotional distress	Engaging in outrageous conduct that's likely to cause extreme emotional distress to the party toward whom the conduct is directed	For treatment of physical illness resulting from emotional stress
Against property	Trespass to realty	Entering another person's land or placing an object on another person's land without the owner's permission	For harm caused to property and losses suffered by rightful owner
	Trespass to personalty	Interfering with another person's use or enjoyment of personal property	For harm to property
	Conversion	Permanently removing property from the rightful owner's possession	For full value of converted item
Against economic interests	Disparagement	Making a false statement of material fact about a business product	For actual economic loss
	Intentional interference with a contract	Enticing someone to breach a valid contract	For loss of expected benefits from contract
	Unfair competition	Going into business for the sole purpose of taking business from another concern	For lost profits
	Misappropriation	Using an unsolicited idea for a product or marketing method without compensating the originator of the idea	For economic losses

Source: Adapted from Nancy A. Kubasek, Bartley A. Brennan, and M. Neil Browne, *The Legal Environment of Business: A Critical Thinking Approach*, 5th ed. (Upper Saddle River, NJ: Pearson Education, 2009), 348.

An example of invasion of privacy is the following situation:

In 1986 model Russell Christoff posed for a photo shoot for Nestlé Canada for Taster's Choice coffee. He was paid $250 and promised $2,000 if Nestlé used his photo on its product. In 2002 he discovered Nestlé had indeed used his photo on Taster's Choice coffee without his permission (Figure 7.3 "Russell Christoff"), and he sued Nestlé for misappropriation. A California jury awarded him over $15 million in damages.[1] Misappropriation/invasion of privacy can be a very broad tort because it covers more than just a photograph or drawing being used without permission—it covers any likeness or identifying characteristic. For example, in 1988 Ford Motor Company approached Bette Midler to sing a song for a commercial, which she declined to do. The company then hired someone who sounded just like Midler to sing one of Midler's songs, and asked her to sound as much like Midler as possible. The company had legally obtained the copyright permission to use the song, but Midler sued anyway, claiming that the company had committed misappropriation by using someone who sounded like her to perform the commercial. An appellate court held that while Ford did not commit

1. [1]

copyright infringement, it had misappropriated Midler's right to publicity by hiring the sound-alike,[2] and a jury awarded her over $400,000 in damages.

Notes

1. Jaime Holguin, "$15.6M Award for Coffee 'Mug,'" *CBSnews.com*, February 2, 2005, http://www.cbsnews.com/stories/2005/02/01/national/main670754.shtml (accessed September 27, 2010).

2. *Midler v. Ford Motor Company*, 849 F.3d 460 (9th Cir. 1988).

19. Negligence

OPENSTAX

Negligence

Negligence is another type of tort that has two meanings. It is the name of a cause of action in a tort, and it is a form of conduct that does not meet the **reasonable standard of care** (Kionka, 2013). The cause of action is the reason for the damage, and the standard of care is based on the care that a reasonable person would need in a given situation. Negligence is decided by determining the duty of the defendant, whether or not the defendant committed a breach of that duty, the cause of the injury, and the injury itself.

For an action to be deemed negligent, there must be a legal duty of care, or responsibility to act, based on the reasonable standard in a situation (Baime, 2018). An individual can be considered negligent if he agreed to watch a child, but did not do so, and then harm came to the child. An individual would not be considered negligent if he did not know that he was supposed to watch the child, or did not agree to watch the child.

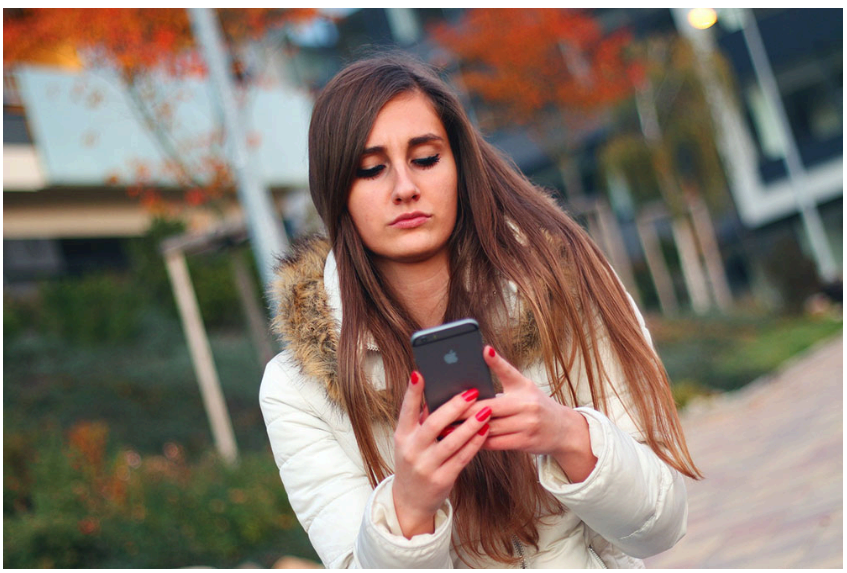

Figure 6.3 If an individual agrees to watch a child and the child is injured while that person pays attention to her cell phone, it would be considered negligence. (Credit: JESHOOTScom/ pixabay/ License: CC0)

A reasonable person is defined as someone who must exercise reasonable care based on what he or she knows about the situation, how much experience he or she has with the situation, and how he or she perceives the situation (Kionka, 2013). In some cases, this knowledge could be based on common knowledge of community matters, such as knowing that a bridge is closed for repairs.

In some cases, the duty of care is based on a special relationship, which is a relationship based on an implied duty of care. This implied duty of care often comes about as a duty to aid, or a duty to protect another, e.g., a nurse caring for patients in a hospital, or a lifeguard being responsible for swimmers in the guarded area (Baime, 2018). A passerby does not have a duty to aid, but if the individual tries to help, then he or she is responsible for acting responsibly.

The elements of a negligence cause of action are (Kionka, 2013):

- A duty by the defendant to either act or refrain from acting
- A breach of that duty, based on a failure to conform to the standard of care by the defendant
- A causal connection between the defendant's action or inaction, and the injury to the plaintiff
- Measurable harm that can be remedied in monetary damages

Jensen was employed as a truck driver. He was driving a new, light truck at 40 mph on a mild day when a tire blew out. As a result, his truck collided with another vehicle and caused both extensive damage to the other vehicle and injury to the driver. Most reasonable persons would agree that Jensen was not negligent in this case. But suppose Jensen was driving at 70 mph, the tires were worn, the day and the pavement hot and the truck was heavily loaded. In that case, most people would say that Jensen was negligent. It is not a particular act that constitutes negligence, but the circumstance that surround it.

Foreseeability

Negligence case decisions are influenced by whether or not a defendant could have predicted that an action or inaction could have resulted in the tort, or **foreseeability** (Baime, 2018). Responsibility is often based on whether or not the harm caused by an action or inaction was reasonably foreseeable, which means that the result was fairly obvious before it occurred (Baime, 2018). A person assisting an inebriated individual into her car could be considered negligent due to the likelihood that harm would come to her while she is driving in an intoxicated state. This situation is an example of the foreseeable probability of harm.

The concept of duty is broad and extends beyond those in immediate physical proximity. In a famous case from California, for example, a radio station with a large teenage audience held a contest with a mobile DJ announcing clues to his locations as he moved around the city. The first listener to figure out his location and reach him earned a cash prize. One particular listener, a minor, was rushing toward the DJ when the listener negligently caused a car accident, killing the other driver. During a negligence trial, the radio station argued that hindsight is not foreseeability and that the station therefore did not owe the dead driver a duty of care. The California Supreme Court held that when the radio station started the contest, it was foreseeable that a young and inexperienced driver may drive negligently to claim the prize and that therefore a duty of care existed.[1] Radio stations should therefore be very careful when running promotional contests to ensure that foreseeable deaths or injuries are prevented. This lesson apparently eluded Sacramento station KDND, which in 2007 held a contest titled "Hold Your Wee for a Wii" where contestants were asked to drink a large amount of water without going to the bathroom for the chance of winning a game console. An otherwise healthy twenty-eight-year-old mother died of water intoxication hours after the contest, which led to a lawsuit and a $16 million jury verdict.

Conclusion

Intentional torts and negligence arise based on intentional and unintentional acts committed by individuals. Damages are decided in civil courts by first determining fault and harm, and then by assigning a remedy. Sometimes, the damage can be excused if the circumstances indicate that the defendant acted with permission, or in his or her own defense. The main standard used to make a decision is the reasonable standard of care: what would a reasonable person do?

1. *Weirum v. RKO General*, 15 Cal.3d 40 (1975).

20. Strict and Product Liability

OPENSTAX

Determination of fault and damages for intentional torts and negligence are based on the reasonable standard of care. Another form of torts looks at **liability without fault, or strict liability**. Strict liability determines liability, or harm, based on reasons other than fault (CCBC Legal Studies, n.d.). The mistakes leading to harm can be completely unintentional, and in some cases, unavoidable. Yet, damage is done, and a civil suit arises.

Strict Liability

Strict liability provides a remedy when harm is suffered through no intentional fault. The courts needed to create a standard that would cover this form of tort, or one without fault. The courts came up with the abnormally dangerous activity standard, which assigns responsibility when an individual engages in some form of dangerous activity, even if care is taken to avoid mishap (CCBC Legal Studies, n.d.). If a homeowner has horses in a pasture that is bounded by electric fencing, it can be determined that the homeowner exercised reasonable care. However, suppose that the electricity goes down, the horses get out onto the road, and an accident occurs as a result. In this case, the owner is responsible, even though he took reasonable care and the event was unforeseen.

Figure 6.4 If horses get out of a fenced-in area, the owner would be liable for any damage they cause while loose. (Credit: Slack/ pexels/ License: CC0)

For a court to assign strict liability based on abnormally dangerous activities, the activity must meet certain criteria. The court must establish that at least four of the following six factors are present (CCBC Legal Studies, n.d.):

- The activity poses a high degree of risk of harm to a person, the land of another, or the property owned by another.

- The harm resulting from this activity would likely be substantial.
- The use of reasonable care would not eliminate this risk.
- The activity is not something that would be considered a matter of common usage.
- The activity is not appropriate for the place where it occurs.
- The danger of the activity overshadows the benefit it poses to a given community.

In essence, the basis for determining strict liability is the extent of the risk involved in the activity. This basis could also apply to the ownership of dangerous pets. A dog that is known to be aggressive would qualify the owner for strict liability should it get out and bite someone. The courts would find that the owner knew, or should have known, that the dog was dangerous and had a propensity to cause harm (Kionka, 2013).

A light bulb factory that manufactures a million safe light bulbs, for example, and then manufacturers one that explodes when it is turned on due to some production defect, is strictly liable for the injuries caused. Similarly, a frozen pizza factory that produces thousands of pizzas without any trouble would be strictly liable if one frozen pizza is produced that contains foreign contaminants because of a production defect such as an inattentive worker or machine breakdown.

Trespass

In some situations, the owner of the dangerous activity might not be held liable. One such situation is **trespassing**. Trespassing occurs as an individual enters or remains upon property owned by another without permission (Kionka, 2013). In the case of trespassing, the owner of the property does not have a duty to make the premises safe based on reasonable care for the trespasser (Kionka, 2013). Also, the owner does not have a responsibility to cancel or alter activities on the premises to avoid endangering the trespasser (Kionka, 2013).

Figure 6.5 Train tracks are a common area for trespassing. (Credit: Muscat_Coach/ pixabay/ License: CC0)

In some cases, however, the property owner could be held liable (Kionka, 2013):

- When the area in question is a common place for trespassing
- When the owner knows a trespasser is present
- When the trespasser needs aid, then the owner has a duty to rescue him or her
- When the trespasser is a child, and the dangerous activity is deemed as an attractive nuisance, or an attraction that a reasonable child would wish to view

Even though trespassing can present an exception to liability in the presence of a dangerous activity, it is not a given. There are numerous exceptions that allow for liability. In effect, strict liability can occur in a given situation even when the property owner has provided care that goes above and beyond what is reasonable. The court does not need to establish proof of lack of due care when applying strict liability to a case (Baime, 2018).

Product Liability

Individuals are not always the defendants involved in civil suits. Manufacturers, wholesalers, distributors, and retailers can also be named in torts that pertain to **products and qualify as strict liability (**CCBC Legal Studies, n.d.). Some products contain flaws that were not intentionally created; such flaws may not be discovered until an individual suffers harm as a result of using them.

It is not always possible to conclusively prove that an act or omission was responsible for the harm (Baime, 2018). As a result, the courts developed the doctrine of **res ipsa loquitor,** which means that whatever it is speaks for itself. The burden of proof shifts from the plaintiff to the defendant, who must disprove negligence. However, the plaintiff must first establish three factors (Baime, 2018):

- The defendant had control over the product in question while it was being manufactured.
- Under normal use and circumstances, the product would not cause damage or harm, but damage or harm has occurred in the case in question.
- The behavior of the plaintiff did not significantly contribute to the harm caused.

The doctrine of res ipsa loquitor does not establish proof of negligence, but it does allow the jury to infer what is not explicitly available pertaining to negligent acts or omissions on the part of the defendant (Baime, 2018).

Negligence can occur when products are created because defects can harm consumers. Think about the potential harm that would occur if brake manufacturers were negligent. This negligence would cause brakes to have flaws, which would prevent them from doing their job of stopping cars. If a car does not stop, people will likely be injured. The manufacturing defect would result in a product liability lawsuit, based on legal responsibility for the harmful consequences proximately caused by the product defect (Baime, 2018). Since the courts would not be able to see the negligence occurring, the courts would base their decision on res ipsa loquitor and the fact that the brakes would not normally fail under normal use by the driver.

Figure 6.6 If brakes do not work like they are supposed to, it could be the result of a manufacturing defect that would result in product liability. (Credit: Valtercirillo/ pixabay/ License: CC0)

The Unreasonably Dangerous Product Standard

In the case of product liability, the court uses an **unreasonably dangerous product standard** to determine liability. The unreasonably dangerous product would be so dangerous that the danger would be beyond the expectation of the user, and a less dangerous option could have been produced instead (Kionka, 2013). This type of unreasonably dangerous product often falls into one of three categories (Kionka, 2013):

- A flaw in the manufacturing process that occurred because the manufacturer failed to exercise proper care during manufacturing
- A defect in the design of the product, which makes it dangerous, and safer alternatives are available and economically feasible
- The product includes insufficient warnings or instructions for the proper use of the product and its potential dangers

Defenses

There are defenses to product liability claims. In some cases, the plaintiff's own behaviors contribute to his or her injuries, based on his or her own negligence. This situation is known as **contributory negligence.** Contributory negligence, when determined by the court, prevents any recovery of damages by the plaintiff (Baime, 2018). So, if the court finds contributory negligence, the plaintiff is unable to recover any damages for the injury. Two forms of contributory negligence are assumption of risk and misuse.

Assumption of risk is one defense. In some cases, the defendant can argue that the user assumed the risk of using the product if he or she used the product while knowing that the defect in the product created a risk (CCBC Legal Studies, n.d.). An individual who purchases a saw and sees that the guard is too small to cover the teeth, but decides to use it anyway, is assuming the risk of using the product. If the saw cuts the individual, then the manufacturer could argue that the person assumed the risk because he saw the defect, understood the risk, and used the saw anyway.

Another defense is **product misuse**. In some cases, an individual will use a product in ways that it is not meant to be used (CCBC Legal Studies, n.d.). The user might not be aware of a defect, and he or she proceeds to use the product incorrectly. Misuse by the individual would be to blame for any resulting harm.

Figure 6.7 Using a chainsaw with bare feet could be dangerous and add to the risk of use without a guard. If the plaintiff suffered harm because his bare foot could not hold the wood down properly, he could be responsible for comparative negligence. (Credit: edman_eu/ pixabay/ License: CC0)

Plaintiffs might also be responsible for **comparative negligence.** With comparative negligence, the plaintiff's own actions in the use of the product contributed to the harm caused by the product, but the plaintiff might still receive damages (CCBC Legal Studies, n.d.). The amount of negligence on behalf of each part (plaintiff and defendant) is compared to determine the damages to which the plaintiff is entitled (Baime, 2018). If a plaintiff is found to be 30% responsible, and the defendant 70% responsible, then the plaintiff would be entitled to 70% of the damages suffered.

Conclusion

In some cases, a plaintiff suffers harm, but fault is not easily determined, or fault is not the issue. A defendant can exercise reasonable care while the nature of the activity lends itself to risk of harm. Products could have obvious or hidden defects that cause harm to another. When defects occur, the plaintiff has the ability to file a civil suit against the entity that is responsible for the harm-causing defect. The plaintiff might also share some responsibility in the harm, and based on product liability, the court decision will be adjusted accordingly.

21. End Notes

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CHAPTER IV
INTELLECTUAL PROPERTY

The competencies covered in this area are:

Competency	**Explain intellectual property**
Criteria	Define intellectual property and why it needs to be protected
Criteria	Summarize basic characteristics of copyright, trademarks, patents and trade secrets

In this chapter, we'll discuss how the law protects Intellectual Property (IP).

22. Constitutional Roots

SAYLOR ACADEMY

The **Copyright Clause**, part of the U.S. Constitution, says that Congress may "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

Although the Constitution addresses only copyrights and patents, modern intellectual property (IP) law also includes trademarks (probably left out of the Constitution because of the relative unimportance of corporations and branding at the time) and trade secrets (a relatively new form of IP protection).

Essentially, the Copyright Clause permits (even commands) the federal government to protect certain products of the mind, just as much as it protects personal land or money. If someone trespasses on your property, you can call the police and have them removed or you can sue them in court for damages. In either case, the full force and power of government is involved. The same thing can be said about IP. On the other hand, you know from your economics classes that, in general, our capitalist economy frowns on monopolies. We believe that monopolies are immune from competitive pressures and can therefore charge exorbitant prices without any regard to the quality of their product. Efficiency suffers when monopolies are allowed to exist, and ultimately the consumer loses in choice and price. If you think about it, though, the Copyright Clause essentially allows the government to create a special kind of monopoly around IP. Take, for example, a pharmaceutical company that invents a certain kind of drug and applies for a patent on that drug. If the government grants the patent, then the company can charge as much as it wants (some drugs can cost tens of thousands of dollars per year for consumers) without any regard for competitors, since competitors are shut out of that drug market by virtue of the patent. If any competitor dares to copy the drug to compete against the inventing company, the full force and weight of the government will be brought down on the competitor. Violations of patent law carry extremely stiff penalties.

How can we say that monopolies are bad, and yet grant Constitutional protection to monopolies on IP? The answer lies in the genius of the Copyright Clause itself. As in all monopolies, there are two sides: the producer and the consumer. The producer always wants the monopoly to last as long as possible, while the consumer wants the monopoly to end as quickly as possible. The Copyright Clause strikes a compromise between the producer and the consumer in two ways.

First, the Clause states that Congress can grant the monopoly only to "promote the progress of Science and Useful Arts." In other words, the monopoly exists for a specific purpose. Note that "making Beyoncé rich" or "allowing Pfizer to make billions of dollars" is not the purpose. Rather, the purpose is **progress.** Granting monopolies can encourage progress by providing a financial incentive to producers. Singers, songwriters, inventors, drug companies, manufacturers—they all invent and innovate in the hope of making money. If they knew that the law wouldn't protect what they came up with, they'd either not invent at all or they'd simply do it for themselves and their families, without sharing the fruits of their labor with the rest of society.

Second, the clause states whatever monopoly Congress grants has to be for a "limited time." In other words, at some point the monopoly will end. When the monopoly ends, science is once again progressed because then society can freely copy and improve upon the producer's products. Society benefits greatly from the expiration of these IP monopolies. Important drugs such as aspirin and penicillin, for example, can now be purchased for pennies and are accessible to the entire human population. Grand literary works, such as Shakespeare's *Hamlet* or Beethoven's Fifth Symphony, can be performed and enjoyed by anyone at any time without seeking permission or paying any fees or royalties. These inventions and works are in the public domain, to be enjoyed by all of us.

The Copyright Clause does not state how long the monopoly can last; it leaves that task to Congress. Congress must make the decision based on what's best to promote progress. Remember, though, that producers want monopolies to last as long as possible. For example, consider how long copyrights last. Since 1976 copyrights have lasted for fifty years after the death of the author. After that, copyrighted works fall into the public domain (such as works by Shakespeare or Beethoven). In 1998, however, Congress began considering adding an extra twenty years to that term, for a total of seventy years after the author's death. In the early part of the twentieth century, the United States experienced a cultural renaissance that accompanied the Industrial Revolution. The invention of the phonograph and cameras allowed the creative genius of Walt Disney, George Gershwin, and Charlie Chaplin (to name a few) to flourish. Under the 1976 copyright law, though, some of these early works (including early versions of Winnie the Pooh) were about to fall into the public domain by 1998. The United States was also under some pressure from international trading partners to increase the copyright term.

23. Patents

SAYLOR ACADEMY

Imagine that you invented the Apple iPhone 4. If you invent a patentable item that is useful, new, and nonobvious, and if you are capable of describing it in clear and definite terms, you may wish to protect your invention by obtaining a **patent.** A patent grants property rights to the inventor for a specified period of time, with a utility patent and a plant patent expiring twenty years following the original patent application and a design patent expiring fourteen years afterward. A patentee owns a patent.

