CHAPTER 1

Foundations of Law and the Role of Ethics   
in Business

cHAPTER IN A nUTSHELL

This first chapter and the remainder of the chapters in Part 1 of the text set the stage for the study of business law. Point out to your students that they will discover the law is all pervasive and affects nearly every facet of society. Part 1 should sharpen their interest in the study of law once they discover its relevancy in their daily lives. One responsibility as an instructor is to engender a feeling that the rule of law is the highest authority in the land and that no person is above it in spite of the shortcomings of our legal system and the way it operates.

This first chapter defines law, its functions, its development, and its sources, and it distinguishes civil from criminal law. The remainder of the chapter focuses on the impact of unethical behavior in the workplace along with the challenges faced by business owners and managers in the ordinary course of their work. One important point made in the ethics section of the chapter is that ethics in the workplace is a compelling force and that a company that maintains strong ethical practices will face positive grow.

# teaching points

1. First define law, or better yet, ask your students for their definition. You will get broad definitions as well as those narrow in scope. One of my student’s definitions of law was: “A cop telling me I couldn’t park there.” Once you and your class reach an acceptable definition, then talk about it. Here are some possibilities:

a. What promises does the law make?

b. How does law protect you and what are its limits?

c. How does law evolve?

d. Do we have too much law?

e. Do we always turn to law to settle disputes?

2. Define **society**. (A group of people, large or small, the students in your classroom, people living in your state, or the people living in the United States.) Have students consider the following questions:

a. Of what importance is law in our daily lives?

(It keeps people from doing what they want to do; people by nature have a tendency to do as they please, which of course may lead to serious conflict.)

b. What would be some of the consequences of having a society in which there were no laws?

(There would be chaos. Without laws, our society would be plagued with traffic problems, people stealing from one another, senseless killings, neighbors destroying other neighbors’ property, and in general, people abusing the rights of others to satisfy their own needs.)

c. Why do people obey laws?

(Some people, for example, often obey the law simply to avoid unpleasant consequences.)

d. Can we better handle ourselves in a society if we have knowledge of law?

(A major reason for taking a law course is to have people become more sensitized to those legal problems that exist in society and, if they affect them directly, to seek professional legal advice.)

3. Students should be aware that law is complex and that there are no simple solutions to legal problems. However, you should also point out that law seeks justice for all members of society by providing remedies for those individuals harmed, such as requiring the wrongdoer to pay money damages or to spend time in prison, or in some cases, both.

4. Indicate that law is constantly changing. Consider these changes in your discussion: interplay amongst the three branches of government: dismantling the separation of juvenile and adult offenders, increased emphasis on individual rights, that companies have the responsibility to look beyond making a profit and as their primary motive, but to also consider employee well being, reducing pollution, investing in the community and responding to concerns about their core product, responding to safety measures law in this age of terrorism (USA Patriot Act), greater protection for individuals accused of crimes, and environmental protection.

5. Law should not be thought of in a narrow sense—that is, how it affects one person only. Discuss law in a broad sense by emphasizing the positive effects it has on individuals and on society as a whole. To bring this point out, you may wish to discuss the legitimate functions of a legal system.

6. Discuss the concept of stare decisis—when courts follow previous decisions to decide similar cases. Stare decisis is still a very important concept within our legal system. In fact, the first question asked when a point of law is in dispute is: Is there a precedent case? Note, that U.S. Supreme Court cases are valid as precedent cases regardless of the age of the cases until overruled by the court itself, by a constitutional amendment, or by Congress.

7. Attorneys researching a point of law will look to precedent cases as much as they look to statutes. Precedent cases are created either when a court has to make a decision on a point for which no statute exists as a guide or when a court has to interpret a statute. Researching cases, however, has created difficulties because of the large volume of cases. The internet now aids in locating cases and in determining the status of cases as legal precedents (e.g., findlaw.com). It is interesting to note that the Internet has caused courts to expand the term precedent to include (in some cases) unpublished opinions.

8. Be sure to point out that statutes take precedence over court decisions. Also point out that the U.S. legal system is based upon the English common law. Discuss the significance of *Robinson* v. *California* found in the text. Note that one of the most important sources of business law today are administrative regulations, since a great deal of the regulation of individuals and business in this country is done by administrative agencies at the federal, state, and local levels.

9. During a discussion of the section on “Civil Law Versus Criminal Law,” you may wish to point out that the same wrongful act may be both civil and criminal. (Give an example.) Also, point out that a criminal action does not prevent a civil law suit and vice versa. As the chapter information on this topic points out, a criminal case and a civil case are based on two different theories of action (note the comparison in Table 1.1 in the text). The O.J. Simpson case is a good example. O.J. was tried for the crime of murder of his ex-wife Nicole Brown and her friend in the State of California. The jury found him innocent. The Brown family then sued Simpson for wrongful death. The civil jury found him responsible for the death of Nicole Brown and her friend.