Three patent types exist. **Utility patents** may be granted for machines, processes, articles of manufacture, compositions of matter, or for improvements to any of those items. The Apple iPhone 4 certainly is the subject of utility patents. **A design patent** may be granted for ornamental designs for an article of manufacture. **A plant patent** covers inventions or discoveries of asexually reproduced plants (e.g., plants produced through methods such as grafting).

Not all items are patentable. For instance, an idea alone (without a definite description) cannot be patented. So even if you dreamed up the idea of something that looked and functioned exactly like the Apple iPhone 4, you would not have been eligible for a patent on your idea alone. Likewise, physical phenomena, the laws of nature, abstract ideas, and artistic works cannot be patented. Note, however, that artistic works can be copyright protected. Additionally, otherwise patentable subjects that are not useful, or items that are offensive to public morality, are not patentable.

So what does it mean to have a patent? Just like real property ownership, a patent confers the right to exclude others. If you owned a parcel of real property, your ownership interest would allow you to exclude others from your land. The rule of law would protect your right to exclude against the intrusions of others, which is the very essence of ownership. Likewise, a patent confers the legal right to exclude others from making, using, or selling the patented product. This is consistent with the Copyright Clause of the U.S. Constitution, which grants inventors the “exclusive Right to their…Discoveries.” For others to legally make, use, or sell the patented product, they would have to be granted permission by the patentee. This is often accomplished through a licensing agreement, in which the patentee authorizes others to sell, make, or use the product.

You might be wondering how a patent can be granted over a living thing, like a plant. As mentioned earlier in this section, in the United States living things are patentable. Living things became the legal subjects of patents when, in 1980, the U.S. Supreme Court held that a bacterium designed by its inventor to break down crude oil components was the legitimate object of a patent.[1] Indeed, as the Supreme Court noted in that case, congressional intent regarding the U.S. Patent Act was that “anything under the sun that is made by man” is patentable. Since then, we have seen many living organisms patented.

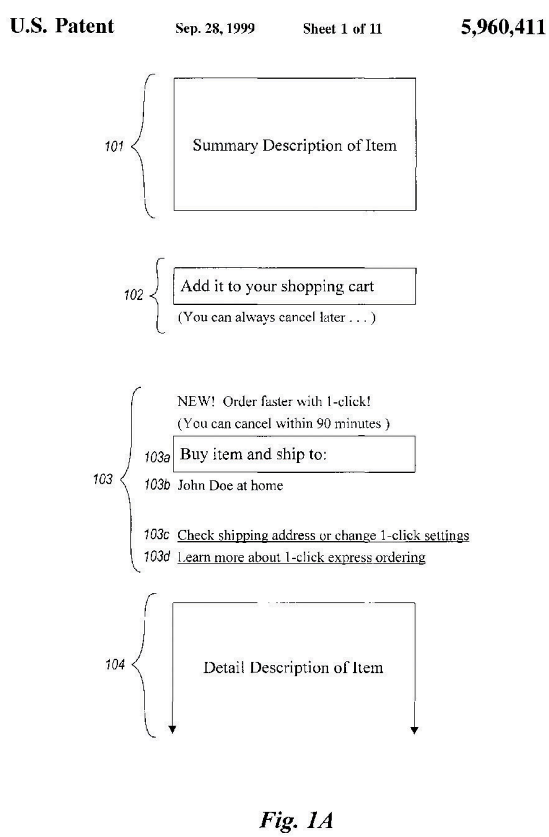
The U.S. Patent and Trademark Office (USPTO) grants property rights to patentees within the United States, its territories and possessions. Patent law is complicated, and attorneys who wish to prosecute patents (file and interact with the USPTO) must have an engineering or science background and pass a separate patent bar exam. When an application is filed, the USPTO assigns a patent examiner to decide whether the patent application should be approved. While the application is pending, the applicant is permitted to use the term “patent pending” in marketing the product to warn others that a patent claim has been filed. Even after a patent has been issued by the USPTO, however, the patent is merely “presumed” to be valid. If someone challenges a patent in a lawsuit, final validity rests with the U.S. federal courts. For decades, the U.S. Supreme Court routinely ignored patent appeals, allowing lower courts to develop patent

1. *Diamond v. Chakrabarty*, 447 U.S. 303 (1980).

law. In recent years, under Chief Justice John Roberts, the Supreme Court has dramatically increased its acceptance of patent disputes, perhaps as a sign that the Court believes too many patents have been issued.

In the last decade there has been an over 400 percent increase in the number of patents filed, resulting in a multiyear delay in processing applications. An increase in the number of business method patents contributed to this dramatic increase in patent applications. A business method patent seeks to monopolize a new way of conducting a business process. Figure 9.5 "Patent Filing for One-Click Web Ordering", for example, describes a method of e-commerce by which a customer can order an item and pay for it immediately with just one click of a mouse button. This one-click patent was granted to Amazon.com, much to the chagrin of other online retailers such as Barnes & Noble, who were prohibited from using a similar checkout mechanism. Amazon licensed the patent to Apple so that it could feature one-click on its Web site.

Figure 9.5 Patent Filing for One-Click Web Ordering



Source: Courtesy of Free Software Magazine, http://www.freesoftwaremagazine.com/files/www.freesoftwaremagazine.com/nodes/1250/1A.jpg.

Outside the United States, a patent granted by the USPTO does not protect the inventor's interest in that property. Other steps must be taken by the inventor to protect those rights internationally. If someone possesses the patented object without permission from the patentee, then the possessor can be said to have infringed on the patent owner's rights. Patent infringement is an actionable claim. A successful action may result in an injunction, treble damages, costs, and attorney's fees. One defense to a patent infringement claim is to challenge the validity of the patent.

In recent years several companies that do nothing but sue other companies for patent infringement have emerged. These patent holding companies, sometimes called patent trolls by critics, specialize in purchasing patents from companies that are no longer interested in owning them and then finding potential infringers. One such company, NTP, sued Research in Motion (RIM), the maker of the BlackBerry device, for a key technology used to deliver the BlackBerry's push e-mail feature. Faced with a potential shutdown of the service, RIM decided to settle the case for more than six hundred million dollars.

24. Trade Secrets

SAYLOR ACADEMY

Imagine that you are in an antique store and find a nineteenth-century ledger book for sale, originally from the W. B. Morrison & Co. Old Corner Drug Store in Waco, Texas. Among the recipes for hair restorers and cough syrups, something in particular catches your eye—a recipe entitled *D Peppers Pepsin Bitters*. What if you also knew that Dr. Pepper was first created and served in that very drugstore? What if you offered to pay two hundred dollars for the old ledger book, even though if it did contain the recipe for Dr. Pepper, it would be worth far more? After all, according to the company that manufactures Dr. Pepper, only three people know the recipe to that very closely guarded trade secret. Something very similar to this happened to Bill Waters. He found the ledger book in an antique store, and he paid two hundred dollars for it. However, at the time, he did not know that the book might date back to the exact time and place from which the popular soda was created. In fact, he did not even notice the recipe until later, and it took him several more days to recognize the possibility that it might be an early version of Dr. Pepper.

Unlike patents, a trade secret can last forever. That is, it can last forever if the owner of the secret can, well, keep it a secret. If someone uses lawful means to uncover the secret, then the secret is no longer protected by the secret's owners. Does this include reverse engineering? Yes. Reverse engineering is an absolutely legal means of discovering a trade secret. What about ferreting out secrets from an employer's safekeeping, while employed and under a binding confidentiality agreement? No. That is an actionable claim for misappropriation, and the secret's owners can pursue damages.

Trade secrets are unlike patents in another important way. With a patent, the inventor must specifically disclose the details of the invention when applying for a patent. This means that the inventor has not protected the secret of the invention. However, in exchange for this disclosure, a patent owner has a legal monopoly over the property for a specified period of time. So even if others discover the secret of the invention (not a difficult task since patent applications are public record), they are prohibited from making, using, or selling it without the patentee's permission. After the patent expires, then the patentee no longer has a property right to exclude others.

So what is a trade secret? It is, in short, secret information. This information may include a process, formula, pattern, program, device, method, technique, or compilation. For many companies, lists of suppliers, costs, margins, and customers are all trade secrets. Soft drink recipes, KFC's eleven spices, the donut mix sent to Krispy Kreme franchisees, the Big Mac's special sauce, and even the combination of wood that is used in the burning process to make Budweiser beer are all trade secrets. Additionally, the information derives actual or potential economic value from being a secret that is not readily discoverable by others, and the information is the subject of efforts to keep it a secret. While most states have adopted the Uniform Trade Secrets Act (UTSA), not all have, so the definition of trade secret can vary by jurisdiction. Unlike patents, trademarks, and copyrights, there is no federal law protecting trade secrets.

A claim for misappropriation may be brought when a trade secret has been wrongfully obtained, such as through corporate espionage or bribery. Generally, according to the UTSA, misappropriation occurs if the secret was acquired by improper means, or if the secret was disclosed or used without permission from the secret's owner. Damages may include actual loss and unjust enrichment not captured by actual loss. Additionally, in cases of willful or malicious misappropriation, double damages may be awarded, as well as attorney's fees.

So what if you are never lucky enough to discover a multimillion-dollar secret recipe hidden away in an antique shop? As long as the recipe is not patented, you can try to reverse engineer it. If you succeed, you can use it immediately. However, if you are working for an employer in a creative capacity, working with others to develop the secret, and if you have agreed not to use trade secrets, then the right to the trade secret will belong to your employer, at least in most jurisdictions. Ask Peter Taborsky, an undergraduate student at South Florida University in 1988. According to Taborsky, while working in the university's chemical engineering lab, he began conducting experiments on his own. He discovered a highly effective method for treating sewage. The university demanded that he hand over his notebooks that contained the secrets of this invention. Taborsky refused and filed for a patent for his invention, which he received. However, the university pressed criminal charges for stealing trade secrets. Taborsky lost his case and found himself in a maximum-security facility working on a chain gang.

So does Bill Waters need to worry about Dr. Pepper's owners suing him for misappropriation or pressing criminal charges for stealing trade secrets? No. He lawfully obtained the ledger book by purchasing it in the open market. Additionally, according to a company spokesman, the ingredient list under *D Peppers Pepsin Bitters* is most likely an old remedy for a stomachache rather than any version of the recipe for Dr. Pepper. Even if Mr. Waters had accidentally stumbled on the exact Dr. Pepper recipe, he would have a good argument that the company did not take steps to keep the secret a secret. If it had, he could argue, the company never would have allowed the recipe out of its sight.

25. Trademarks

SAYLOR ACADEMY

Look at Figure 9.7 "McDonald's, One of the Most Recognized Trademarks in the World". It's obviously a McDonald's restaurant, but can you tell where this restaurant is? Is it in a mall or airport? Is it in Trenton, Toronto, or Tokyo (or, as it turns out, Messestadt Riem in Germany)? Without additional information, it may be impossible to tell. And yet, no matter where you are in the world, if you enter this McDonald's restaurant, there are certain standards that you expect. You would expect to find a Big Mac on the menu, perhaps Chicken McNuggets and french fries too. You would expect those menu items to taste the same as they do in your local McDonald's. Perhaps you'd expect a certain level of service from the employees, a certain value proposition for your money, a certain look from the uniform and fixtures, or perhaps a clean restroom. If you walked into this McDonald's restaurant and found out that it was in fact not McDonald's, you might be confused. The ultimate goal of trademark law is to prevent this consumer confusion. To prevent any other restaurant from using the name McDonald's, or from using a logo that looks like a stylized "M," McDonald's can trademark both its name and logo (and a lot of other elements of its brand as well). In this section, we'll examine how trademark law accomplishes this goal.

Figure 9.7 McDonald's, One of the Most Recognized Trademarks in the World

Source: http://commons.wikimedia.org/wiki/ File:RiemArcaden.McD.JPG.

A trademark is any kind of name, logo, motto, device, sound, color, or look that identifies the origin of a particular good or service. Something begins to look like a trademark when a consumer *identifies* it with a particular origin. For example, someone buying a Diet Coke knows that he or she is getting a carbonated beverage from the Coca-Cola Company. If he or she bought a Diet Cola, on the other hand, there's no association in the mind with any particular company, so it could be from Coca-Cola, Pepsi, or any number of other companies. The key is that consumer identification with a specific origin. If a consumer thinks of a class of goods rather than one specific origin, then it's not a trademark. So, for example, when a consumer hears "aspirin," he or she thinks of a class of goods with no particular origin because aspirin is not a trademark. But if a consumer hears "Bayer," he or she thinks of a specific aspirin from a specific source, making "Bayer" a trademark.

A federal law, the Lanham Act, protects trademarks. Unlike copyrights and patents, trademarks can last forever and are not subject to the Constitution's "limited time" restriction. Since the objective of trademark law is to prevent consumer confusion, the public good is best served by allowing companies to maintain their trademarks as long as consumers associate a trademark with a specific origin. The moment they no longer make that association, however, the trademark ceases to exist.

If you are considering marketing as a career, you will become intimately familiar with the concepts related to branding and the value of branding. At its core, marketing involves the science of relating to consumers, telling them an authentic story about your product and service, and satisfying their wants and needs. Having a brand is essential to carrying out this objective, and it can lead to startling profits. The Apple and iPhone brands, for example, are very strong and yield billions of dollars in profits for Apple. Luxury brands are particularly aware of this phenomenon, as often their brand alone can justify pricing far above a similar good. Gucci, such as this store in Hong Kong (Figure 9.8 "Gucci Store in Hong Kong"), trades on the value of its brand to command premium prices (and margins) in the marketplace. Brands such as Rolex, Hermes, Rolls-Royce, and Bentley have similar business models. These brands are all trademarks—indeed, all brands are either registered trademarks or are trademark-able because they share the common feature of consumer identification. Be careful, though. "Trademark" and "brand" are not interchangeable terms because not all trademarks are brands.

Figure 9.8 Gucci Store in Hong Kong

Trademark law is especially important for luxury brands such as Gucci. Source: Photo courtesy of Maizeam, http://commons.wikimedia.org/wiki/File:HK_TST_Canton_Road_GUCCI_Shop.JPG.

So what can be a trademark? Obviously, words can be trademarked. When it comes to trademarks, distinctiveness is good. Therefore, an invented word is the best type of trademark. In 1997, for example, when Stanford grad students Larry Page and Sergey Brin were brainstorming names for their new Internet search engine, they settled on the word "Google," a play on "googol," which means 1 followed by 100 zeroes. They felt the name reflected their goal to organize the staggering amount of information available on the Internet. On the other hand, regular words can also become trademarks, as long as consumers identify them with a particular source. Amazon, for example, is the name of the world's longest river, but it's also the name of an online retailer. Since consumers now identify Amazon.com as an online retailer, the name can be trademarked. Another example is the phrase "You're Fired" when used in a television program. The phrase was made popular by billionaire Donald Trump and has such lasting recognition now that it's unlikely any other television show could use that phrase as a central part of its theme.

Consider what would happen if you tried to trademark your name. If your name happens to be Sam Smith, you'd probably have a pretty hard time getting a trademark for your name. If, however, you called your business Sam Smith anyway, and started growing your business so that eventually, over time, consumers began to identify "Sam Smith" as your business, then your name has acquired secondary meaning and can be trademarked. Thus, Sam Adams is a trademark for a beer, Ben & Jerry's is a trademark for ice cream, and Ford is a trademark for a motor vehicle.

Hyperlink:

http://www.npr.org/templates/story/story.php?storyId=19227066

Can a sportscaster trademark the phrase "Are you ready to rumble"? Can Paris Hilton trademark the phrase "That's hot"? As long as the public associates these phrases with a distinctive origin, the answer is yes. Listen to this National Public Radio broadcast for more examples.

Note that when you get a trademark, it's typically granted for a specific category of goods. The same name can sometimes be used for multiple categories of goods. The name Delta, for example, is a trademark for both an airline and a brand of faucets. Since there is little chance that a consumer will be confused by an airline or faucet brand, trademark law allows these dual registrations. On the other hand, some brands are so strong that they would probably stop registration even for a completely different category of goods. McDonald's is a good example of this. The McDonald's trademark is one of the strongest in the world, meaning that it is instantly recognizable. In 1988, for example, hotel chain Quality Inns decided to launch a new line of budget motels called "McSleep." McDonald's sued, claiming trademark infringement. McDonald's claimed that consumers might be confused and believe that McDonald's owned the hotel chain. A federal judge agreed and ordered Quality Inns to change the name of the chain, which it did, to Sleep Inns.

Trademarks go beyond simply a company's name or its logo. A color can be trademarked if it's strong enough to create consumer identification. Pink, for example, is trademarked when used for building insulation by Owens Corning. All other insulation manufacturers must use different colors. Sounds can be trademarked too, such as MGM Studios' "lion's roar." Even a certain "look" can be trademarked if a consumer identifies it with a certain origin. Thus, the distinctive colors, materials, textures, and signage of a Starbucks or T.G.I. Friday's are considered trade dress and cannot be copied. A bottle shape can be considered trade dress, too, such as the shape of a nail polish bottle (Figure 9.9 "OPI's Nail Polish Bottle"). OPI, a nail polish manufacturer, has registered this bottle shape with the U.S. Patent and Trademark Office (USPTO) and is suing other manufacturers that use a similarly designed bottle. Interestingly, courts have been reluctant to grant certain smells trademark protection, even though it can be argued that certain fragrances such as Old Spice or CK One are distinctive. Imagine the chaos that would ensue if one company claimed trademark protection for vanilla or strawberry scents—consumers would ultimately be robbed of choice if that were to happen.

A trademark is not limited to a name or logo used to sell goods. If a company provides a service (as opposed to selling goods), it too can receive trademark protection. In this case it's called a service mark. Facebook, for example, is a service mark. A trademark can also be used to demonstrate certification meeting certain standards, such as the Good Housekeeping Seal of Approval. If you study operations management, you'll learn about the International Organization for Standardization (ISO) and its various standards for quality management (ISO 9000) or environmental quality (ISO 14000). The Forest Stewardship Council (FSC) allows its logo to be used on paper products that come from sustainable forests, while certain foods can be labeled "Organic" or "Fair Trade" if they meet certain standards as established by governmental or nongovernmental organizations. Each of these marks is an example of a certification mark. Finally, a mark can represent membership in an organization, such as the National Football League, Girl Scouts of America, Chartered Financial Analyst, or Realtor (Figure 9.10 "“Realtor” Certification Mark"). Each of these is known as a collective mark. The rules that apply to trademarks apply equally to service marks, collective marks, and certification marks.

Figure 9.9 OPI's Nail Polish Bottle

A bottle's shape can be trademarked if it is distinctive enough. Source: Photo courtesy Jessica Ta, http://www.flickr.com/photos/blogggles/4288368487.

If a color or sound can be trademarked, is there anything that cannot be trademarked? The Lanham Act excludes a few categories from trademark registration, mainly for public policy purposes. Obviously, trademarks will not be granted if they are similar or identical to a trademark already granted. If you're starting a new company, it's a good idea to make sure that not only is a domain name available for your company's name, but that the name isn't already trademarked by someone else. Trademarks also cannot contain the U.S. flag, any government symbol (such as the White House or Capitol buildings), or anything immoral. Trademarks cannot be merely descriptive. (Thus every restaurant is allowed to offer a "Kid's Meal," but only McDonald's can offer a "Happy Meal.")

Figure 9.10 "Realtor" Certification Mark

Source: http://upload.wikimedia.org/wikipedia/en/1/16/Realtor_logo.jpg.

Whether or not a region can be trademarked (a geographic indicator, or GI) is the subject of some controversy, especially with our trading partners. "Maine Lobster," "Napa Valley Wine," or "Florida Orange Juice," for example, may indicate to some consumers the origin of a particular lobster or bottle of wine or orange juice, and thus may be of commercial value to distinguish the product from competitors from other regions. For the time being, these foods must come from Maine, California, or Florida to avoid liability under consumer protection statutes for fraud (lying) about their origin. What happens, though, if consumers lose the association with the region? For years, sparkling wine manufacturers in Champagne, France, have fought to prevent this from happening by requiring that only sparkling wine made in the Champagne region be called "champagne." Now, food producers (especially in the European Union) are seeking similar protection under international trademark law for Feta, Parmesan, Gorgonzola, Asiago, and hundreds of other names.

A trademark is valid as long as consumers believe that the mark is associated with a specific producer or origin. If the mark refers to a class of goods instead, then the trademark can no longer exist. This process is called genericide. Many words today once started as trademarks: furnace, aspirin, escalator, thermos, asphalt, zipper, softsoap, cellophane, lite beer, Q-tip, and yo-yo are all examples of trademarks that are now generic and have therefore lost legal protection. To prevent genericide from occurring, trademark owners must take active steps, often costing millions of dollars, to educate consumers on the importance of using their trademarks properly and to prosecute infringers. For example, when you hear the word "Kleenex," do you think of a brand of tissue owned by Kimberly-Clark, or do you think of tissues generally? Does "Rollerblade" refer to a brand of in-line skates, or to all in-line skates? In Southern states, does "Coke" refer to a Coca-Cola, or to soft drinks generally? When you run a "Xerox" photocopy, is it on a Xerox photocopier or some other machine? These trademarks, all currently active and worth billions of dollars to their owners, are in danger of becoming generic in the United States. If that happens, the companies will lose control of the marks and the public (and competitors) will be free to use those words just as they use "aspirin" and "yo-yo" today. Xerox has taken many steps to educate the public about its trademark, including running print advertisements in business periodicals. In one of these ads, the text says, "When you use 'Xerox' the way you use 'aspirin,' we get a headache."

Trademark infringement occurs when someone uses someone else's mark, either completely or to a substantial degree, when marketing goods or services, without the permission of the mark's owner. Obviously, making your own pair of jeans and slapping a "Levi's" label on it, or making your own handbag and sewing a "Coach" label on it, constitutes trademark infringement. When Apple first released the iPhone, to its embarrassment it found out that "iPhone" was already a registered trademark belonging to Cisco, another company, for a phone used for placing phone calls over the Internet. To avoid trademark infringement liability, Apple had to pay Cisco an undisclosed sum to purchase the trademark. Ford found itself in a similar situation when it released a supercar called the "Ford GT." Ford made a similar racing car in the 1960s called the "GT 40" but lost control of the trademark after production ceased. Unable to reach agreement with the current trademark owners, Ford settled for releasing the new car as simply the "GT."

The law also permits trademark owners to sue infringers who use their marks to a substantial degree. For example, when Samsung announced its new smart phone, the Black Jack, the makers of the BlackBerry device sued for trademark infringement. When a software company released a product to eliminate unwanted e-mails called "Spam Arrest," it was sued by Hormel, makers of Spam canned luncheon meat. When a small coffee shop in Syracuse, New York, opened as "Federal Espresso," the shipping company FedEx filed a trademark infringement claim.

Even if a trademark owner doesn't believe a similar use of its mark would lead to any consumer confusion, it can protect its trademark through a concept called dilution. Such was the case when an adult novelty store in Kentucky opened as "Victor's Secret" (the owner's name was Victor). The trademark owners of "Victoria's Secret" filed a dilution suit in response. Traditionally, trademarks are intended to prevent consumer confusion. Dilution permits a trademark owner to stop usage of a similar word or phrase even if consumers aren't confused. Under dilution concepts, the trademark owner only needs to show that its mark will be diluted or tarnished in some way.

Companies or persons accused of trademark infringement have several defenses to rely on. The most obvious is arguing that no infringement has occurred because the two marks are sufficiently different that consumers won't be misled. For example, in 2002 Jeep sued General Motors for infringing on what Jeep called its trademark grill. GM's Hummer division released the H2 that year, with a similar seven-bar grill. A district court held that there was no trademark infringement because the grills were too dissimilar to cause consumer confusion. Look at the Hummer H2 grill (Figure 9.11 "Hummer H2 Grill") and the Jeep grill (Figure 9.12 "Jeep Grill"). Do you think there is a chance of consumer confusion?

Figure 9.11 Hummer H2 Grill

Source: Photo courtesy of Ramchandran Maharajapuram, http://www.flickr.com/photos/me_ram/3157719487.

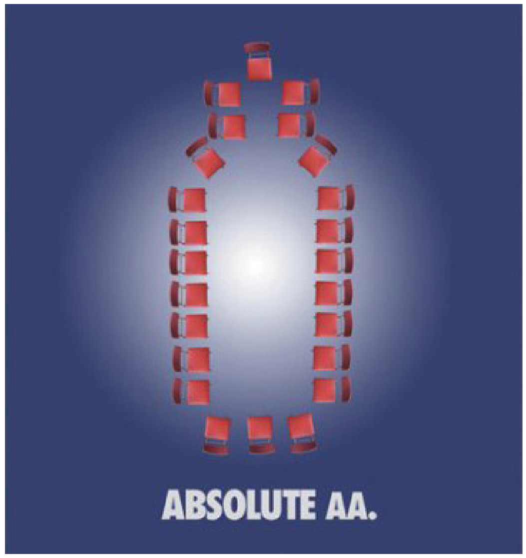
Figure 9.12 Jeep Grill

Source: Photo courtesy of 3obryans, http://www.flickr.com/photos/3obryans/1017233.

Another defense is fair use. The Lanham Act prohibits the use of someone else's trademark when selling goods. It's not uncommon to see various items such as laptop computers, telephones, soda cans, or other foods with their labels covered by stickers or blurred out on television shows and movies because of the trademark law. On the other hand, what if a company wanted to mention a competitor's product to draw a comparison with its own product? This is called comparative advertising, and it's considered fair use. Honda, therefore, is free to claim that its "Honda Accord is better than the Ford Taurus" in its advertising even though Ford and Taurus are both trademarks owned by Ford Motor Company.

The First Amendment also recognizes the use of parody, comedy, or satire as fair use. Comedy skits on television that make fun of, or use, company logos are an example of this fair use. Canadian nonprofit Adbusters, for example, claims to be an organization seeking to advance "a new social activist movement in the information age." Part of its work involves making fun of corporations and consumer spending, sponsoring "Buy Nothing Day" as an antidote to the annual holiday spending season. Making fun of corporations also involves spoofing their commercial messages, as the ad in Figure 9.13 "A Parody of the Well-Known Absolut Vodka Print Ads" illustrates. Although the ad undoubtedly infringes on a trademark, it is considered fair use because of the social commentary and satire behind its message.

Figure 9.13 A Parody of the Well-Known Absolut Vodka Print Ads



Source: Photo courtesy of Adbusters, https://www.adbusters.org/gallery/spoofads/alcohol/absolutaa.

An interesting aspect of trademark infringement arises through the use of domain names on the Internet. The practice of cybersquatting (or domain name squatting) arises when a company registers a domain name containing a famous trademark in hopes of selling that trademark to its rightful owner for a large profit. The practice arose in the early days of the Internet, when domain name registration took place on a first-come, first-served basis. There is nothing wrong with registering a domain name for a generic word such as "shoes.com," but incorporating a registered trademark into the domain name, for purposes of selling it later, is considered cybersquatting. This practice was made illegal in 1999 with the passage of the Anticybersquatting Consumer Protection Act. It is only illegal, however, if the domain name is registered to make a profit through later sale. It is not illegal if someone registers the domain name in "good faith." A good example is the domain name registered by Canadian teenager Mike Rowe in 2003. An avid computer user, he registered "mikerowesoft.com" as a domain name. Software giant Microsoft launched legal proceedings against him, claiming violation of the cybersquatting statute and trademark infringement. Rowe's defense was that the Web site merely reflected his name and his interest in computer programming and software and was being used for that purpose. After heavy negative publicity, Rowe and Microsoft settled the case with Microsoft taking control of the domain. Another example surrounds the Nissan.com domain. Uzi Nissan, a computer storeowner, had owned the domain for years before Nissan Motors attempted to gain ownership of the domain. Since the domain was registered in good faith, no cybersquatting has occurred. The First Amendment is also a defense to cybersquatting. Web sites run by consumer activists who seek to criticize or parody companies, such as "fordreallysucks.com" or "fordlemon.com" or "peopleofwalmart.com" are not cybersquatting in spite of their use of trademarks.

26. Copyright

SAYLOR ACADEMY

The final form of intellectual property (IP) protection is copyright. Like patents and trademarks, federal law protects copyright. Whereas trade secrets protect confidential company information, patents protect processes and inventions, and trademarks protect brands and identity, copyright is designed to protect creativity. It is one of the two types of IP specifically mentioned in the Copyright Clause of the U.S. Constitution. Of course, back then the only works copyrighted would have been songs, art, or works in writing. Today, copyright extends to any form of creative expression, including digital forms.

If asked to write down four numbers from one to fifty in random sequence, most of us would write four different numbers. The process of picking those numbers requires creativity, so the sequence of the four numbers you write down is copyrighted. Note that the numbers themselves aren't copyrighted, of course. It's just the unique sequence that you choose, the expression of your creativity, that is copyrighted. Since computer software is a compilation of binary code expressed in 1 and 0, all software is copyrighted. On the other hand, sequential page numbers or listings in a phone directory show no creativity and are therefore not copyrightable. Similarly, if a group of students were given a camera and each was asked to photograph the same subject, each student would come up with a different photograph. Each student would frame the subject differently, and that is an expression of creativity. Finally, consider the notes that you take in class for this course. A group of students could read the same textbook and listen to the same lecture, and come up with different sets of notes. Each work is unique and demonstrates creativity, so each is copyrighted.

A work must be original (not copied) and fixed in a durable medium to be copyrighted. Therefore, if you sing an original song in the shower in the morning and your roommate hears it and records it, the copyright to the song belongs to your roommate, not you. This requirement exists because it would be impossible to prove, without a durable medium, who is the original author of a work. Ideas, by themselves, cannot be copyrighted. If you had an idea for a novel about a boy wizard who goes to a boarding school with his friends and battles evil monsters while growing up, that would not be copyrighted. If you wrote a novel featuring such a story line, however, you would run the risk of violating the copyrighted Harry Potter works. A similar dispute arose in 2006 after the blockbuster success of Dan Brown's novel, "The Da Vinci Code." Two authors, Michael Baigent and Richard Leigh, claimed the novel infringed on their copyrighted book, "Holy Blood Holy Grail." In their book, the authors theorized that Jesus survived his crucifixion, married Mary Magdalene, and had children. The British judge hearing the case dismissed the claims, holding that the theory was "too general or too low a level of abstraction to be capable of protection by copyright law.[1]

A copyrighted work is automatically copyrighted upon its creation. Unlike patents and trademarks, which must go through an expensive and rigorous application and approval process with the government, authors do not need to send their work to the government for approval. Although it's a good idea to write "Copyright" or place a © symbol on the work, it's not legally required.

Copyright protection lasts for seventy years after the death of the author. If there is more than one author, the copyright expires seventy years after the death of the last surviving author. If a company, such as a publisher, owns a copyrighted work, the copyright expires ninety-five years from the date of publication, or one hundred twenty years from the date of creation, whichever comes first. After copyright expires, the work falls into the public domain. The works of Shakespeare, Bach, and Beethoven, for example, are in the public domain. They may be freely recorded, performed, or modified without permission. If you were to record yourself reciting Shakespeare's "To be or not to be" speech

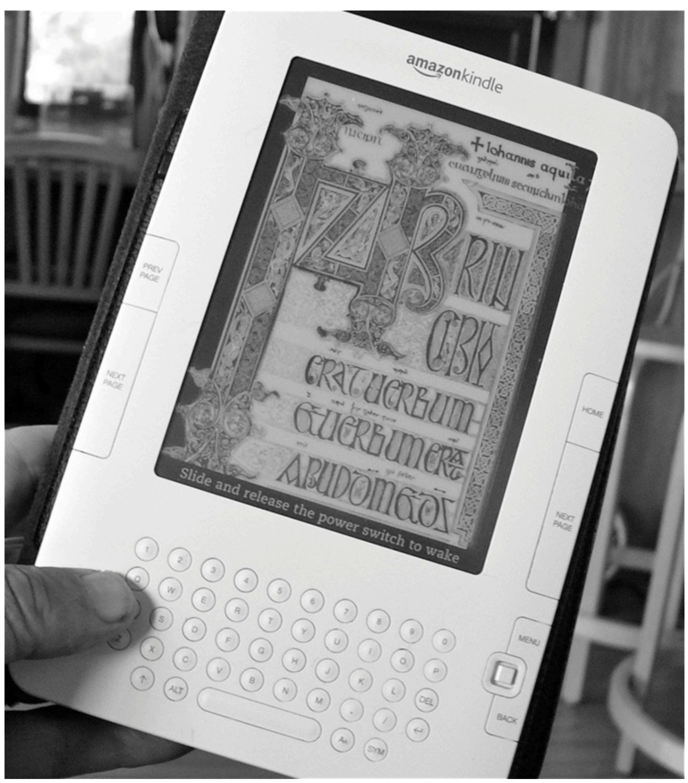
1.

from *Hamlet*, however, that recording is copyrighted even though the underlying work (*Hamlet*) is in the public domain as a new creative expression. Classical music recordings are similarly copyrighted under the same concept.

The owner of a copyright may allow members of the public to view or use a copyrighted work, for free or for a fee. This use is contained in a copyright license, sometimes called an End User License Agreement (EULA) for software. A license is essentially permission from the copyright holder to violate the copyright, within the terms of the license. When you purchase a physical book or CD or DVD, for example, the copyright license allows you to view the movie, listen to the music, or read the book, in private. The license does not allow you to show the movie in class to a broad audience, or to record the music into your computer and then modify it, or to run photocopies of the book to give away or sell. These rights of reproduction, exhibition, and sale are not part of the license you received and are reserved by the copyright holder. Of course, you may purchase those rights if you wish, but they will probably cost a lot more than the price of the book or disc. Some organizations advocate the creation of a common license that authors can easily refer to if they wish to distribute their work easily. The General Public License (GPL) for software and Creative Commons (CC) license for text and media are well-known examples. One right that you do have, however, in spite of any language in the license, is the right of first sale. Essentially this means that as the owner of the physical work, you can do with it as you please, including resell the original work.

Licenses in the digital arena can be very restrictive if you purchase digital media. Copyright holders may use schemes such as Digital Rights Management (DRM) to limit your ownership rights in digital media. DRM limits the number of copies and devices a digital file can be transferred to, and in some cases even permits the copyright holder to delete the purchased work. Amazon.com recently deleted digital George Orwell books from owners who had purchased the works for their Kindle reading devices (Figure 9.14 "Amazon's Kindle E-reader"), without any prior notification. This would have been impossible if the books were in a physical form. Although Amazon.com was within its rights to do so, the public outcry that followed made Amazon.com promise to not engage in such behavior again in the future.

Figure 9.14 Amazon's Kindle E-reader



Source: Photo courtesy of Larry Page, http://www.flickr.com/photos/igboo/3879913438.

Copyright infringement occurs when someone uses a copyrighted work without permission or violates the terms of a copyright license. For example, if a classmate takes your class notes without your permission and makes photocopies of them, the classmate has infringed on your copyright. It's also copyright infringement if you take someone else's work and simply repackage it as your own. This happened recently to Harry Potter author J. K. Rowling. Her books created a huge fan following, and many fans gather online to discuss the Potter series. One such site is the Harry Potter Lexicon, run by Steve Vander Ark, a former school librarian. The site serves as an encyclopedia to the Harry Potter world, with reference notes on characters, places, spells, and other details. When Vander Ark announced plans to publish the contents of the Lexicon in a book format, J. K. Rowling sued, claiming copyright infringement. The judge agreed and ordered the Lexicon rewritten so that it uses less material from the copyrighted work.

Copyright infringement also occurs when you assist someone in violating a copyright, or create a device that assists in violating a copyright. Thus, Web sites such as the former Napster and Grokster, which existed solely for the purpose of facilitating illegal downloading of music, were held to be infringers even though the Web sites themselves didn't violate any copyrights. Similarly, if you make digital media available for download for others, you are not engaged in illegal downloading but still liable for contributory copyright infringement. The recording industry, which is battling for its very survival in a new file-sharing world, pursues these cases aggressively. In June 2009, a court in Minnesota ordered Jammie Thomas to pay $80,000 per song for making twenty-four songs available for download, for a total fine of $1.92 million. In September 2009, the industry won a $675,000 verdict against a college student in Massachusetts for file sharing thirty songs. Devices that can be used for purposes other than violating copyrights (such as photocopiers, video/DVD burners, and peer-to-peer networks used for sharing research) are not considered infringing devices.

Copyright law makes a distinction between "fair" use and "infringing" use of a copyrighted work. A fair use includes copying a work for purposes of commentary, criticism, news reporting, teaching, or research. Just because a work is used in a news article or in a classroom, however, does not make its use fair. The law provides four factors that courts must consider in determining whether or not the use is fair. First, the court must consider the purpose and character of the use. Is it for educational purpose, or for making a profit? Second, the court must consider the nature of the copyrighted work. Is the work part of the "core" of the intended protection that copyright provides? Third, the court must consider the amount and substantiality of the portion used. This is an important factor—it's one thing for your professor to copy an excerpt from a journal or book for distribution in class (probably fair) and another to copy the entire journal or book (probably infringing). Finally, the court must consider the effect of the use on the potential market for the copyrighted work. If the use is considered fair, what would it do to the market for the copyrighted work? For example, if copying an entire textbook is fair, it would probably eliminate the market for new textbooks.

In an attempt to tackle the problem of copyright infringement on the Internet, Congress passed the Digital Millennium Copyright Act (DMCA) in 1998. One portion of the law helps Internet service providers by expressly stating that those providers can't be sued for copyright infringement if others use their networks for infringing uses. Another portion of the law helps Web sites by stating that if a Web site user uploads infringing material and the Web site complies with a copyright holder's request to remove the material, the Web site won't be liable for infringement. For example, if you upload a portion of a copyrighted song, movie, or television show to YouTube, you may find that YouTube has removed your clip at the request of the copyright holder. Finally, the DMCA makes it illegal to attempt to disable a copy protection device. DVD and Blu-ray Discs, for example, are copy protected to prevent them from being copied easily. Anyone who writes software (even if the software is distributed for free) that disables this copy protection device is violating the DMCA. In recent years the DMCA has been used by companies to prevent competitors from making replacement inkjet cartridges, replacement garage door openers, and other replacement parts on the grounds that the replacements circumvent a copy protection device.

Notes

1. "[2]

2. *Baigent v. Random House Group*, http://www.scribd.com/doc/2473519/da-vinci-code-ruling-baigent-v-rhg-0406 (accessed October 2, 2010).

CHAPTER V
CONTRACT LAW

Contracts are a fundamental part of doing business.

A contract is a legally enforceable promise. Therefore, it is important to know whether promises made are legally enforceable. You certainly have made many promises in your life. You have probably broken a few promises, too. For example, if you promised your best friend that you would be best friends forever, but then your relationship changed, we might say that is a broken promise. However, you would not be held legally liable to pay damages for breaking that promise. On the other hand, if you promised your bank that you would make payments to it in exchange for the bank loaning money to you to purchase a car, and if you broke that promise by failing to pay as scheduled, then you have broken a legally enforceable promise. The bank could seek damages from you to make itself whole again. What is the difference between these two promises? Why would you have to pay damages to the bank but not to your former best friend? More specifically, why is one considered a breach of contract and the other simply a broken promise?(Saylor)

This chapter part will introduce you to the world of contracts. The following will be covered:

Competency	**Explore common law contracts**
Performance Indicator	Dissect contracts for basic requirements of common law contracts
Criteria	Define various classifications of contracts
Criteria	Determine when a contract is valid
Criteria	Outline the requirements of an offer, acceptance, consideration
Criteria	Discuss what contracts need to be in writing
Criteria	Compare types of damages

27. Agreement, Consideration, and Promissory Estoppel

OPENSTAX

A contract is defined as an agreement between two or more parties that is enforceable by law.

To be considered enforceable by law, a contract must contain several elements, including offer and acceptance, genuine agreement, consideration, capacity, and legality.

Figure 7.2 Before a contract can become legal and enforceable, several elements must first be in place. (Credit: rawpixel/ pixabay/ License: CC0)

The key to a contract is that there must be an offer, and acceptance of the terms of that offer. An offer is a proposal made to demonstrate an intent to enter a contract. Acceptance is the agreement to be bound by the terms of the offer. Offers must be made with intent, must be definite and certain (i.e., the offer must be clearly expressed for it to be enforceable), and must be communicated to the offeree. An acceptance must demonstrate the willingness to consent to all of the terms of the offer.

Genuine agreement, i.e., "a meeting of the minds," is also required. Agreement can be destroyed by fraud, misrepresentation, mistake, duress, or undue influence.

Consideration must be included in contracts. Consideration is a thing of value promised in exchange for something else of value. This mutual exchange binds the parties together.

Capacity to contract is the next element required for a valid agreement. The law presumes that anyone entering a contract has the legal capacity to do so. Minors are generally excused from contractual responsibility, as are mentally incompetent and drugged or drunk individuals.

Finally, legality is the last element considered. Parties entering into contracts that involve illegal conduct may not expect judicial relief to have that contract enforced. This theory has also been applied to conduct that would be considered in opposition to public policy.

Consideration and Promissory Estoppel

Contract law employs the principles of consideration and promissory estoppel.

Consideration

In most cases, consideration need not be pecuniary (monetary). Most contracts are enforceable only if each party gets consideration from the agreement. Consideration can be money, property, a promise, or some right. For instance, when a music company sells studio equipment, the promised equipment is the consideration for the buyer. The seller's consideration is the money the buyer promises to pay for the equipment.

Promissory Estoppel

The promissory estoppel doctrine is an exception to the requirement of consideration for contracts. Promissory estoppel is triggered when one party acts on the other party's promise. In cases where it is triggered, there is harm or severe injustice to the party who acted because they relied on the other party's broken promise.

The doctrine of promissory estoppel allows aggrieved parties to pursue justice or fairness for the performance of a contract in court, or other equitable remedies, even in the absence of any consideration. Its legal application may vary from state to state, but the basic elements include:

- A legal relationship existed between the parties.
- A promise was made.
- There was reliance on the promise that caused one party to act before any real consideration was exchanged.
- A substantial and measurable detriment occurred as a result of the failure to perform on the contract.
- An unconscionable result, or gross injustice, resulted from the broken promise.