10. During the discussion on “Uniform Laws,” point out that adoption of the Uniform Commercial Code (UCC) has led to uniformity in business transactions throughout the country. All laws governing commercial transactions are together in one body of law and generally apply in all states, with some state modifications. The UCC will be discussed in detail in Part 3.

11. A judge grants relief based on what is fair and just in a case presented to an equity court. The technicalities that arise in a civil trial do not enter a judge’s decision in an equity court.

12. Ethical behavior in a business setting is an especially important topic for discussion. Ethics in the workplace is a compelling force today. You can get a good discussion going on this topic. Point out that a company that maintains strong ethical practices within the company will experience positive growth. Good ethics practices can mean the difference between success and failure. Unethical business behavior may occur among employees because management does not make clear the kind of behavior that is expected. Adding fuel to the fire is the fact that management, if driven by the profit motive, may itself engage in unethical behavior leading employees to play “follow the leader.” Consequently, the entire company finds itself being shunned by customers. The Enron sham displayed selfish and irresponsible behavior on the part of upper level management which finally toppled the company. The maneuvering that occurred early in the first Obama administration attempted to keep large financial institutions from going “belly up.” Nevertheless, discoveries of serious ethical violations by management did occur. The biggest scam was the Bernard Madoff scam. Madoff, a former owner of an investment securities firm, was convicted in 2009 of a scheme that defrauded thousands of clients out of billions of dollars through false investments over a forty year period. It is considered the largest financial fraud in U.S. history.

13. An important part of our system of judicial relief is **equity**. A person who is harmed by another person may seek redress in a civil court of law and receive money damages for the harm. However, if money damages will not adequately compensate an injured party for the harm done, nonmonetary relief based on equitable principles is available. The system of equity permits a court to deal quickly with a case involving civil harm to a person without getting bogged down in technical requirements. Judges are able to make decisions based on what is fair and just.

# CHALLENGES IN THE CHAPTER

1. Vocabulary terms will need to be given a priority throughout the course. The law has some unique terms that many students will find foreign to them and for which there is no common everyday meaning. In today’s society students are much more tuned in to law and have a good knowledge of “how it works.” They read about the law, they watch news and crime stories on TV, they observe law in action on the streets, daily. Be prepared for some tough questions about legal issues especially those that may arise in the material that is presented in the “Understanding Your Legal Environment” chapters, Chapters 1 through 5.

2. Some students will have negative things to say about the law, especially about police. Counter this by discussing some very positive effects of the law on them personally and on society as a whole.

3. Students may have difficulty understanding the concept of **equity**. Generally speaking, equity means justice. There are many technicalities in our law. Consequently, for some of the wrongs committed, there may be no legal remedy available to the injured party if, for example, a case is improperly presented in a court of law or perhaps money damages that turn out not to be a satisfactory way to compensate for the wrong committed. Thus, a system of judicial relief (equity) evolved to provide satisfactory relief *when the law did not or could not provide relief*.

4. Many students believe that law refers almost completely to statutes. Emphasize that there are many other sources of law, such as court decisions and administrative rules.

5. To avoid any confusion, point out to students that the terms **common law, case law**, and **court decisions**are interchangeable. Case law is a modern version of the common law of England.

6. Students need to understand that as society grows the “rules of the game” become more complex; consequently, it makes it more difficult for businesses to adopt any hard and fast regulations relating to ethical standards. A problem does occur however, when businesses fail to adhere to ethical standards as they operate their business on a daily basis. It could spell disaster in the form of lawsuits, government intervention, and consumer retaliation when they believe there has been a breach of trust by management.

# TEACHING TIPS

1. Keep in mind that the first time you walk into your classroom, your students will be forming opinions of you. Introducing the material to be covered in the text will also be very important moments for you. You will be making a first impression on your class. Seasoned instructors know that it is crucial to set the stage for learning. Some students may have already formed opinions about some aspects of the law, especially torts and criminal law. Some topics you will cover like sales and negotiable instruments law may require you first to be “on top” of these topics and secondly to devise ways to present them in an interesting manner. (You could get a text message that says “boring.”)

2. Encourage your students to search the Internet, to read newspapers and magazines, and to watch TV searching for material involving the principles of law they are learning in class. You could start your class by spending a short time discussing an article that fits into a topic you have already covered or will cover that period. This may help set the mood for “getting into” the lesson you have planned for that day.