If it is found that these elements are satisfied and that the doctrine of estoppel is applicable, then the court will issue the appropriate damages in the form of reliance damages to restore the aggrieved party to the position they were in prior to the broken promise. Expectation damages are not usually available if promissory estoppel is being claimed.

An example of how this principle would apply is:

After a bidding war for his services, Bob turns down a job offer with We are the Best, LLC in Miami, Florida (where he lives), and accepts a dream job offer from MegaCorp Co. in San Francisco, California. The offer contains a specific start date, compensation terms, benefits outline, and more. However, it does not include relocation expenses or provisions. The company is aware of his plans to move across the country for the sole purpose of taking this dream role. Bob breaks his Miami lease with penalty and spends approximately $13,000 in moving and travel costs. As the cost of living in San Francisco is much higher than in Miami, he puts down a much pricier first and last month's rent and security deposit payment than he is used to. Within two days of his planned start date, he receives a call from management at MegaCorp Co. stating that the company has changed its mind and decided to go in a different direction. If Bob brings a promissory estoppel suit, he will likely be entitled to all of the costs that he incurred while anticipating the start of the promised role (i.e., penalty for the broken lease, moving costs, difference in the rental costs, cost of breaking the new lease, if necessary, etc.) Following reimbursement of his costs, Bob will be returned to the same position he was in prior to the broken promise. However, the company will not likely be required to reopen the role for him or give him the job, as originally anticipated. Also, he will not likely be awarded any damages for the job that he turned down with We are the Best, LLC, as expectation damages are not usually available.

The doctrines of consideration and promissory estoppel are essential to an understanding of how contracts are formed and enforced in the United States.

28. Capacity and Legality

OPENSTAX

For a contract to be legally binding, the parties entering into the contract must have the capacity to do so. As a legal matter, there are certain classes of people who are presumed to have no capacity to contract. These include legal minors, the mentally ill, and those who are intoxicated. If people meeting these criteria enter into a contract, the agreement is considered voidable. If a contract is voidable, then the person who lacked capacity has the choice to either end the contract or continue with it as agreed upon. This design is meant to protect the party lacking capacity.

Following are some examples of the application of these rules.

Minors Have No Capacity to Contract

In most states, minors under the age of 18 lack the capacity to make a contract and may therefore either honor an agreement or void the contract. However, there are a few exceptions to this rule. In most states, a contract for necessities (i.e. food and clothing) may not be voided. Also, in most states, the contract can no longer be voided when the minor turns 18.

EXAMPLE

Mary, 16, an athlete, signs a long-term endorsement deal with a well-known brand and is compensated for several years. At age 20, she decides she wants to take a better endorsement deal, so she tries to void the agreement on the grounds that it was made when she was a minor and that she lacked capacity at that time. Mary will not likely succeed in having her agreement voided, as she has passed the period of incapacity.

Mental Incapacity

If a person lacks the mental capacity to enter a contract, then either he or she, or his or her legal guardian, may void it, except in cases where the contract involved necessities. In most states, mental capacity is measured against the "cognitive standard" of whether the party understood its meaning and effect.

EXAMPLE

Mr. Williams contracted to sell a patent. Later, however, he claimed that he lacked capacity to enter the agreement. He, therefore, sought to have the contract voided. Williams based his claim on the fact that he had been diagnosed as manic-depressive and had received treatment from a variety of mental hospitals for this condition. His doctor stated that he was unable to properly evaluate business opportunities and contracts while in a "manic" state. A California Court of Appeals, evaluating a similar situation, refused to terminate the contract and stated that even in his manic state, the party was capable of contracting, as his condition may have impaired his judgment but not his understanding of the contract. With other mental conditions, a different legal conclusion could be reached.

Voluntary Intoxication – Drugs and Alcohol

Courts generally do not find lack of capacity to contract for people who are voluntarily intoxicated. The rationale for this decision is found in the reasoning that individuals should not be allowed to side-step their contractual obligations by virtue of their self-induced states. By another token, however, courts also seek to avoid the undesirable result of allowing the sober party to take advantage of the other person's condition. Therefore, if a party is so inebriated that he or she is unable to understand the nature and consequences of the agreement, then the contract may be voided by the inebriated party.

EXAMPLE

In the late 1900s, the owner of a significant amount of stock went on a three-month drinking binge. A local bank that was aware of his consistent inebriation hired a third party to contract with him. The third party succeeded in getting him to sell his stock for about 1.5% of the worth of its total value. When the duped seller ended his binge a month later, he learned that the third party had sold the stock to the local bank behind the deal. He then sued the third party. Ultimately, the case was decided by the U.S. Supreme Court, which found that the agreement was void because both the bank and the third party knew that the plaintiff was unaware of what he was doing when he entered the contract. The bank was required to return the shares to the plaintiff, minus the 1.5% amount of real value that he had been paid for the shares.

Legality

Contracts must be created for the exchange of legal goods and services to be enforced. An agreement is void if it violates the law, or is formed for the purpose of violating the law. Contracts may also be found voidable if they are found in violation of public policy, although this is more rare. Typically, this conclusion is only invoked in clear cases where the potential harm to the public is substantially incontestable, eluding the idiosyncrasies of particular judges.

For a contract to be binding, it must not have a criminal or immoral purpose or go against public policy. For example, a contract to commit murder in exchange for money will not be enforced by the courts. If performing the terms of the agreement, or if formation of the contract, will cause the parties to engage in activity that is illegal, then the contract will be deemed illegal and will be considered void or "unenforceable," similar to a nonexistent contract. In this case, there will not be any relief available to either party if they breach the contract. Indeed, it is a defense to a breach of contract claim that the contract itself was illegal.

EXAMPLE

In a state where gambling is illegal, two parties enter into an employment contract for the hiring of a blackjack dealer. The contract would be void because the contract requires the employee to perform illegal gambling activities. If the blackjack dealer tries to recover any unpaid wages for work completed, his claim will not be recognized because the courts will treat the contract as if it never existed.

By contrast, parties enter a contract that involves the sale of dice to a known dealer in a state where gambling is unlawful. The contract would not be considered void because the act of selling dice, in and of itself, is not illegal.

Some examples of contracts that would be considered illegal are contracts for the sale or distribution of illegal drugs, contracts for illegal activities such as loansharking, and employment contracts for the hiring of undocumented workers.

An understanding of the several theories outlined herein for establishing (or challenging) capacity and legality in contract law is essential to this area of law.

29. Breach of Contract and Remedies

OPENSTAX

Once a contract is legally formed, both parties are generally expected to perform according to the terms of the contract. A breach of contract claim arises when either (or both) parties claim that there was a failure, without legal excuse, to perform on any, or all, parts and promises of the contract.

Several inquiries are triggered when a breach of contract claims is initiated. The first step is to determine whether a contract existed in the first place. If it did, the following questions may be asked: What did the terms of the contract require of the parties? Were the contractual terms modified at any point? Did the breach actually occur? Was the claimed breach material to the contract? Does any legal excuse or defense to enforcement of the contract exist? What damages were caused by the breach?

Material vs. Minor Breach

The parties' obligations and remedies for a breach of contract depend on whether the breach is considered material or minor.

When something substantially different from what was expected under the terms of the contract is delivered, the breach will be considered material. For example, the breach will be considered material if the contract promises the delivery of Christmas ornaments, but the buyer receives a box of candies. In the case of a material breach, the non-breaching party has the right to all remedies for breach of the entire contract and is no longer expected to perform their obligations. In considering whether a breach is material, courts will determine whether the non-breaching party still received a benefit, and if so, how much was received, adequate compensation for the damages, the extent of the performance (if any) by the breaching party, any hardship to the breaching party, the negligence or intent behind the behavior of the breaching party, and finally, the possibility that the breaching party will perform the remainder of the contract.

There are times, however, that despite the breaching party's failure to perform some of the contract, the other party still receives a majority of the goods or services specified in the contract. In this case, the breach will be considered minor. For example, the breaching party may be late on delivering goods or services promised under a contract that does not specify a firm delivery date and that doesn't state that time is of the essence. In this case, a reasonably short delay would likely only be considered a minor breach of the contract. Consequently, the non-breaching party would still be required to perform as pursuant to the contract. However, damages may be available to them if they suffered some harm as a result of the delay.

Remedies

Typically, the remedies that will be available if a breach of contract is found are money damages, restitution, rescission, reformation, and specific performance.

Figure 7.3 When there is a breach of contract, the courts might get involved to help determine the remedy. (Credit: succo/ pixabay/ License: CC0)

Money damages include compensation for financial losses caused by the breach.

Restitution restores the injured party to status quo or the position they had prior to the formation of the contract, by returning to the plaintiff any money or property given pursuant to the contract. This type of relief is typically sought when a contract is voided by courts due to a finding that the defendant is incompetent or lacks capacity.

Rescission or reformation may be available to parties who enter into contracts by mistake, fraud, undue influence, or duress. Rescission terminates the duties of both parties under the contract, while reformation allows courts to equitably change the contract's substance.

Specific performance compels one party to perform the promises stated in the contract as nearly as practicable. Specific performance is only mandated when money damages do not adequately compensate for the breach. Personal service, however, may not be used to compel specific performance, since doing so would constitute forced labor, i.e. slavery, which is in violation of the U.S. Constitution.

Inevitably, when valid contracts are created, the potential for breach exists. An understanding of what happens when a contract's terms are breached is fundamental to an understanding of contract law.

30. End Notes

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CHAPTER VI

SALES CONTRACTS

Remember when we mentioned the Uniform Commercial Code (UCC) in the first chapter of this book? Now you will see it in action.

When we turn to contracts for the sale and the lease of goods, we move away from common law principles and into the area of statutory law. State statutory law is based upon the UCC which as been adopted as law by all of the states.

In this chapter part, we will cover the following:

Competency	**Apply the Uniform Commercial Code (UCC)**
Criteria	Define the features of sales contracts
Criteria	Differentiate sales contract properties from other contracts
Criteria	Define title, risk of loss and insurable interest
Criteria	Discuss warranties
Criteria	Outline the remedies of the seller and buyer under UCC

31. The Nature and Origins of Sales Contracts

OPENSTAX

Features of Sales Contracts

Commercial enterprises that engage in buying and selling practices need to be aware of the features and nature of sales contracts. A contract of sale is a specific type of contract in which one party is obligated to deliver and transfer ownership of a good to a second party, who in turn is obligated to pay for the good in money, or its equivalent. The party who is obligated to deliver the good is known as the vendor or seller. The party who is obligated to pay for the good is known as the vendee or buyer.

It has generally been established that there are six main features of sales contracts. Sales contracts are:

1. Consensual: they are perfected by mere consent without the need for any additional acts
2. Bilateral: both parties in the contract are bound to fulfill reciprocal obligations toward each other
3. Onerous: the good sold is conveyed in consideration of the price, and the price paid is conveyed in consideration of the good
4. Commutative: the good sold is considered to be the equivalent of the price, and vice versa
5. Nominate: this type of contract has a special designation (i.e., sale)
6. Principal: the validity does not depend upon the existence of other contracts

Sources of Law for Sales Contracts

Only in very limited circumstances (such as in the buying and selling of stocks) does federal law govern sales contracts. Until the 1950s, there were two main sources of law for sales contracts: state common law and state statutory law. Thus, the laws governing sales contracts differed from state to state. As interstate commercial activity grew in importance, there was a need for a uniform law for sales transactions that would harmonize rules across the states. Therefore, in 1952, the Uniform Commercial Code (UCC)was created to govern business transactions. All 50 states have adopted the Code, but each has the power to modify it, in line with the wishes of the state legislature.

The Uniform Commercial Code

The UCC categorizes items that can be bought or sold into three types:

1. Goods are defined in Section 2-105 of the UCC as tangible items "which are movable at the time of identification to the contract for sale." Therefore, the primary features of goods are that they are movable and tangible. Refrigerators, paper, and furniture are all examples of goods.
2. Services are items that are movable but not tangible. Accounting is an example of a service.
3. Realty describes non-good items that are tangible but not movable. Under this definition, commercial and residential property are classed as realty.

These definitions have created some grey areas that have been clarified by the courts in their interpretation of the UCC. In the 2008 case *Crown Castle Inc. et al. v. Fred Nudd Corporation et al.*, a case in which the telecommunications company Crown Castle sued a cell phone tower installation firm for the construction of faulty towers, the courts had to determine whether cell phone towers (monopoles) should be classified as movable (and hence goods) or non-movable (and therefore realty). Ultimately, it was determined that monopoles are goods. Items that are attached to realty (e.g. a counter or a bar) and that are used for business activities are described as trade fixtures and treated as goods. Software licenses are not tangible, but they are also not movable, and have been treated in different ways: as goods, a mixed sale (a tangible item tied to an intangible item), and pure services. Items such as soil and clay may be treated as goods even if they are part of immovable land because they can be extracted and moved. Crops that are sold while they are still growing on the land are also considered to be goods even though they are technically immovable while growing.

Article 2 of the UCC specifically pertains to sales contracts of goods. It defines a sale as a transaction that involves "the passing of title from the seller to the buyer for a price." However, merchants are classified as a separate entity under the terms of the UCC. This distinction is important because the Code contains provisions that specifically apply to merchants and place greater duties on merchants to protect private citizens. There are four ways in which an entity can be classified as a merchant:

Classification	Examples
An agent who regularly sells goods as part of his or her business or trade	A seller on an online auction site
An individual who employs other people to sell goods	The owner of a clothing store
A person who works for a person who sells goods	An employee at a grocery retailer
Any entity who self-identifies as a merchant	An individual who describes himself or herself as a merchant in corporate documents

Table8.1

Formation of Sales Contracts under the UCC

Sales contracts require most of the same components as general contracts, but the UCC includes some provisions that specifically pertain to the creation of sales contracts. First, the UCC includes a new category of offer. Basic contract law states that for an offer to be valid, it has to have "definiteness of terms." In the UCC, most of that particular rule is modified for greater flexibility. If the parties have "open" (in other words, "not definite") terms, the UCC addresses the situation with an overlay of "reasonableness"–for example, if no time for performance is designated, the performance must occur within a "reasonable" time. As a result, the following terms are legally allowed to be "open," and there is a "default" provision that will apply under the UCC:

Open Term	Default	Applicable UCC Provision
Price	If price is not named, the default is "reasonable price."	UCC 2-305(1)
Payment	If payment is not named, default is "due at the time and place at which the buyer is to receive the goods."	UCC 2-310(a)
Delivery	If delivery is not named, the default is "buyer normally takes delivery at the seller's place of business."	UCC 2-308(a)
Duration of an Ongoing Contract	If duration of an ongoing contract is not named, the default is "buyer normally takes delivery at the seller's place of business."	UCC 2-308(a)

Table8.2

The only term that really *cannot* be left open is the quantity term. The court is not going to second-guess a quantity if the parties don't set one in the contract—for example, why would the court arbitrarily want to force the parties to buy and sell 15,000 widgets if a quantity wasn't specified? There are two exceptions to this rule: requirements contracts ("as much as I need") and output contracts ("as much as you can produce"). Even though these ideas are illusory, they're generally allowed in the commercial setting with good-faith limitations under UCC 2-306.

Sometimes, however, the courts will not allow purported "requirements" contracts. In one case, a court ruled that the contract was an unenforceable illusory contract instead of an enforceable requirements contract, even though it was a contract for the sale of goods ("as much as I need"). The reason for this ruling was that it did not appear that the buyer had any real intention of going through with any purchase.

Under Section 2-205 of the UCC, offers made by merchants are considered to be firm offers if the offers are made in writing and explicitly state that there is a three-month irrevocability period. A three-month irrevocability period is assumed if no mention is made with the offer. Acceptance of the offer can be made in any reasonable manner, but the mirror-image rule does not apply under the UCC. This means that if the terms of the acceptance do not mirror those of the offer, the acceptance is treated as a counteroffer and no legal contract is formed. Sale of goods contracts must be in writing if the value of the goods is $500 or more. Modifications to the contract must be made in good faith, and new consideration is not required. A contract provision, or the entire contract itself, can be considered to be unconscionable if its terms are unfair or unreasonable. If a court deems this to be the case, the contract, or certain provisions of it, may be unenforceable.

Title

Title means ownership of a good. When the sale is completed, an agent must pass the title for the good to the buyer. There are three types of titles:

1. Good title describes a title that is obtained from an individual who owns the goods free and clear.
2. Void title occurs when the title is passed to the buyer from a person who does not legitimately own the title. An important point is that good faith is irrelevant when a void title is acquired. For example, a person who unknowingly purchased stolen goods has a void title. An exception occurs when an owner entrusts goods to a merchant who ordinarily deals in those goods, and then that merchant sells the goods to a good-faith buyer. In this case, the buyer acquires a good title. For example, if a motorcycle owner takes the motorcycle to a vehicle repair shop and the motorcycle is accidentally sold, the buyer acquires the title.
3. Voidable title occurs when the contract would have been good, but certain circumstances make it voidable. For example, if the buyer was deceitful about his or her true identity, the buyer is a minor, or the buyer wrote a bad check in the sale, then the title is deemed voidable.

Figure 8.2 A sale is defined as a transaction that involves the passing of a title from the seller to the buyer for a price. (Credit: Negative Space/ pexels/ License: CC0)

Issues Associated with Title

Imagine the following scenario: A café purchases a new coffee machine from a supplier. However, when the supplier tries to deliver the equipment to the café, it is involved in an accident and the coffee machine is destroyed. A question emerging from this scenario is this: Is the supplier legally obligated to replace the machine? Asked differently: Who holds the good title in this scenario?

Prior to the introduction of the Uniform Common Code, the loss would have fallen on the owner of the café, since he or she paid for the coffee machine prior to taking possession of it. Under the UCC, however, as long as the supplier is considered a merchant, the risk of loss remains with the merchant until the buyer takes possession of the good.

Given problems like the one described above, the UCC separately considers four specific issues relating to titles:

- Ownership. Under consideration is the question of *when* the title transfers from vendor to vendee, and hence when ownership is said to occur.
- The concept of encumbrance considers when the vendee is granted an interest in the good such that the good can be used as collateral for a debt.
- The UCC considers when the risk of loss attaches and what the responsibilities of the buyer and seller are to each other, should a loss occur.
- Insurable interest is the right to insure the goods against exposure to risk of loss or damage

The UCC allows four scenarios for sales contracts: simple delivery contracts, common-carrier delivery contracts, goods-in-bailment contracts, and conditional sales contracts.

Each type involves the title, risk of loss, and insurable interest passing at different times.

A simple delivery contract occurs when the goods are transferred from the buyer to the seller at the time of the sale or later, e.g., if the goods are delivered. Title transfers when the contract is executed, insurable interest passes at the same time, and risk of loss transfers when the buyer takes possession, unless the seller is not a merchant. In the latter case, under the rule of tender of delivery, risk remains with the buyer.

A common-carrier delivery contract occurs when a common carrier, who is an independent contractor rather than an agent of the seller (e.g., a trucking line), delivers the goods. The UCC further categorizes these types of contracts into shipment contracts and destination contracts:

1. A shipment contract occurs when it is the responsibility of the seller to make the shipping arrangements and to transfer the goods to the common carrier. Under this contract, title passes to the buyer at the time of shipment, so the buyer bears the risk of loss, even when he or she has not taken possession of the goods.
2. A destination contract occurs when the seller is required to deliver the goods to a location that is stipulated in the contract. Under this contract, title transfers when the goods are delivered, but the seller bears the risk of loss until that time.

A goods-in-bailment contract occurs when the goods are stored under the control of a third party, such as in a warehouse or on a ship. Transfer of title and risk of loss depends on whether the seller has a document indicating ownership of the goods and whether that document is negotiable or non-negotiable. A negotiable document contains the words, "deliver to the order of [seller]." As soon as that document is endorsed to the buyer, both title and risk pass to the buyer. A non-negotiable document lacks those words. Under these circumstances, title passes with the endorsement of the document, but risk of loss does not pass until the custodian of the goods is notified of the title. If a document of title is completely absent, title passes at the same time as the execution of the contract, but risk does not pass until the custodian is notified of, and acknowledges, the transaction. Insurable interest is created when either the buyer or seller has the title, risk of loss, or an economic interest in the goods.

Finally, a conditional sales contract is a contract that occurs when the sale is dependent on approval. For example, a sale-or-return agreement occurs when both parties agree that the buyer can return the goods at a later date. Insurable interest is created once the goods are identified in the contract. Title and risk of loss depend on whether the goods are delivered by the common carrier, the seller, or in bailment, as described above.

The International Sale of Goods

With globalization, there has been a significant expansion of commercial transactions undertaken across international borders. The United Nations Convention on Contracts for the International Sale of Goods, or the CISG, is the main legal structure offered for the governance of international commercial transactions. The CISG broadly covers the same topics as the UCC, but it preempts the UCC if there is a problem with an international sale.

32. Warranties and Sales Contracts

OPENSTAX

Figure 8.3 The law provides remedies for breach of sales contracts. (Credit: rawpixel/ pexels/ License: CC0)

Warranties

A warranty is a guarantee on the good that comes as part of the sales contract, but contract law treats warranties as an additional form of contract that binds the selling party to undertake a certain action. Typically, the selling party has an obligation to provide a product that achieves a specified task, or to deliver a service that meets certain minimal standards. Warranties are offered for a range of different goods and services, from manufactured goods to real estate to plumbing services. The warranty assures the buyer that the good or service is free from defects, and it is a legally binding commitment. In the event that the product or service fails to meet the standards set out in the warranty, then the contract provides a specific remedy, such as a replacement or repair.

According to UCC 1-203, the performance and execution of all contracts must be undertaken in good faith. Good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing. If the parties in the contract are merchants, the UCC also requires that the contract be undertaken in accordance with commercial reasonableness. This requirement means that the transaction should be undertaken in a sensible and prudent way.

Express and Implied Warranties

Warranties can be express, implied, or both. Both express and implied warranties provide legal relief for the purchaser in the event of a breach of contract.

An express warranty is one in which the seller explicitly guarantees the quality of the good or service sold. Typically, the vendor provides a statement, or other binding document, as part of the sales contract. What this means in practice is that the buyer has engaged in the contract on the reasonable assumption that the quality, nature, character, purpose, performance, state, use, or capacity of the goods or services are the same as those stated by the seller. Therefore, the sales contract is based, in part, on the understanding that the goods or services being supplied by the seller will conform to the description, or any sample, that has been provided.

There are myriad ways in which the seller can make statements as to the characteristics of the goods.

Here are a few examples of express warranties:

“Wrinkle-free shirt”

“Lifetime guarantee”

“Made in the USA”

“This orange juice is not from concentrate”

“24k gold”

There is not a specific way that words must be formed to make an express warranty valid. Importantly, the sales contract does not need to explicitly state that a warranty is being intended. It is enough that the seller asserts facts about the goods that then become part of the contract between the parties. However, the courts do apply a reasonableness test of reliance upon warranties. Puffery, or language used to bolster sales, is lawful, and the consumer is required to apply reason when evaluating such statements. For example, buyers are expected to use reason when judging seller claims such as “this sandwich is the best in the world.” Obvious sales talk cannot ordinarily be treated as a legally binding warranty.

A breach of the warranty occurs when the express warranty has been found to be false. In such circumstances, the warrantor is legally liable just as though the truth of the warranty had been guaranteed. The courts do not accept as a defense:

- Seller claims the warranty was true.
- Seller claims due care was exercised in the production or handling of the product.
- Seller claims there is not any reason to believe that the warranty was false.

Implied Warranties

In certain circumstances where no express warranty was made, the law implies a warranty. This statement means that the warranty automatically arises from the fact that a sale was made. With regard to implied warranties, the law distinguishes between casual sellers and merchant sellers, with the latter held to a higher standard, given that they are in the business of buying or selling the good or service rendered. For example, unless otherwise agreed, goods sold by merchants carry an implied warranty against claims by any third party by way of trademark infringement, patent infringement, or any other intellectual property law infringement. This type of warranty is known as the warranty against infringement. Another implied warranty provided by merchant sellers is the warranty of fitness for normal use, which means that the goods must be fit for the ordinary purposes for which they are sold.

It is important to note that if express warranties are made, this does not preclude implied warranties. If an express warranty is made, it should be consistent with implied warranties, and can be treated as cumulative, if such a construction is reasonable. If the express and implied warranties cannot be construed as consistent and cumulative, the express warranty generally prevails over the implied warranty, except in the case of the implied warranty of merchantability, or fitness for purpose.

Breaches of Warranty

If the buyer believes that there has been a breach of the implied warranty of merchantability, it is their responsibility to demonstrate that the good was defective, that this defect made the good not fit for purpose, and that this defect caused the plaintiff harm. Typical examples of defects are:

- Design defects
- Manufacturing defects
- Inadequate instructions on the use of the good
- Inadequate warning against the dangers involved in using the good.

Specific Examples of Goods Under the Warranty of Merchantability

Type	Description
Second-hand goods	The UCC treats warranties arising for used goods in the same way as warranties arising for new goods, but second-hand products tend to be held to a lower standard on the warranty of merchantability.
Buyer-designed goods	The same warranties arise for mass manufactured goods as for goods that have been specified or made to order for the buyer. However, in this case, no warranty of fitness for purpose can arise since the buyer is using his or her own decisions, skill, and judgment when making the purchase.
Food and drink	The sale of food or drink carries the implied warranty of being fit for human consumption.

Table8.3

The buyer might intend to use the goods purchased for a different purpose than that for which it was sold. In this case, the implied warranty holds only if the buyer relies on the seller's skill or judgment to select the product, the buyer informs the seller at the time of purchase of his or her intention for the use of the good, and the buyer relies on the seller's judgment and skill in making the final choice. If the seller is not made aware of the buyer's true intention, or does not offer his or her skill and judgment in aiding the sale, then warranty of fitness for a particular purpose does not arise. For this reason, it is common for vendors to include provisions in the average terms and conditions of sale with regard to the true and intended purpose of use.

Warranty of Title

By the mere act of selling, the vendor implies a warranty that the title is good and that the transfer of title is lawful. In addition, the act of the sale creates a warranty that the goods shall be delivered free from any lien of which the buyer was unaware. In some circumstances, the warranty of title can be excluded from the contract documents. For instance, when the seller makes the sale in a representative capacity (e.g. as an executor of an estate), then a warranty of title will not arise.

Remedies to Buyers under the UCC

Remedy	Description
Cancel the contract	The UCC allows buyers to cancel the contract for nonconforming goods and to seek remedies that give them the benefit of the bargain.
Obtain cover	Buyers are allowed to substitute goods for those due under the sales contract. However, substitutes must be reasonable, acquired without delay, and obtained in good faith.
Obtain specific performance	If the goods are unique or a legal remedy is inadequate, the seller may be required to deliver the goods as identified in the contract.
Sue	Buyers are entitled to consequential and incidental damages if there is a breach of contract. They may also be able to obtain liquidated damages (damages before the breach occurs) or punitive damages.

Table8.4

33. End Notes

Kubasek, N., Browne, M. N., Dhooge, L. J., Herron, D. J., Williamson, C., & Barkacs, L. L. (2015). *Dynamic business law*. McGraw-Hill Education.

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CHAPTER VII

BUSINESS ORGANIZATIONS

When forming a business, the owners must decide which legal form of ownership is best for them and for the business. No single form of ownership will provide everything. The owner must make some trade-offs.

In the following section we'll compare the several ownership options for the business owner. We will cover:

Competency	**Summarize common business forms and securities law**
Criteria	Evaluate the advantages and disadvantages of sole proprietorships
Criteria	Evaluate the advantages and disadvantages of partnerships
Criteria	Evaluate the advantages and disadvantages of corporations

34. Sole Proprietorships

SAYLOR ACADEMY

The Most Common Form of Business

Lily, a college sophomore, is home for the summer. Unable to find even part-time work in a tough economy, she begins to help her parents by cleaning up their overgrown garden. After a few days of this work, Lily discovers that she enjoys doing this and is good at it. The neighbors see the work Lily is doing, and they ask her to help their gardens too. Within a week, Lily has scheduled appointments and jobs throughout the neighborhood. Using the money she has earned, she places orders for additional landscaping equipment and materials with a local retailer. Within a month, she is so busy that she has to hire workers to do some of the more routine tasks, such as mulching and lawn mowing, for her. By the middle of summer, Lily has applied knowledge she picked up in her business classes by developing a name for her business (Lily's Landscaping) and developing marketing materials such as a Facebook fan page, flyers to be posted at local stores, business cards, and a YouTube video showing her projects. By the end of the summer, Lily has earned a healthy profit for all her work and developed valuable know-how on how to run her business. She has to stop working when the weather gets cooler and she returns to school, but promises herself to restart the business next summer.

Lily is a sole proprietor, the most common form of doing business in the United States.About 72% of the businesses in the US fall under this category.

Legal Perspective

From a legal perspective, there is absolutely no difference between Lily and Lily's Landscaping—they are one and the same, and completely interchangeable with each other. If Lily's Landscaping makes a profit, that money belongs exclusively to Lily. If Lily's Landscaping needs to pay a bill to a supplier or creditor, and Lily's Landscaping doesn't have the money, then Lily has to pay the bill. When Lily's Landscaping enters into a contract to plant a new flower garden, it is actually Lily that is entering into the contract. If Lily's Landscaping wants to open a bank account to accept customer payments or to pay bills, then Lily will actually own the account. When Lily's Landscaping enters into a contract promising to pay a worker to mow lawns or lay mulch, it is actually Lily that is entering into that contract. Lily can even apply for a "doing business as" or d.b.a. filing in her state, so that her business can carry on under the fictitious name "Lily's Landscaping." Note, however, that legally Lily's Landscaping is still no different from Lily herself. Any fictitious name therefore cannot have any words in it that suggest a separate entity, such as "Corp." or "Inc."

Advantages

There are many advantages to doing business as a sole proprietor, advantages that make this form of doing business extremely popular. First, it's easy to create a sole proprietorship. In effect, there is no creation cost or time, since there is nothing to create. The entrepreneur in charge of the business simply starts doing business, charging money, and providing goods or services. Depending on the business, some sole proprietors may need to obtain permits or licenses before they can begin operating. A pizza restaurant, for example, may need to obtain a food service license, while a bar or tavern may need to obtain a liquor license. A small grocery store may need a license to collect sales tax. Do not confuse these governmental permits with legal approval for a business organization; in a sole proprietorship, the license is granted to the individual owner.

Another key advantage to sole proprietorships is autonomy. Since the owner is the business, Lily can decide for herself what she wants to do to Lily's Landscaping. She could set her own hours, grow as quickly or slowly as she wants, expand into new lines of businesses, take a vacation, or wind down the business, all at her own whim and direction. That autonomy also comes with total ownership of the business's finances. All the money that Lily's Landscaping takes in, even if it is in a separate bank account, belongs to Lily, and she can do with that money whatever she wants.

Challenges

These advantages must be weighed against some very important disadvantages. First, since a sole proprietorship can have only one owner, it is impossible to bring in others to the business. Lily cannot bring in her college roommate to work on Web site design as a partner in the business, for example. In addition, since the business and the owner are identical, it is impossible to pass on the business from Lily. If Lily dies, the business dies with her. Of course, she can always sell or give away the business assets (equipment, inventory, as well as intangible assets such as customer lists and goodwill).

Raising working capital can be a problem for sole proprietors, especially those early in their business ventures. Many entrepreneurial ventures are built on great ideas but need capital to flourish and develop. If the entrepreneur lacks individual wealth, then he or she must seek those funds from other sources. For example, if Lily decides to expand her business and asks her wealthy uncle to invest money in Lily's Landscaping, there is no way for her uncle to participate as a profit-sharing owner in the business. He can make a loan to her, or enter into a profit-sharing contract with her, but there is no way for him to own any part of Lily's Landscaping. Traditionally, most sole proprietors seek funding from banks. Banks approach these loans just like any other personal loan to an individual, such as a car loan or mortgage. Down payment requirements may be high, and typically the banks require some form of personal collateral to guarantee the loan, even though the loan is to be used to grow the business. Many sole proprietors resort to running their personal credit cards to the maximum limit, or transferring balances between credit cards, in the early stage of their business.

Tax planning can also be challenging for the sole proprietor. Since there is no legal distinction between the owner and the business, all the income generated by the business is treated as ordinary personal income to the owner. The United States has several income tax rates depending on the type of income being taxed, and ordinary personal income typically suffers the highest rate of taxation. Being able to plan effectively to take advantage of lower income tax rates is very difficult for the sole proprietor.

Finally, sole proprietors suffer from one hugely unattractive feature: unlimited liability. Since there is no difference between the owner and the business, the owner is personally liable for all the business's debts and obligations. For example, let's say that Lily's Landscaping runs into some financial trouble and is unable to generate planned revenue in a given month due to unexpectedly bad weather. Creditors of the business include landscaping supply stores, employees, and outside contractors such as the company that prints business cards and maintains the business Web site. Lily is personally liable to pay these bills, and if she doesn't she can be sued for breach of contract. Some proprietors are very successful and can generate many hundreds of thousands of dollars in profit every year. Unlimited liability puts all the personal assets of the sole proprietor reachable by creditors. Personal homes, automobiles, boats, bank accounts, retirement accounts, and college funds—all are within reach of creditors. With unlimited liability, all it takes is one successful personal injury lawsuit, not covered by insurance or exceeding insurance limits, to wipe out years of hard work by an individual business owner.

Advantages and Disadvantages of Sole Proprietorships

Factors	**Consideration**
Start-up	Easy and cheap to form
Control	Owner has complete control over business
Benefactors	Owner receives all income earned by the business
Taxation	Profits earned are taxed as personal income (no any special federal and state income taxes are incurred)
Capability	Owner must supply all talents necessary to make the business a success.
Sustainability	If the owner dies, the business dissolves
Financing	All money borrowed by the business is loaned personally to the owner
Liability	Unlimited personal liability for losses incurred by the business or for any legal action

35. Partnerships

SAYLOR ACADEMY

Let's assume that after her first summer running Lily's Landscaping, Lily decides that it's time to take her business to the next level. She has gathered a lot of expertise in running the operations in her business, from placing orders with suppliers to scheduling workers for client projects. She realizes, however, that she's not very good at marketing or accounting, and that if her business is to grow, she needs to bring someone on board who can create a strong brand and strategy for growth, as well as keep good records of her accounts so that she can plan for the future. Fortunately, her good friend Adam is a double major in accounting and marketing, and after a series of discussions, Adam and Lily decide to run Lily's Landscaping together.

General Partnership

Lily and Adam have formed a general partnership. The moment they agreed to run Lily's Landscaping together, and to share in the profits and losses of the business together, the partnership was formed. Although they formed their partnership verbally, most general partnerships are formed formally, with partners writing down their agreement in a special type of contract known as the articles of partnership. The articles can set forth anything the partners wish to include about how the partnership will be run. Normally, all general partners have an equal voice in management, but as a creation of contract, the partners can modify this if they wish. As in a sole proprietorship, there is no state involvement in creating a general partnership because there is no separation from the business and the partners—they are legally the same.

Properties

General partnerships are dissolved as easily as they are formed. Since the central feature of a general partnership is an agreement to share profits and losses, once that agreement ends, the general partnership ends with it. In a general partnership with more than two persons, the remaining partners can reconstitute the partnership if they wish, without the old partner. A common issue that arises in this situation is how to value the withdrawing partner's share of the business. Articles of partnership therefore typically include a buy/sell agreement, setting forth the agreement of the partners on how to account for a withdrawing partner's share, which the remaining partners then agree to pay to the withdrawing partner (or the spouse or heir if the partner dies).

A general partnership is taxed just like a sole proprietorship. The partnership is considered a disregarded entity for tax purposes, so income "flows through" the business to the partners, who then pay ordinary income tax on the business income. The partnership may file an information return, reporting total income and losses for the partnership, and how those profits and losses are allocated among the general partners. As is the case for sole proprietors, tax planning opportunities are limited for general partners.

General partnerships are also similar to sole proprietorships in unlimited liability. Every partner in the partnership is jointly and severally liable for the partnership's debts and obligations. This is a very unattractive feature of general partnerships. One partner may be completely innocent of any wrongdoing and still be liable for another partner's malpractice or bad acts.

Limited Partnerships

Let's assume that the general partnership formed by Lily and Adam flourishes and becomes profitable. To grow the landscaping business, they want to bring in Lily's wealthy uncle as a partner. The uncle, however, is worried about maintaining limited liability. In most states, they can form a limited partnership. A limited partnership has both general partners and limited partners. In this case, Lily and Adam will remain as general partners in the business, but the uncle can become a limited partner and enjoy limited liability. As a limited partner, the most he can lose is the amount of his investment into the business, nothing more. Limited partnerships have to be formed in compliance with state law, and limited partners are generally prohibited from participating in day-to-day management of the business.

Advantages and Disadvantages of Partnerships

Factors	**Consideration**
Start-up	Fairly easy and cheap to form, though legal assistance is often helpful
Control	Partners must share decision making
Benefactors	Partners share profits
Taxation	Partners pay personal income taxes on their share of profits; the partnership doesn’t pay any special taxes
Capability	Can bring together a diverse group of talented individuals who share responsibility for running the business
Sustainability	Partners can agree legally to allow the partnership to survive if one or more partners die

Financing	The business can draw on the financial resources of a number of individuals
Liability	Partners are subject to unlimited liability; each partner is personally liable not only for his or her own actions but also for *the actions of all the partners*. The law also permits a limited partnership, which has two types of partners: a single *general partner* who runs the business and is responsible for its liabilities, and any number of *limited partners* who have limited involvement in the business and whose losses are limited to the amount of their investment.

The Partnership Agreement

Partnerships are susceptible to conflicts and disputes since they require decision-maker to occur across all partners. The impact of disputes can be lessened if the partners have executed a well-planned *partnership agreement* that specifies everyone's rights and responsibilities. The agreement might provide such details as the following:

- Amount of cash and other contributions to be made by each partner
- Division of partnership income (or loss)
- Partner responsibilities—who does what
- Conditions under which a partner can sell an interest in the company
- Conditions for dissolving the partnership
- Conditions for settling disputes

36. Corporations

SAYLOR ACADEMY

So far in this chapter, we have explored sole proprietorships and partnerships, two common and relatively painless ways for persons to conduct business operations. Both these forms of business come with significant disadvantages, however, especially in the area of liability. The idea that personal assets may be placed at risk by business debts and obligations is rightfully scary to most people. Businesses therefore need a form of business organization that provides limited liability to owners and is also flexible and easy to manage. That is where the modern corporation comes in.

Consider, for example, tech entrepreneur and Apple cofounder Steve Jobs (Figure 11.4 "Apple Cofounder Steve Jobs"). As a young man, he was a college dropout without much ability for computer engineering. If doing business as a sole proprietor was his only option, Apple would not exist today. However, Jobs met a talented computer engineer named Steve Wozniak, and the two decided to pool their talents to form Apple Computer in1976. A year later, the company was incorporated and in 1980 went public in an initial public offering (IPO). Incorporation allowed Jobs much more flexibility in carrying out business operations than a mere sole proprietorship could. It allowed him to bring in other individuals with distinct skills and capabilities, raise money in the early stage of operations by promising shares in the new company, and eventually become very wealthy by selling stock, or securities, in the company.

Corporation Properties

Unlike a sole proprietorship or general partnership, a corporation is a separate legal entity, separate and distinct from its owners. It can be created for a limited duration, or it can have perpetual existence. Since it is a separate legal entity, a corporation has continuity regardless of its owners. Entrepreneurs who are now dead founded many modern companies, and their companies are still thriving. Similarly, in a publicly traded company, the identity of shareholders can change many times per hour, but the corporation as a separate entity is undisturbed by these changes and continues its business operations.

Since corporations have a separate legal existence and have many legal and constitutional rights, they must be formed in compliance with corporate law. Corporate law is state law, and corporations are incorporated by the states; there is no such thing as a "U.S. corporation." Most corporations incorporate where their principal place of business is located, but not all do. Many companies choose to incorporate in the tiny state of Delaware even though they have no business presence there, not even an office cubicle. Delaware chancery courts have developed a reputation for fairly and quickly applying a very well-developed body of corporate law in Delaware. The courts also operate without a jury, meaning that disputes heard in Delaware courts are usually predictable and transparent, with well-written opinions explaining how the judges came to their conclusions.

To start a corporation, the corporate founders must file the articles of incorporation with the state agency charged with managing business entities. These articles of incorporation may vary from state to state but typically include a common set of questions. First, the founders must state the name of the company and whether the company is for-profit or nonprofit. The name has to be unique and distinctive, and must typically include some form of the words "Incorporated," "Company," "Corporation," or "Limited." The founders must state their identity, how long they wish the company to exist, and the company's purpose. Under older common law, shareholders could sue a company that conducted business beyond the scope of its articles (these actions are called ultra vires), but most modern statutes permit the articles to simply state the corporation can carry out "any lawful actions," effectively rendering ultra vires lawsuits obsolete in the

United States. The founders must also state how many shares the corporation will issue initially, and the par value of those shares. (Of course, the company can issue more shares in the future or buy them back from shareholders.)

Unlike sole proprietorships, corporations can be quite complicated to manage and typically require attorneys and accountants to maintain corporate books in good order. In addition to the foundation requirements, corporate law requires ongoing annual maintenance of corporations. In addition to filing fees due at the time of incorporation, there are typically annual license fees, franchise fees and taxes, attorney fees, and fees related to maintaining minute books, corporate seals, stock certificates and registries, as well as out-of-state registration. A domestic corporation is entitled to operate in its state of incorporation but must register as a foreign corporation to do business out of state. Imagine filing as a foreign corporation in all fifty states, and you can see why maintaining corporations can become expensive and unwieldy.

Shareholders

Owners of companies are called shareholders. Corporations can have as few as one shareholder or as many as millions of shareholders, and those shareholders can hold as few as one share or as many as millions of shares. In a closely held corporation, the number of shareholders tends to be small, while in a publicly traded corporation, the body of shareholders tends to be large. In a publicly traded corporation, the value of a share is determined by the laws of supply and demand, with various markets or exchanges providing trading space for buyers and sellers of certain shares to be traded. It's important to note that shareholders own the share or stock in the company but have no legal right to the company's assets whatsoever. As a separate legal entity, the company owns the property.

Shareholders of a corporation enjoy limited liability. The most they can lose is the amount of their investment, whatever amount they paid for the shares of the company. If a company is unable to pay its debts or obligations, it may seek protection from creditors in bankruptcy court, in which case shareholders lose the value of their stock. Shareholders' personal assets, however, such as their own homes or bank accounts, are not reachable by those creditors.

Shareholders can be human beings or can be other corporate entities, such as partnerships or corporations. If one corporation owns all the stock of another corporation, the owner is said to be a parent company, while the company being owned is a wholly owned subsidiary. A parent company that doesn't own all the stock of another company might call that other company an affiliate instead of a subsidiary. Many times, large corporations may form subsidiaries for specific purposes, so that the parent company can have limited liability or advantageous tax treatment. For example, large companies may form subsidiaries to hold real property so that premises liability is limited to that real estate subsidiary only, shielding the parent company and its assets from tort lawsuits. Companies that deal in a lot of intellectual property may form subsidiaries to hold their intellectual property, which is then licensed back to the parent company so that the parent company can deduct royalty payments for those licenses from its taxes. This type of sophisticated liability and tax planning makes the corporate form very attractive for larger business in the United States.

Corporate law is very flexible in the United States and can lead to creative solutions to business problems. Take, for example, the case of General Motors Corporation. General Motors Corporation was a well-known American company that built a global automotive empire that reached virtually every corner of the world. In 2009 the General Motors Corporation faced an unprecedented threat from a collapsing auto market and a dramatic recession, and could no longer pay its suppliers and other creditors. The U.S. government agreed to inject funds into the operation but wanted the company to restructure its balance sheet at the same time so that those funds could one day be repaid to taxpayers. The solution? Form a new company, General Motors Company, the "new GM." The old GM was brought into bankruptcy court, where a judge permitted the wholesale cancellations of many key contracts with suppliers, dealers, and employees that were costing GM a lot of money. Stock in the old GM became worthless. The old GM transferred all of GM's best assets to new GM, including the surviving brands of Cadillac, Chevrolet, Buick, and GMC; the plants and assets those brands rely on; and the shares in domestic and foreign subsidiaries that new GM wanted to keep. Old GM (subsequently renamed as "Motors Liquidation Company") kept all the liabilities that no one wanted, including obsolete assets such as shuttered plants, as well as unpaid claims from creditors. The U.S. federal government became the majority shareholder of General Motors Company, and may one day recoup its investment after shares of General Motors Company are sold to the public. To the public, there is very little difference in the old and new GM. From a legal perspective, however, they are totally separate and distinct from each other.

One exception to the rule of limited liability arises in certain cases mainly involving closely held corporations. Many sole proprietors incorporate their businesses to gain limited liability but fail to realize when they do so that they are creating a separate legal entity that must be respected as such. If sole proprietors fail to respect the legal corporation with an arm's-length transaction, then creditors can ask a court to pierce the corporate veil. If a court agrees, then limited liability disappears and those creditors can reach the shareholder's personal assets. Essentially, creditors are arguing that the corporate form is a sham to create limited liability and that the shareholder and the corporation are indistinguishable from each other, just like a sole proprietorship. For example, if a business owner incorporates the business and then opens a bank account in the business name, the funds in that account must be used for business purposes only. If the business owner routinely "dips into" the bank account to fund personal expenses, then an argument for piercing the corporate veil can be easily made.

Not all shareholders in a corporation are necessarily equal. U.S. corporate law allows for the creation of different types, or classes, of shareholders. Shareholders in different classes may be given preferential treatment when it comes to corporate actions such as paying dividends or voting at shareholder meetings. For example, founders of a corporation may reserve a special class of stock for themselves with preemptive rights. These rights give the shareholders the right of first refusal if the company decides to issue more stock in the future, so that the shareholders maintain the same percentage ownership of the company and thus preventing dilution of their stock.

A good example of different classes of shareholders is in Ford Motor Company stock. The global automaker has hundreds of thousands of shareholders, but issues two types of stock: Class A for members of the public and Class B for members of the Ford family. By proportion, Class B stock is far outnumbered by Class A stock, representing less than 10 percent of the total issued stock of the company. However, Class B stock is given 40 percent voting rights at any shareholder meeting, effectively allowing holders of Class B stock (the Ford family) to block any shareholder resolution that requires two-thirds approval to pass. In other words, by creating two classes of shareholders, the Ford family continues to have a strong and decisive voice on the future direction of the company even though it is a publicly traded company.

Shareholder rights are generally outlined in a company's articles of incorporation or bylaws. Some of these rights may include the right to obtain a dividend, but only if the board of directors approves one. They may also include the right to vote in shareholder meetings, typically held annually. It is common in large companies with thousands of shareholders for shareholders to not attend these meetings and instead cast their votes on shareholder resolutions through the use of a proxy.

Under most state laws, including Delaware's business laws, shareholders are also given a unique right to sue a third party on behalf of the corporation. This is called a shareholder derivative lawsuit (so called because the shareholder is suing on behalf of the corporation, having "derived" that right by virtue of being a shareholder). In essence, a shareholder is alleging in a derivative lawsuit that the people who are ordinarily charged with acting in the corporation's best interests (the officers and directors) are failing to do so, and therefore the shareholder must step in to protect the corporation. These lawsuits are very controversial because they are typically litigated by plaintiffs' lawyers working on contingency fees and can be very expensive for the corporation to litigate. Executives also disfavor them because oftentimes, shareholders sue the corporate officers or directors themselves for failing to act in the company's best interest.

One of the most important functions for shareholders is to elect the board of directors for a corporation. Shareholders always elect a director; there is no other way to become a director. The board is responsible for making major decisions that affect a corporation, such as declaring and paying a corporate dividend to shareholders; authorizing major new decisions such as a new plant or factory or entry into a new foreign market; appointing and removing corporate officers; determining employee compensation, especially bonus and incentive plans; and issuing new shares and corporate bonds. Since the board doesn't meet that often, the board can delegate these tasks to committees, which then report to the board during board meetings.

Shareholders can elect anyone they want to a board of directors, up to the number of authorized board members as set forth in the corporate documents. Most large corporations have board members drawn from both inside and outside the company. Outside board members can be drawn from other private companies (but not competitors), former government officials, or academe. It's not unusual for the chief executive officer (CEO) of the company to also serve as chair of the board of directors, although the recent trend has been toward appointing different persons to these functions. Many shareholders now actively vie for at least one board seat to represent the interests of shareholders, and some corporations with large labor forces reserve a board seat for a union representative.

Board members are given wide latitude to make business decisions that they believe are in the best interest of the company. Under the business judgment rule, board members are generally immune from second-guessing for their decisions as long as they act in good faith and in the corporation's best interests. Board members owe a fiduciary duty to the corporation and its shareholders, and therefore are presumed to be using their best business judgment when making decisions for the company.

Shareholders in derivative litigation can overcome the business judgment rule, however. Another fallout from recent corporate scandals has been increased attention to board members and holding them accountable for actually managing the corporation. For example, when WorldCom fell into bankruptcy as a result of profligate spending by its chief executive, board members were accused of negligently allowing the CEO to plunder corporate funds. Corporations pay for insurance for board members (known as D&O insurance, for directors and officers), but in some cases D&O insurance doesn't apply, leaving board members to pay directly out of their own pockets when they are sued. In 2005 ten former outside directors for WorldCom agreed to pay $18 million out of their own pockets to settle shareholder lawsuits.

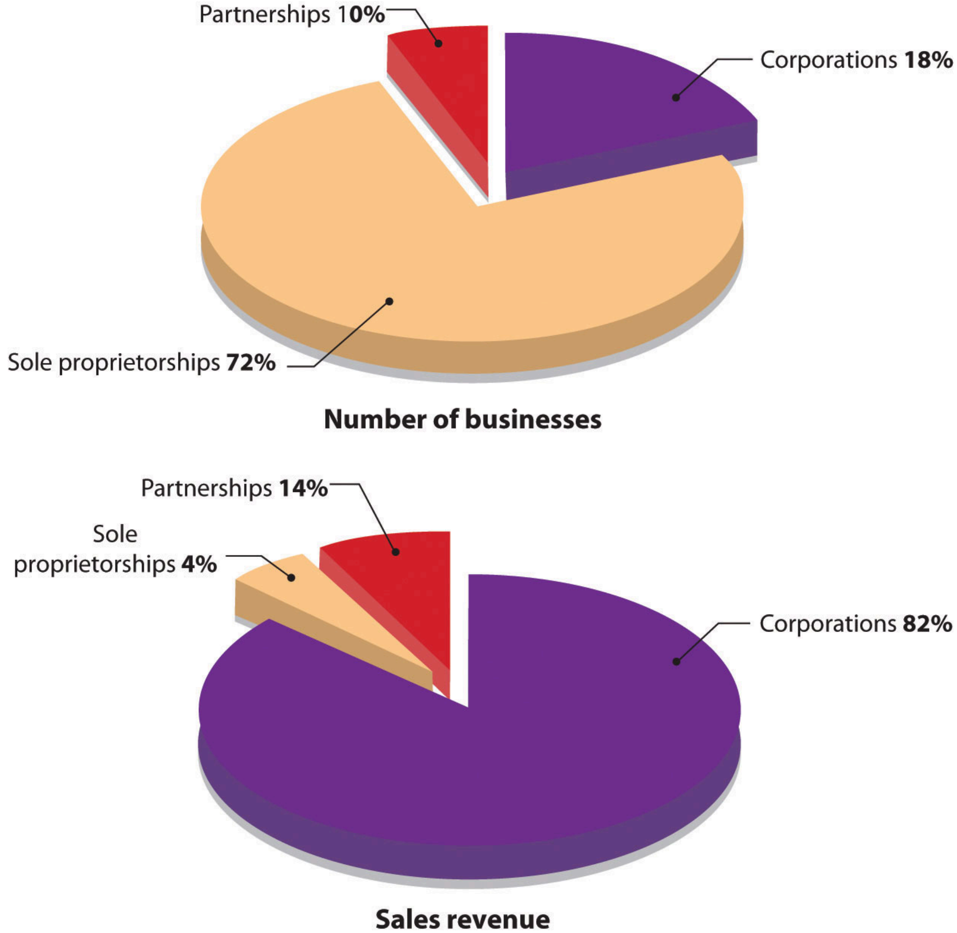
One critical function for boards of directors is to appoint corporate officers. These officers are also known as "C-level" executives and typically hold titles such as chief executive officer, chief operating officer, chief of staff, chief marketing officer, and so on. Officers are involved in everyday decision making for the company and implementing the board's strategy into action. As officers of the company, they have legal authority to sign contracts on behalf of the corporation, binding the corporation to legal obligations. Officers are employees of the company and work full-time for the company, but can be removed by the board, typically without cause.

In addition to being somewhat cumbersome to manage, corporations possess one very unattractive feature for business owners: double taxation. Since corporations are separate legal entities, taxing authorities consider them as taxable persons, just like ordinary human beings. A corporation doesn't have a Social Security number, but it does have an Employer Identification Numbers (EIN), which serves the same purpose of identifying the company to tax authorities. As a separate legal entity, corporations must pay federal, state, and local tax on net income (although the effective tax rate for most U.S. corporations is much lower than the top 35 percent income tax rate). That same pile of profit is then subject to tax again when it is returned to shareholders as a dividend, in the form of a dividend tax.

One way for closely held corporations (such as small family-run businesses) to avoid the double taxation feature is to elect to be treated as an S corporation. An S corporation (the name comes from the applicable subsection of the tax law) can choose to be taxed like a partnership or sole proprietorship. In other words, it is taxed only once, at the shareholder level when a dividend is declared, and not at the corporate level. Shareholders then pay personal income tax when they receive their share of the corporate profits. An S corporation is formed and treated just like any other corporation; the only difference is in tax treatment. S corporations provide the limited liability feature of corporations but the single-level taxation benefits of sole proprietorships by not paying any corporate taxes. There are some important restrictions on S corporations, however. They cannot have more than one hundred shareholders, all of whom must be U.S. citizens or resident aliens; can have only one class of stock; and cannot be members of an affiliated group of companies. These restrictions ensure that "S" tax treatment is reserved only for small businesses.

Advantages and Disadvantages of Corporations

Factors	Consideration
Start-up	Including filing and licensing fees with accounting and attorney fees, incorporating a business can cost $1,000 to $6,000 or more depending on the size and scope of the business.
Control	Shareholders elect a board of directors, a group of people (primarily from outside the corporation) who are legally responsible for governing. Corporate managers don't necessarily own stock, and shareholders don't necessarily work for the company.
Benefactors	All shareholders share in the profits of the business.
Taxation	Corporations are subject to "double taxation." They are taxed by the federal and state governments on their earnings. When these earnings are distributed as dividends, the shareholders pay taxes on these dividends. Corporate profits are thus taxed twice—the corporation pays the taxes the first time and the shareholders pay the taxes the second time.
Capability	Corporations are generally able to attract more skilled and talented employees than are proprietorships and partnerships.
Sustainability	The corporation has a legal life separate from the lives of its owners. Transferring ownership of a corporation is easy: shareholders simply sell their stock to others.
Financing	Incorporation makes it possible to raise funds by selling stock. Depending on its size and financial strength, it may also have an advantage in getting bank loans.
Liability	Incorporation limits the liability to which shareholders are exposed: they are not responsible for the obligations of the corporation, and they can lose *no more than the amount that they have personally invested in the company*.



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CHAPTER VIII

THE PROPERTY SYSTEM

The concepts of property and ownership are fundamental to any society. Property refers to tangible and intangible items that can be owned. Ownership is a concept that means the right to exclude others. Disputes over both have been at the root of conflicts and wars since time immemorial. Without laws to protect property ownership, the stability of our society would be seriously undermined.

Here is what we will cover in this chapter part:

Competency	**Summarize real property and unfair trade practice law**
Criteria	Contrast the characteristics of personal and real property
Criteria	Compare the options available for property ownership
Criteria	Determine how ownership rights in real property are transferred
Criteria	Evaluate the duties of landlords and tenants
Criteria	List methods of acquiring ownership of personal property

37. The Law and Property

SAYLOR ACADEMY

Our legal system creates a peaceful means to acquire, retain, and divest of property, and to settle property disputes. It punishes those who operate outside of those rules. Indeed, those who do not acquire property lawfully or who do not settle property disputes within the confines of our legal system are subjected to criminal and civil penalties.

Before engaging in questions regarding the evolution of property ownership rights, it is necessary to lay the foundation for studying this fascinating area of law. It is this foundation to which we now turn. This chapter explores the differences between real and personal property, and the acquisition, transfer, and protection of real and personal property interests. Additionally, it examines different interests in real property.

38. Personal Property

SAYLOR ACADEMY

While it might be perfectly legal to destroy a piece of personal property—like a chair—without obtaining permission from the government, destruction of real property is a different matter altogether. For example, the owner of an office building who wishes to demolish it would be subject to many local laws, such as requirements to obtain the necessary permits. Such an activity might also be subject to further legal scrutiny, if the building in question holds particular historic value, for example. Let's compare this to the destruction of a chair, which is personal property. Even if the chair is the chair that Abraham Lincoln sat in while drafting the Emancipation Proclamation, as long as the chair is owned by the person who wishes to destroy it, the owner may simply load it into his or her truck and haul it to the dump. No special permission is required, because there are few legal restrictions to the destruction of private property.

Different Types of Property

As you can see, property can be classified as real or personal. Real property is land, and certain things that are attached to it or associated with it. Real property is raw land, such as a forest or a field, as well as buildings, like a house, a condominium, or an office building. Additionally, things that are associated with land, like mineral rights, are also real property. People often talk about real property by using the term real estate, which reflects both the concept of real property and the ownership interest concept of estate.

Many businesses, from grocery stores to coffee shops to hotels, rely on real property for customers or clients to visit to conduct business. Today, many businesses are also conducted virtually, and have only virtual shops. Virtual stores, such as those found on eBay, are *not* forms of real property.

Personal property is property that is not real property. Tangible property is something that can be touched. Moveable, tangible personal property is chattel. Many businesses exist to sell personal property. For example, the primary purpose of retailers such as Wal-Mart, Amazon.com, and Sears is to sell personal property. Some property can also be described as fungible property. Property that can easily be substituted with identical property is said to be fungible. For example, if you bought a pound of sugar from a container containing ten pounds of sugar, you wouldn't care which specific grains of sugar made up your purchase, because all the sugar in the container is fungible. Other types of fungible goods include juices, oil, metals such as steel or aluminum, and physical monetary currency.

Some personal property is intangible. Intangible property does not physically exist, but it is still subject to ownership principles, including acquisition, transfer, and sale. For instance, the right to payment under a contract, the right to exclude others from a patented product, and the right to prohibit others from using copyrighted materials are all examples of intangible property.

Sounds simple, right? Your iPod, your flash drive, and your computer are all personal property. Your dorm room, apartment, or house is real property. So far, so good. But imagine that you found a Jacuzzi for sale that you loved. You plunked down $5,000 to buy it, and you have it delivered to your house. You pay for construction of a deck to surround it and plumbing to service it. Is the Jacuzzi personal property or is it real property? This is an example of personal property that becomes attached to the land as a fixture. A fixture is something that used to be personal property, but it has become attached to the land so that it is legally a part of the land. Fixtures are treated like real property. Accordingly, when real property is transferred, fixtures are transferred as a part of the real property. In our example, if you move, you will have to leave your beloved Jacuzzi behind, unless you make express provisions to remove it. What if you were just renting? Since removing a fixture would cause substantial harm to the property, that fixture remains with the land. The landlord might be very happy about that!

Some things that are attached to the land are not fixtures but are part of the real property itself. Imagine a farm with one thousand acres planted in corn. Is the corn crop personal property, or is it real property? Or imagine a forest. Maybe the owner has been thinking about timbering the forest for some extra money. Is the forest personal property, or is it real property? Both the corn crop and trees are examples of real property that can become personal property, if they are severed from the land. This means that when an ear of corn is picked from the stalk, the ear of corn becomes personal property, even though while it was growing and still attached the land, it was real property. Likewise, when a tree is felled, that tree is transformed from real property to personal property.

Besides property *types*, property can be *classified by ownership*, too. Personal property and real property can be private or public. Private property is owned by someone or something that is not the government. Individuals, corporations, and partnerships, for instance, can own private property. Private property can include real property like land or buildings, and personal property, such as automobiles, furniture, and computers. Property that is owned by the government is public property. Yellowstone National Park and the Gifford Pinchot National Forest are both examples of public property that is real property. Public property can also include personal property, such as automobiles, furniture, and computers owned by state or local governments.

Methods of Acquisition of Personal Property

Personal property may be acquired for ownership in several different ways. For example, if you produce something, then you may own it, unless you are producing it in the capacity of your work for someone else. If you buy four yards of wool fabric and sew a coat out of it, then you own that coat by virtue of having produced it with your own materials. This is ownership by production. However, if you sew a coat as part of your job while working for your employer, then the employer will own the coat.

If you are in the business of producing coats to sell, then you may be a merchant, and the rules of the Uniform Commercial Code (UCC) would govern transactions involving the sale of goods and the purchase of supplies from other merchants. Regardless of whether someone is a merchant or not, purchase is a means of acquiring ownership. Indeed, in today's world, purchase may be the most common method of acquiring property.

Property may also be gifted. A gift is a voluntary transfer of property. Generally, the donor of the gift must intend to gift the property, the donor must deliver the gift, and the gift must be accepted by the intended recipient, known as the donee. A conditional gift is a gift that requires a condition to be met before the gift will transfer. For example, if your parents said, "You can have a new car, if you graduate from school," then that would be an example of a conditional gift. If you do not graduate from school, then you cannot have the gift of the car.

What if you find something? Dating at least to the Institutes of Justinian in Roman law, the concept of "finders keepers" is one known to every preschooler: *finders keepers, losers weepers*. However, in law, things are not quite so simple. Property that someone finds can be classified in several ways. A finder of personal property may claim ownership of the property if it is abandoned. The owners of abandoned property must intend to relinquish ownership in it. For example, if you take your chair to the landfill, you have abandoned the chair. Someone may come along and take possession of it, which will place ownership of the chair in that person. If you change your mind later, that's too bad. The chair now belongs to the new owner. However, if the property is simply lost or mislaid, then the finder must relinquish it once the rightful owner demands its return. If the finder refuses to return lost or mislaid property to its rightful owner, the owner can sue for conversion, which is a tort. Conversion is intentional, substantial interference with the chattel of another. Another classification of personal property applicable to found property is treasure trove. A treasure trove is money or precious metals, like gold, for which the concept of "finders keepers" sometimes is applicable.

Bailment

Sometimes it is necessary to intentionally leave personal property with someone else. For example, imagine that you own a cat. If your cat, which is considered to be chattel, needs to have surgery, you will need to leave her at the veterinary hospital. Instead, in this situation you will be known as bailor, and you will be seeking a bailment with your veterinarian. A bailor is someone in the rightful possession of personal property who gives the property to someone else to hold. A bailment is the arrangement in which when the rightful possessor (such as the owner) of personal property gives the property to someone else to hold. The holding party, known as the bailee, agrees to accept the property and has the duty to return it. The bailee is someone who is in possession of someone else's property. In our example, you rightfully have possession of your cat because she is your personal property. You give your cat to the veterinarian to hold, who has agreed to accept the cat. You also rightfully expect that the cat will be returned to you on demand. Indeed, the veterinarian has a duty, by virtue of the bailment, to return the cat to you.

The bailee has certain duties to the bailor. For example, a bailee has a duty to take reasonable care of the property while the property is in his or her possession. This means different things for different types of bailment. If the bailee is the only party who benefits from the bailment, then the bailee must take extraordinary care with the personal property. A common example of a bailee being the only party who benefits is where the owner of the property loans the property to someone for his or her use. For instance, if you loan your neighbor a snow shovel without asking for something in return, then your neighbor receives the sole benefit of the bailment. His or her duty of care is that he or she must take extraordinary care with the snow shovel. However, when both parties receive benefit from the bailment, such as when you rent a DVD from Blockbuster, only the duty of ordinary care is imposed on the bailee. The bailee receives the DVD and Blockbuster receives a rental fee. When the benefit of the bailment exists for the benefit of the bailor only, then only minimum care is required. Gross negligence will give rise to liability, but there is no great duty for the bailee to be as careful as he or she would be if he or she were receiving some benefit. If someone asks you to hold his or her books while he or she jumps into a swimming pool, you would have a minimum duty of care. If you lost the books, then you would not be liable. However, if you intentionally threw the books into the pool, then you would be grossly negligent and liable for damages.

An involuntary bailment is created when someone finds lost or mislaid property. The finder may not destroy the property, though the duties that he or she owes regarding the property may vary from state to state. A voluntary bailment is created when intention exists to create the bailment, as described in the previous paragraph.

As you can imagine, bailment is common in business. Examples of bailment in business include placing packages or goods with common carriers for delivery, warehousing goods with a third party prior to sale or delivery, or taking clients' or customers' automobiles in a valet service. Consider whether a business should be able to disclaim bailment (and the duties that go along with bailment). For example, if a hotel required its guests to sign a "no bailment created" clause on check-in, should that excuse the hotel from liability if the guests' personal property is damaged while the property is left in the hotel?

39. Legal Issues with Personal Property

SAYLOR ACADEMY

Most legal issues about personal property center on its acquisition. Acquisition by purchase is the most common way we acquire personal property, but there are at least five other ways to legally acquire personal property: (1) possession, (2) finding lost or misplaced property, (3) gift, (4) accession, and (5) confusion.

Possession

It is often said that "possession is nine-tenths of the law." There is an element of truth to this, but it's not the whole truth. For our purposes, the more important question is, what is meant by "possession"? Its meaning is not intuitively obvious, as a moment's reflection will reveal. For example, you might suppose than you possess something when it is physically within your control, but what do you say when a hurricane deposits a boat onto your land? What if you are not even home when this happens? Do you possess the boat? Ordinarily, we would say that you don't, because you don't have physical control when you are absent. You may not even have the intention to control the boat; perhaps instead of a fancy speedboat in relatively good shape, the boat is a rust bucket badly in need of repair, and you want it removed from your front yard.

Even the element of physical domination of the object may not be necessary. Suppose you give your new class ring to a friend to examine. Is it in the friend's possession? No: the friend has custody, not possession, and you retain the right to permit a second friend to take it from her hands. This is different from the case of a bailment, in which the bailor gives possession of an object to the bailee. For example, a garage (a bailee) entrusted with a car for the evening, and not the owner, has the right to exclude others from the car; the owner could not demand that the garage attendants refrain from moving the car around as necessary.

From these examples, we can see that possession or physical control must usually be understood as the power to exclude others from using the object. Otherwise, anomalies arise from the difficulty of physically controlling certain objects. It is more difficult to exercise control over a one-hundred-foot television antenna than a diamond ring. Moreover, in what sense do you possess your household furniture when you are out of the house? Only, we suggest, in the power to exclude others. But this power is not purely a physical one: being absent from the house, you could not physically restrain anyone. Thus the concept of possession must inevitably be mixed with legal rules that do or could control others.

Possession confers ownership in a restricted class of cases only: when no person was the owner at the time the current owner took the object into his possession. The most obvious categories of objects to which this rule of possession applies are wild animals and abandoned goods. The rule requires that the would-be owner actually take possession of the animal or goods; the hunter who is pursuing a particular wild animal has no legal claim until he has actually captured it. Two hunters are perfectly free to pursue the same animal, and whoever actually grabs it will be the owner.

But even this simple rule is fraught with difficulties in the case of both wild animals and abandoned goods. We examine abandoned goods in Section 36.2.2 "Lost or Misplaced Property". In the case of wild game, fish in a stream, and the like, the general rule is subject to the rights of the owner of the land on which the animals are caught. Thus even if the animals caught by a hunter are wild, as long as they are on another's land, the landowner's rights are superior to the hunter's. Suppose a hunter captures a wild animal, which subsequently escapes, and a second hunter thereafter captures it. Does the first hunter have a claim to the animal? The usual rule is that he does not, for once an animal returns to the wild, ownership ceases.

Lost or Misplaced Property

At common law, a technical distinction arose between lost and misplaced property. An object is lost if the owner inadvertently and unknowingly lets it out of his possession. It is merely misplaced if the owner intentionally puts it down, intending to recover it, even if he subsequently forgets to retrieve it. These definitions are important in considering the old saying "Finders keepers, losers weepers." This is a misconception that is, at best, only partially true, and more often false. The following hierarchy of ownership claims determines the rights of finders and losers.

First, the owner is entitled to the return of the property unless he has intentionally abandoned it. The finder is said to be a quasi-bailee for the true owner, and as bailee she owes the owner certain duties of care. The finder who knows the owner or has reasonable means of discovering the owner's identity commits larceny if she holds on to the object with the intent that it be hers. This rule applies only if the finder actually takes the object into her possession. For example, if you spot someone's wallet on the street you have no obligation to pick it up; but if you do pick it up and see the owner's name in it, your legal obligation is to return it to the rightful owner. The finder who returns the object is not automatically entitled to a reward, but if the loser has offered a reward, the act of returning it constitutes performance of a unilateral contract. Moreover, if the finder has had expenses in connection with finding the owner and returning the property, she is entitled to reasonable reimbursement as a quasi-bailee. But the rights of the owner are frequently subject to specific statutes, such as the one discussed in *Bishop v. Ellsworth* in Section 36.4.1 "Lost or Misplaced Property".

Second, if the owner fails to claim the property within the time allowed by statute or has abandoned it, then the property goes to the owner of the real estate on which it was found if (1) the finder was a trespasser, (2) the goods are found in a private place (though what exactly constitutes a private place is open to question: is the aisle of a grocery store a private place? the back of the food rack? the stockroom?), (3) the goods are buried, or (4) the goods are misplaced rather than lost.

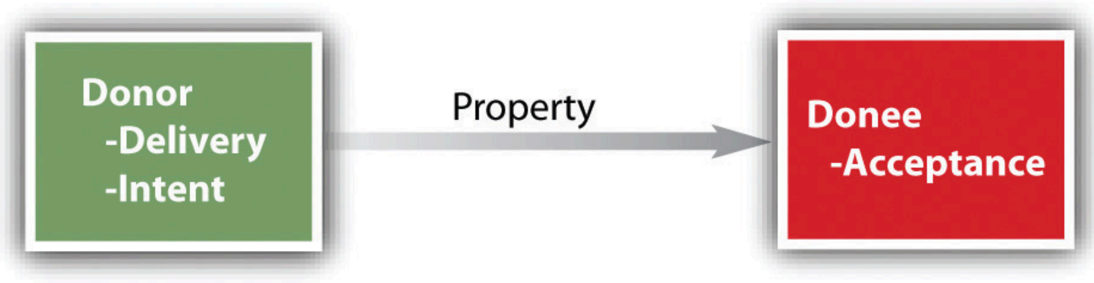
If none of these conditions apply, then the finder is the owner. These rules are considered in the *Bishop* case, (see Section 36.4.1 "Lost or Misplaced Property").

Gift

A gift is a voluntary transfer of property without consideration or compensation. It is distinguished from a sale, which requires consideration. It is distinguished from a promise to give, which is a declaration of an intention to give in the future rather than a present transfer. It is distinguished from a testamentary disposition (will), which takes effect only upon death, not upon the preparation of the documents. Two other distinctions are worth noting. An inter vivos (enter VYE vos) gift is one made between living persons without conditions attached. A causa mortis (KAW zuh mor duz) gift is made by someone contemplating death in the near future.

Requirements

Figure 36.1 Gift Requirements



To make an effective gift inter vivos or causa mortis, the law imposes three requirements: (1) the donor must *deliver* a deed or object to the donee; (2) the donor must actually *intend* to make a gift, and (3) the donee must *accept* (see Figure 36.1 "Gift Requirements").

Delivery

Although it is firmly established that the object be delivered, it is not so clear what constitutes delivery. On the face of it, the requirement seems to be that the object must be transferred to the donee's possession. Suppose your friend tells you he is making a gift to you of certain books that are lying in a locked trunk. If he actually gives you the trunk so that you can carry it away, a gift has been made. Suppose, however, that he had merely given you the key, so that you could come back the next day with your car. If this were the sole key, the courts would probably construe the transfer of the key as possession of the trunk. Suppose, instead, that the books were in a bank vault and the friend made out a legal document giving both you and him the power to take from the bank vault. This would not be a valid gift, since he retained power over the goods.

Intent

The intent to make a gift must be an intent to give the property at the present time, not later. For example, suppose a person has her savings account passbook put in her name and a friend's name, intending that on her death the friend will be able to draw out whatever money is left. She has not made a gift, because she did not intend to give the money when she changed the passbook. The intent requirement can sometimes be sidestepped if legal title to the object is actually transferred, postponing to the donee only the use or enjoyment of the property until later. Had the passbook been made out in the name of the donee only and delivered to a third party to hold until the death of the donor, then a valid gift may have been made. Although it is sometimes difficult to discern this distinction in practice, a more accurate statement of the rule of intent is this: Intention to give in the future does not constitute the requisite intent, whereas present gifts of future interests will be upheld.

Acceptance

In the usual case, the rule requiring acceptance poses no difficulties. A friend hands you a new book and says, "I would like you to have this." Your taking the book and saying "thank-you" is enough to constitute your acceptance. But suppose that the friend had given you property without your knowing it. For example, a secret admirer puts her stock certificates jointly in your name and hers without telling you. Later, you marry someone else, and she asks you to transfer the certificates back to her name. This is the first you have heard of the transaction. Has a gift been made? The usual answer is that even though you had not accepted the stock when the name change was made, the transaction was a gift that took effect immediately, subject to your right to repudiate when you find out about it. If you do not reject the gift, you have joint rights in the stock. But if you expressly refuse to accept a gift or indicate in some manner that you might not have accepted it, then the gift is not effective. For example, suppose you are running for office. A lobbyist whom you despise gives you a donation. If you refuse the money, no gift has been made.

Gifts Causa Mortis

Even though the requirements of delivery, intent, and acceptance apply to gifts causa mortis as well as inter vivos, a gift causa mortis (one made in contemplation of death) may be distinguished from a gift inter vivos on other grounds. The difference between the two lies in the power of the donor to revoke the gift before he dies; in other words, the gift is conditional on his death. Since the law does not permit gifts that take place in the future contingent on some happening, how can it be that a gift causa mortis is effective? The answer lies in the nature of the transfer: the donee takes actual title when the gift is made; should the donor not in fact die or should he revoke the gift before he dies, then and only then will the donee lose title. The difference is subtle and amounts to the difference between saying "If I die, the watch is yours" and "The watch is yours, unless I survive." In the former case, known as a condition precedent, there is no valid gift; in the latter case, known as a condition subsequent, the gift is valid.

Gifts to Minors

Every state has adopted either the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA), both of which establish the manner by which irrevocable gifts are made to minors. Under these acts, a custodian holds the gifts until the minor reaches the age of eighteen, twenty-one, or twenty-five, depending on state law. Gifts under UGMA are limited for the most part to money or securities, while UTMA allows other types of gifts as well, such as real estate or tangible personal property.

Gift Tax

The federal government and many states impose gift taxes on gifts above a certain dollar amount.

Accession

An accession is something that is added to what one already possesses. In general, the rule is that the owner of the thing owns the additional thing that comes to be attached to it. For example, the owner of a cow owns her calves when she gives birth. But when one person adds value to another person's property, either through labor alone or by adding new materials, the rule must be stated somewhat differently. The general rule is this: when goods are added to goods, the owner of the principal goods becomes the owner of the enhanced product. For example, a garage uses its paint to repaint its customer's automobile. The car owner, not the painter, is the owner of the finished product.

When someone has wrongfully converted—that is, taken as her own—the property of another, the owner may sue for damages, either to recover his property or its value. But a problem arises when the converter has added to the value of that property. In general, the courts hold that when the conversion is willful, the owner is entitled to the full value of the goods as enhanced by the converter. Suppose that a carpenter enters a ten-acre forest that he knows belongs to his neighbor, cuts down one hundred trees, transports them to his shop, and cuts them up into standard lumber, thus increasing their market value. The owner is entitled to this full value, and the carpenter will get nothing for his trouble. Thus the willful converter loses the value of his labor or materials. If, on the other hand, the conversion was innocent, or at most negligent, the rule is somewhat more uncertain. Generally the courts will award the forest owner the value of the standing timber, giving the carpenter the excess attributable to his labor and transportation. A more favorable treatment of the owner is to give her the full value of the lumber as cut, remitting to the carpenter the value of his expenses.

Confusion

In accession, the goods of one owner are transformed into a more valuable commodity or are inextricably united with the goods of another to form a constituent part. Still another type of joining is known as confusion, and it occurs when goods of different owners, while maintaining their original form, are commingled. A common example is the intermingling of grain in a silo. But goods that are identifiable as belonging to a particular person—branded cattle, for instance—are not confused, no matter how difficult it may be to separate herds that have been put together.

When the goods are identical, no particular problem of division arises. Assuming that each owner can show how much he has contributed to the confused mass, he is entitled to that quantity, and it does not matter which particular grains or kernels he extracts. So if a person, seeing a container of grain sitting on the side of the road, mistakes it for his own and empties it into a larger container in his truck, the remedy is simply to restore a like quantity to the original owner. When owners of like substances consent to have those substances combined (such as in a grain silo), they are said to be tenants in common, holding a proportional share in the whole.

In the case of willful confusion of goods, many courts hold that the wrongdoer forfeits all his property unless he can identify his particular property. Other courts have modified this harsh rule by shifting the burden of proof to the wrongdoer, leaving it up to him to claim whatever he can establish was his. If he cannot establish what was his, then he will forfeit all. Likewise, when the defendant has confused the goods negligently, without intending to do so, most courts will tend to shift to the defendant the burden of proving how much of the mass belongs to him.

40. Real Property

SAYLOR ACADEMY

Real property is land, and certain things that are attached to it or associated with it. Real property includes undeveloped land, like a forest or a field, and it includes buildings, such as houses, condominiums, and office buildings. Real property also includes things associated with the land, like subsurface rights. Fixtures are personal property that have become attached to the land, and they are transferred with the land. Fixtures in a house include things like the lights affixed to the ceiling, the furnace, and the bathtub. Plants and trees that grow on the land are real property until they are severed from the land. For example, farmers' crops are part of their real property until they are separated from the land, at which time they become personal property.

Methods of Acquisition

Real property may be acquired for ownership (the title may be obtained) in one of several ways. It may be purchased, inherited, gifted, or even acquired through adverse possession. Ownership rights are transferred by title. Ownership of real property means that the owner has the right to possess the property, as well as the right to exclude others, within the boundaries of the law. If someone substantially interferes with your use and enjoyment of your real property, you may bring a claim in nuisance (a form of tort law). For example, if a neighbor decides to start burning tires on his property, the smell of the burning tires might substantially interfere with your use and enjoyment of your property, so you would have an actionable claim in nuisance. Similarly, if you own real property, you might rightfully seek damages against those who enter your land without your consent or permission. This would be a trespass to land claim. Owners of real property may also sell the real property, in whole or in part.

The most common way that real property is acquired is through purchase. Property law is a state law matter, and state laws vary regarding conveyance of property. Typically, someone who is interested in acquiring real property will ask a third party, such as a real estate agent or a broker, to help locate a suitable property and to facilitate the terms of the deal. The buyer and seller will negotiate a contract, which will contain all essential terms of the sale, such as location of the real property, price, fixtures that will be excluded from sale, and the type of ownership interest that is being transferred. Both parties will perform their promises under the contract (e.g., the buyer will pay the seller, and the seller will transfer the title via deed) to close the deal ("closing"), and then the deed will be recorded. A contract for any interest in property must be in writing to be valid against the defendant according to the Statute of Frauds.

Different types of deeds convey different types of interests. A quitclaim deed, for instance, conveys whatever interests in title that the grantor has in the property to the party to whom the quitclaim is given. Of course, that means if the grantor has no interests in the real property, a conveyance by quitclaim will not grant any interests in the property. For example, if you grant a quitclaim deed to your friend for the Empire State Building, then that means that you have transferred your interests in title to that building to your friend. If you have no interests in the title to the Empire State Building to begin with, then on conveyance of the quitclaim deed, your friend will not have any interests in the building either. You cannot convey interests that you do not have. On the other hand, many states allow a warranty deed, which conveys title and a warranty against defects in title as well as encumbrances. Buyers typically demand a warranty deed when they purchase property.

After title is transferred by the deed, the deed is typically recorded. Recording the deed is not necessary for ownership. However, recording a deed to property is important because it places others on notice that whoever has recorded the deed to the property owns the property. Some states favor the rights of those who record the deed first (under a race statute), while other states favor the rights of those who acquired the interest first without notice of other claims to the property (under a notice statute). A race/notice system, which has a race/notice statute, is one in which priority is given to the first bona fide purchaser to record when there is a conflict in ownership claim. A bona fide purchaser is simply a purchaser who takes title in good faith, with no knowledge of competing claims to title.

Besides outright purchase, another common way in which real property may be obtained is through inheritance. Real property may be bequeathed through a will or may transfer per state statutes when a decedent dies intestate. Generally speaking, people have the right to dispose of their property as they wish when they die, providing that their will or other transfer instrument meets their state's requirements for validity. When someone dies intestate, state statutes will determine who among the decedent's relatives receives the property. For example, state statutes often specify that property will go to the spouse, and if there is no spouse, then to the children. If there are no children, then to the parents. If there are no living parents, then to the siblings, and so on. If no such person exists, the property may finally escheat to the state.

Real property may also be acquired through a gift. Providing that the person who is giving the property actually intends to make the gift of title, delivers the deed to the recipient, and the gift is accepted, then the gift is valid. If one of these elements is not met, for instance, if the deed is not delivered to the intended party (or to a third party to hold for the intended party), then the gift has not been successfully made, and the title will not be conveyed.

A less common way to acquire real property is through the doctrine of adverse possession. Colloquially, this is often referred to as "squatter's rights." At its heart, this method of acquiring property captures the deeply held belief that a land's value is in its use for profit. If a land sits idle at the owner's hands but someone else puts it to use, then the law may—just may—favor the user's claim to the land over that of the actual owner.

Adverse possession is when someone who is not the owner of real property has claimed the real property for his own. To be successful under this doctrine, several elements must be met. These include the following:

- The possessor must be in actual possession.
- The possession must be open and notorious, which means that it must be obvious to others (visible).
- The possession must be hostile, which means that it is against the actual owner's interests.
- The possession must be continuous, which means that the possessor cannot have been evicted during the statutory length of time required to obtain title through possession.
- The possession must be exclusive.
- The state statutory length of time must be met, and this time varies from state to state. For example, some states, like Maine, require a twenty-year period, while other states, like Nevada, require only a five-year period.

Some states' adverse possession laws also require that the possessor pay property taxes on the property during the course of the adverse possession. If all of these elements are met, then the possessor can bring a claim to quiet title. If successful, the possessor becomes the owner, without any compensation being made to the former owner.

Adverse possession and claims for quiet title often occur around property lines, where one party has routinely used another's property because a fence has been misplaced. Other instances involve claims concerning land owned by people who do not visit it, such as land owned in a remote area. Still other examples exist in cases of ouster, when a tenant in common constructively or actually evicts others with valid ownership interests. Remember that all elements of an adverse possession must occur for the entire statutory length of time for an action for quiet title to be successful. This means, for instance, if the owner checks on the property and finds someone there, the owner must interfere with those elements. The owner should evict the trespasser, and this can be accomplished by summoning the police. Doing so would break the continuity requirement.

Interests and Scope

Owning real property carries many responsibilities, as well as the potential for great profit and great liability. It is important to recognize the duties associated with property ownership, and learn how to protect yourself against potential liability associated with it. For instance, if a toxic waste site is discovered on your real property, you may very well be liable for its cleanup, even if you did not realize that such a site was there when you purchased the land. Each buyer of real property has a duty to exercise due diligence when purchasing land. The idea is that you should have known about the site, if it was discoverable on inspection. Knowing this, along with familiarity with the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), helps us recognize that we should never agree to buy land "sight unseen," or at least without a professional inspector that we trust. But what if an old toxic waste site is located on property that you wish to sell? You would have a duty to disclose such a defect in the land to prospective buyers before conveying ownership.

Additionally, we must consider duties that landowners have to other people who enter the land. What are our duties to people who visit our home? Or our retail establishment? What if they are not invited but instead are trespassers? These duties of landowners will vary depending on the status of the person who was injured.

What if a gold mine were discovered on land that you used to own? Can you profit from that discovery? Probably not, if you conveyed full ownership to someone else.

As these examples illustrate, it is important to know about the *duties of landowners*, how to *limit liability* associated with the ownership of land, and when severance of liability occurs. These types of questions can be considered more fully when we consider ownership interests.

Additionally, it is important to know how an owner of real property may use the property, or the *scope* of his or her rights. Consider these questions: If you owned a lot in the middle of a city, can you build an apartment building that blocks the neighboring landowner's light? Or if you own a piece of raw land where you discover oil, can you drill on your land if it siphons oil from underneath your neighbor's land, or if it causes your neighbor's land to collapse due to lack of subsurface support? If you live on a coastline and your neighbor builds a dyke that causes your waterfront property line to erode so that over the years your property is reduced in size, do you have an actionable claim against your neighbor? Conversely, if the ebb and flow of water along the coastline increases your property due to natural accretion, do you own the "new" property, even though it wasn't part of the original purchase? Consider water disputes, which are a very hot topic in the western states. If you live next to a river, can you divert the entire stream of water, even if you wanted to divert it for a capricious reason? Imagine that you dreamed of having a very large private water park for your family, but you needed all the water in a river that adjoined your property to make that dream a reality. If you diverted all that water, other riparian owners might very well have an actionable claim. What if it was a drought year and you relied on water from a river to irrigate your commercial crops, but endangered salmon in the river needed the water for their habitat? Can you take the water for your crop, or must the water be left in the river for the endangered salmon? These types of legal questions can be addressed when we consider the scope of rights.

The following sections address duties of landowners, ownership interests, and scope of interest in real property.

Duties of Landowners

Landowners owe different duties to different types of people who enter their land. These responsibilities vary, depending on whether the person is a trespasser, a licensee, or an invitee.

A trespasser is a person who voluntarily, intentionally enters the land of another without permission or privilege. A landowner has a duty not to intentionally injure a trespasser. For instance, booby traps, pitfalls, or anything of the sort are simply not permitted. Trespassers injured from such a trap have valid claims against the landowner for injuries.

A licensee is someone who has permission to be on the land. Landowners have a higher duty of care to such a person. Not only must a landowner not intentionally injure a licensee, but the landowner must also warn the licensee of known defects. For example, if a landowner knows that the steps to his or her porch are icy, he or she has a duty to warn a licensee—such as a visiting friend—that those steps are icy. Failure to do so may result in liability for the landowner.

An invitee is someone who has entered real property by invitation. Businesses have issued invitations to the public. Public places have issued invitations to the public. Anyone who arrives at the invitation of an owner is an invitee. Landowners must inspect their property for defects, correct those defects when found, and warn invitees about such defects. This is why you will see a "caution" sign on the floor of a grocery store, after it has been mopped or after a liquid spill.

Ownership Interests in Real Property

Different types of interests may be owned in real property. For example, real property may be owned without restriction, subject only to local, state, and federal laws. Or ownership interests may be narrower, subject to conditions, the violation of which can lead to loss of those ownership interests.

The most complete ownership interest is represented by fee simple absolute. The owner of property in fee simple absolute has the greatest ownership interest recognized by law. Generally, if someone wants to buy real property, he or she is looking to buy property in fee simple absolute.

Compare that with a defeasible fee. A fee simple defeasible is subject to a condition of ownership or to some future event. For instance, if you donated land to "the City of Nashville, so long as it is used as a public greenway," then the land would be owned in defeasible fee by the City of Nashville, unless it decided to do something else with the land, besides maintain it as a public greenway. Once the condition is violated, the land would revert back to either the original owner or whoever owned the reversion interest, which is a future interest in real property.

Another ownership interest is a life estate. This interest is measured by the life of the owner in the life estate. If you wished to grant ownership rights in real property to your mother for the length of her life, but then expected the property to be returned to you upon her death, you might grant a life estate to her. Similarly, a common investment, known as a reverse mortgage, employs the concept of life estate. A reverse mortgage is an arrangement where the purchaser of real property agrees to allow the seller of the property to retain possession of the property for a specified period of time (such as the remainder of his or her life) in exchange for the ability to purchase the property at today's price. This can be an attractive investment, if the investor believes that the value of the property will increase in the future, and if the investor does not need immediate possession of the property. These arrangements essentially gamble on life expectancies of the sellers of real property by granting life estates to them in the property.

Sometimes, more than one owner owns the interest in the property. Several types of co-ownership interests are recognized in law. These ownership interests are important for matters of possession, right to transfer, right to profits from the land, and liability. For example, tenancy in common describes an ownership interest in which all owners have an undivided interest in the property, equal rights of possession, and a devisable interest. Compare this to a joint tenancy, which describes an ownership interest in which the surviving owner has the right of survivorship. Imagine that you own a gold mine with your partner, Frank. Would you rather have a tenancy in common or a joint tenancy? You would rather have a joint tenancy because if Frank dies, then his interest in the gold mine would vest in you, rather than in his heirs. After all, you may not want to be a partner with Frank's grandson (or whoever), but that is exactly what might happen with tenancy in common. Similarly, a tenancy by the entirety includes the right of survivorship, but it can only occur between a husband and wife. This concept is recognized in some states, but not all states.

These different interests are created by specific wording in the instrument of conveyance. To create a tenancy in common, the language would be "To John and Frank," if John and Frank were to be the co-owners. However, if a joint tenancy were intended, the conveyance would have to be more specific, like this: "To John and Frank, with rights of survivorship." Note that John and Frank could not benefit from a tenancy by the entirety unless they lived in a state that recognized same-sex marriages, and unless they were, in fact, married.

Note that a tenant in tenancy in common may sell or transfer his or her rights without seeking permission from his or her cotenant. Imagine that you owned a farm with your best friend. At first, you agree to engage only in organic farming practices. Later, your friend wants to move to conventional farming practices. Since you do not want any part in the spraying of pesticides or herbicides on the land, you decide to sell your interests to someone else. Even if your friend opposes the sale, he or she cannot block it. This is because cotenants in a tenancy in common have the unilateral right to transfer their interests in property. Imagine, later, that someone working on that land becomes very sick from a pesticide sprayed there after you sold your interest. You would not be liable for any damages resulting from such an event, because your liability would be severed with the sale. Compare this to a joint tenancy, including tenancy by the entirety. To transfer one's interests, the consent and approval of the cotenant is required. In the case that joint tenants disagree about the use of the property or its disposal, the courts can step in to grant a partition of the land, which essentially results in a separate parcels being granted to the individual tenants. This recasts the formerly joint tenants into adjacent landowners, and it allows them to dispose of or use their property as each sees fit, with no rights to the other's property.

Scope of Interests in Real Property

Scope of ownership matters, because it is determinative of what can (or cannot) be done with the land. The surface of the land and the buildings that are attached to the land are implicitly included when most people contemplate the scope of ownership of real property. However, other interests can be parsed and conveyed separately, including subsurface or mineral rights, and right to light or right to a view. Moreover, water rights are granted differently, depending on whether the property is in the western or the eastern United States. Additionally, easements and covenants grant certain rights to nonpossessors of land.

Subsurface or mineral rights are rights to the substances beneath the actual surface of the land. If you are interesting in drilling for oil, but you do not want to buy every piece of land where you might wish to speculate, then you probably are in the market to purchase or lease mineral rights. This would allow you the right to extract whatever you find under the surface of the land and sell it.

Water rights are determined in two different ways in the United States. Generally speaking, states east of the Mississippi River follow a riparian water rights doctrine, which means that those who live next to the water have a right to use the water. The water is shared among the riparian owners. In a quite different scheme, most western states use the concept of prior appropriation, which grants rights to those who used those rights "first in time." Moreover, under this concept, the use must be beneficial, but the owner of the right need not be an adjacent landowner. This policy has led to some unnatural uses of land in western states, where water rights are highly valued due to the scarcity. For example, we see flourishing farmlands in extremely arid climates because the owners of the water rights want to make sure that they retain their prior appropriation rights to the water by putting it to beneficial use (e.g., crop irrigation). If water is not put to beneficial use under a prior appropriation doctrine, then those rights can be lost. Prior appropriation is basically a “use it or lose it” doctrine. Moreover, adjacent landowners in prior appropriation states may have no right whatsoever to use the water that runs through their land. Indeed, such an outcome is very common.

Easements and covenants are nonpossessory interests in real property. An easement is created expressly or impliedly, and it generally gives people the right to use another’s land for a particular purpose. For example, an easement for utility companies to enter onto the land of others is common. This allows the utility companies to maintain poles, power lines, cable lines, and so on. Other examples include a landlocked property having an easement across another piece of property for the purpose of a driveway, or an easement granted to the public to walk along the property of another to gain access to the shoreline.

A covenant is a voluntary restriction on the use of land. Common covenants are homeowners associations’ rules, which restrict the rights of the owners to use their land in certain ways, often for aesthetic purposes. For instance, such covenants might require houses subject to the covenant to be painted only in certain preapproved colors, or they might contain prohibitions against building swimming pools.

Some covenants and easements run with the land, which means that the restrictions will apply to subsequent owners of the real property. Whether a covenant or easement runs with the land depends on the type of interest granted.

41. Landlord Tenant Relationships

Landlord-Tenant Relationships

A leasehold interest may be created in real property. For example, if you rent an apartment, house, or dormitory room from campus, you are a tenant with a leasehold interest. In such a relationship, you are the tenant and the property owner is the landlord. A leasehold is simply a possessory interest with certain rights and duties, which are typically specified in the lease agreement. For example, a tenant has the right to exclusive possession of the real property and the duty to follow the rules of occupancy set out by the landlord, and a landlord in a residential lease agreement has the right to be paid rent and the duty to ensure that the premises are habitable. If one party does not perform under the lease as required, the other party may seek legal remedy. For example, if a tenant does not pay rent, then a landlord may lawfully evict the tenant from the premises, even if the term of the lease has not run. Like other interests in real property, leases generally must be in writing to be enforceable against the defendant.

Different types of tenancies may be created. The most common tenancies are probably tenancies for years and periodic tenancies. Tenancy for years is simply a tenancy that lasts for a particular, specified period of time. When you rent an apartment, you might sign a lease for nine months to reflect the school year. That would be a tenancy for years, even though the term of the lease is less than one year. A periodic tenancy, on the other hand, is a tenancy that simply runs for a particular period of time and then automatically renews if it is not terminated by the landlord or the tenant. For instance, a one-year lease may become a periodic tenancy if neither party terminates. Imagine that you had a one-year lease but you did not move out at the end of the year, and the landlord continued to accept rent payments and took no action to terminate the lease. A new lease—for a one-year period of time—would be created. Less common types of tenancies are tenancy at will, which is a tenancy for no particular fixed period of time and subject to termination at will by either the landlord or the tenant, and tenancy at sufferance, which is a tenancy that occurs when a tenant remains on the property after the right of possession has ended and without the landlord's consent.

Tenancies may be created for residential purposes or commercial purposes. Commercial leases typically last for longer periods of time than residential leases. For example, it is not uncommon to hear about commercial leases that last five, ten, twenty-five, or even ninety-nine years. Many of the same responsibilities and duties exist with commercial leases, but there are some important differences. For example, a commercial tenant may demand that the landlord refuse to rent to a competitor of the tenant within the same building. For example, if a golf shop locates in a strip mall, it may require as a term in the lease that the landlord refrain from renting other retail space to a competitor golf shop within the same strip mall.

Lease interests are assignable unless those rights are expressly restricted by the lease agreement. This means that the rights conveyed by the lease, which is a contract, may be transferred to another party by assignment, unless an express restriction on assignment exists within the lease. You may have seen restrictions on assignment in your own residential lease in the form of a no-subletting clause. Commercial leases routinely contain a restriction on assignment without permission from the landlord.

Just as the owner of real property may sell any or all of his or her interests, any ownership interest in real property may also be leased. For example, someone who owns the subsurface rights of land may lease the right to drill for oil or gas to another.

CHAPTER IX

UNFAIR TRADE PRACTICES AND THE FEDERAL TRADE COMMISSION

42. Unfair Trade Practices

OPENSTAX

The term "unfair trade practice" describes the use of deceptive, fraudulent, or unethical methods to gain business advantage or to cause injury to a consumer. Unfair trade practices are considered unlawful under the Consumer Protection Act. The purpose of the law is to ensure that consumers have the opportunity to make informed, rational decisions about the goods and services they purchase.

Unfair trade practices include false representation of a good or service, targeting vulnerable populations, false advertising, tied selling, false free prize or gift offers, false or deceptive pricing, and non-compliance with manufacturing standards. Alternative names for unfair trade practices are "deceptive trade practices" or "unfair business practices."

Section 5(a) of the Federal Trade Commission Act prohibits "unfair or deceptive acts or practices in or affecting commerce." Per the rule, unfair practices are those that cause, or are likely to cause, injury to consumers, those that consumers cannot avoid, and those in which the benefits of the product or service do not outweigh the deception. Deceptive practices are defined as those in which the seller misrepresents or misleads the consumer, and the misleading practice is substantial.

The Federal Trade Commission (FTC) is a federal agency that enforces consumer protection laws. Consumers may seek recourse for unfair trade practices by suing for compensatory or punitive damages. Plaintiffs do not have to prove intent. Showing that the practice itself was unfair or deceptive is sufficient.

Figure 12.2 The Federal Trade Commission (FTC) enforces consumer protection laws. (Credit: U.S. Government/ wikimedia/ License: Public Domain)

Unfair Trade Practices and Examples

Product Guarantees and False Endorsements

Companies must be prepared to honor product guarantees. For example, if a product is advertised with a 50 percent money-back guarantee, then that must be provided to customers who meet the requirement(s) attached to the guarantee. Similarly, companies may not create false endorsements and testimonials about their products.

Unfair Advertising

False advertising includes the misrepresentation of a product, service, or price. It may be more expansively defined to include unfair sales strategies, such as advertising one item and then selling another item in its place, e.g., one that is higher priced, lower quality and/or less in demand. This method is most commonly referred to as "bait and switch." Additional examples of unfair advertising include incorrect pricing, fake endorsements, deceptive guarantees, making false statements, and providing descriptions that exaggerate the performance of the product or service.

EXAMPLE

For months, Ivan had searched for just the right window curtain to match the décor of his new high rise condo. Finally, while browsing through Amazon, he saw two gray velvet curtains that featured a damask pattern, with taupe and gold accents and specks of ice blue glitter accents. He could not have designed a more perfect color palette for the window treatments if he tried. Moreover, the velvet blackout touch was just what he needed. Excited, he hit the "Buy Now" button and waited a couple of days for his order to arrive. When it did, what a huge disappointment! He could see, if he stared long and hard enough, how someone with a vivid imagination might consider the curtain to be an abstract interpretation of what was advertised. However, most people would see that the product was not at all close to what was advertised. The velvet was closer to linen, the damask pattern was closer to swirls, and the taupe and gold accents with specks of ice blue were closer to silver and purple, with specks of mauve. After running a Google reverse image search of the original product photo, he saw it featured in an interior design magazine. When Ivan looked up the product endorsements and reviews, he saw that all of the reviewers had only posted reviews for that particular seller's products, and that they had posted nothing but glowing reviews for each of the products. It was clear to Ivan that the seller was guilty of false advertising, as well as faking endorsements. Ivan has enough information to submit a consumer complaint to the Federal Trade Commission.

Taking Advantage of Customers

The FTC also pays particular attention to business ventures that target vulnerable populations. For example, some telemarketing efforts employ intense pressuring tactics to target seniors and people who don't speak English.

EXAMPLE

Devin is involved in the telemarketing of spy gadgets, such as bugs and bug detectors. He has had a lot of trouble finding a market for these products. One day, he speaks with an older citizen who asks him about the benefits of the bug detector. Devin starts to knowingly make unsubstantiated claims that there have been news reports that home bugging is on the rise. His false claims works like a charm. Spooked, the elderly customer buys the most expensive bug detector product. Seeing his success, Devin purchases a report of households in his geographic selling area that are headed by people over the age of 70. Over the next few months, his sales increase at an explosive rate. When he is recognized by management for his leading sales numbers, they also inquire about the secret to his success as they seek to replicate it in training materials for other sales professionals. When Devin proudly explains his tactics, he is terminated by the company. The company calls the customers impacted by his false claims, explains that there was a misrepresentation by one their sales associates regarding the scope of known bugging activity, allows them to keep their bug detectors, and refunds them the money they spent purchasing the products. The sales associate engaged in unfair trade practices, but the company took appropriate steps to correct it.

Misrepresenting a Product

At times, the FTC may be quite technical in its definition of certain terms. For this reason, companies should be very clear about their usage of various phrases and words. For example, the word "new" may only be used to refer to a product that is less than six months old. Other terms may be the subject of debate or litigation, such as whether a lotion will actually "rejuvenate" skin or whether a tablet will actually "cure" baldness. Indeed, a sweater should not be called "wool" unless that is its complete composition. There are many examples, so it is important for businesses to have an understanding of the FTC's rules on this topic.

Giving Misleading Price Information

The FTC sanctions misleading price information as an unfair trade practice. Examples of misleading price information include false sales in which a "limited time offer" might actually be available forever, or running a "Going Out of Business" sale without any plans to go out of business while advertising that items are discounted, although the prices have not changed.

EXAMPLE

A brick and mortar store has an online promotion for a "buy one, get one" offer for the season's hottest new phone, stating that the offer is only available on Black Friday. The store opens at 5:00 a.m., and customers start lining up with their sleeping bags in tow the evening prior to the morning opening time. After customers almost stampede one another, they learn that they will have to also purchase a phone plan that is inflated by 100% of its regular price to qualify for the deal. Nowhere in the literature or promotions was the phone plan, or its over-inflated price, mentioned as a requirement to get the buy one get one free phone deal.

Failing to Disclose Pertinent Information

Merchants must disclose facts that would reasonably influence the consumer's decision to make a purchase. Withholding pertinent information from customers may be viewed by the FTC as equal in severity to the process of using overtly incorrect or deceptive information. For example, sellers should always disclose the full price of their products or services before accepting payment for them.

43. The Federal Trade Commission

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The FTC was created in 1914 to address the problem of monopolies and trusts. Following the Civil War, a wave of consolidation and growth among companies triggered increased public debate. Through handshake agreements, issuance of stock, and pooling arrangements, companies could fix prices and outputs, thus effectively stopping competition and raising consumer prices. A substantial number of mergers gave control over key industries to small groups of businesses. Where companies did not merge, other arrangements were made to have a similar effect. Conglomerates controlled most of the relevant industries that produced household necessities. Goods used in production were also the product of highly concentrated trusts, such as the United States Steel Corporation and the International Paper Company. Concerns about industrialization and a changing economy, with shifting norms for personal lives, triggered antitrust sentiment.

Figure 12.3 The Federal Trade Commission prevents monopolies, like that of U.S. Steel in the early 20th century. (Credit: Bruce McAllister/ wikimedia/ License: Public Domain)

The perceived unfairness and fears caused by the consolidation of businesses created strong anti-business sentiment and increasing cries for price controls to be considered as a remedy for heavily concentrated industries. These organizations posed economic and social problems that became a large social concern. In response, the Federal Trade Commission (FTC) was created with broad powers to investigate and propose formal recommendations to companies about their competitive practices. The FTC did not formally have a consumer protection mission until the passage of the Wheeler-Lea Act in 1938. This act gave the FTC the power to combat false advertising for any foods, drugs, medical devices, or cosmetics.

In addition to the Wheeler-Lea Act, subsequent amendments to the FTC Act, as well as judicial respect toward the agency, broadened the power and jurisdiction of the FTC.

Today, in addition to its original antitrust roots, the FTC enforces consumer protection laws.

Bureaus of the FTC

Several bureaus now stand in support of the FTC's efforts.

Bureau of Consumer Protection

The Bureau of Consumer Protection protects consumers against unfair trade practices. Bureau attorneys enforce consumer protection laws issued by the FTC. In addition to enforcement actions, the Bureau's functions include investigations and consumer and business training. Unfair trade practices in advertising and marketing are a main focus, as well as privacy, financial products and practices, and identity protection. The Bureau also manages the United States National Do Not Call Registry and investigates telemarketing fraud.

Bureau of Competition

The Bureau of Competition's purpose is to eliminate and prevent "anticompetitive" business practices related to the enforcement of antitrust laws. The FTC and the Department of Justice share responsibility for enforcement of antitrust laws.

Bureau of Economics

The Bureau of Economics supports the Bureau of Competition and Bureau of Consumer Protection by providing subject matter expertise regarding the economic impacts of FTC legislative activity.

FTC Activities

The FTC investigates issues raised through a number of sources, including consumer, business, and media reports. If the FTC concludes that there was unlawful conduct, it may seek several forms of recourse. These include the pursuit of voluntary compliance through a consent order, the submission and filing of administrative complaints, or the initiation of a federal action and litigation.

The FTC has the power to create rules regarding widespread industry practices. Rules created in this fashion to address systemic issues are called trade rules.

44. End Notes

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This is where you can add appendices or other back matter.