3. The authors have found that an interesting topic and one to which they often get a lot of response is one involving the fairness of a legal decision following a trial. True, a judge or jury provides a remedy in the form of a decision; the implications of this decision are that an individual may have to pay damages (civil matter), or go to jail or prison (criminal matter), or may be entirely exonerated; but was the decision fair and was justice served? Take the O.J. Simpson case as an example.

4. Explore the impact of ethics violations by large corporations as for example government intervention that has taken place in large corporations.

5. Don’t let the study of ethics end with this chapter. An ethics case has also been introduced at the beginning of every other chapter in the text.

6. The section on “Legal Literacy” provides additional questions for discussion and the opportunity for students to further investigate the law as an “in class or out of class assignment.” Answers to the questions may not necessarily be found in the chapters where the questions appear.

7. Students concerned about changing a particular law may wish to discuss the process in class. Here are some thoughts that may be a topic for discussion: (1) does the change process encourage respect for law; (2) is the change process orderly and unlikely to result in physical injury to people or property; (3) does the change process provide investigation and time for rational deliberation; and (4) is their provision for those subject to the new law to have some voice in what the change will be?

8. Ice breakers and other warm up activities improve classroom participation at the beginning of class when often there is dead silence. These activities involve students in their own learning and often improve classroom discussion and interaction.

ANSWERS TO THE CHAPTER ACTIVITIES

Questions and Problems for Discussion

1. Yes. Ludwig did receive approval from his supervisor. Also, the golf tournament was a legitimate test of skill and a large number of people participated in the tournament.

*2.* (Answers will vary). Law-abiders are not usually trying consciously to obey some laws. Instead, they feel mentally coerced to do—some inner compulsion. In their own minds, people are not always thinking of the legal penalties but the moral costs of noncompliance. A question that a person may ask herself is “What if everyone did as I am now thinking of doing? What kind of a world would it be? This question may come up regardless of the law she is thinking of breaking, a town ordinance, a tax law, a violation of the rights of someone’s private property or personal security. Or the question a person asks herself may be self-serving: What are the consequences for me personally—a fine, jail time, embarrassment to my family, loss of a job or whatever? Of course mental coercion along won’t be the power that will control human conduct. To achieve a system of law there must be built into that system some means of authority, control, or power to insure that people will act, for the most part, in the manner desired.

3. Yes. To many people, the saying “justice always prevails” simply means that in a particular court action, the court will provide a legal remedy to an injured party but this outcome may not necessarily be fair (a term associated with justice). Keep in mind that while absolute justice may be unattainable, the legal process in the United States is the best rule that could be devised under the circumstances.

4. The fact that Abbott thought he was morally correct will not excuse him from the crime he has committed (shooting and wounding three men). However the sentencing judge may consider the moral issue by giving him a less severe punishment. A person, whatever his convictions, is not free to take the law into his/her own hands.

5. Civil matter. Civil law protects the rights of individuals from harm by other individuals.

6. Yes (in both cases). Page could bring a civil action against Clay for the damages to the store window, and Mooney could initiate a civil action against Clay for damages to the car. The state could bring a criminal action against Clay for stealing the car. Clay’s act of stealing Mooney’s car was not only an act against Mooney, it was also an act against society, and Clay should be punished for such activity. In this case, law serves to protect property and to protect society.

7. (Answers will vary.) Some possible considerations might be:

1. Whether to disclose possible delays in delivery.
2. Whether to discuss the possibility of a price increase that would affect the price of computers purchased by the corporation.
3. Whether to discuss that the current model of computers under consideration have been the subject of recalls because of known defects to this particular model.
4. Whether to discuss the fact that repairs to the model computer under consideration are high.
5. Whether to discuss the fact that repairs to the model computer under consideration are high.

The sales person may also wish to consider the following points in dealing with the customer:

* 1. The kind of conduct that is generally regarded as legally permissible.
  2. What is considered as accepted business practice.
  3. What his company expects the salesperson to do.
  4. Will nondisclosure of these facts hurt repeat business.
  5. How he (the salesperson) view the situation if her were the customer.

8. Businesses that have steered away from building a strong ethical base have sometimes found themselves in serious difficulty with the law. The Enron Corporation is one of the best examples of how unethical behavior by upper level management destroyed the company. Management was driven by greed (profit motive). As a result, the company crashed, employees lost their jobs, and the stockholders lost billions of dollars. This may be an extreme case, but is can happen and did happen. There are, however, violations that may have a lower impact, but nevertheless troublesome. For example, employer-employee conflict over issues involving honesty, integrity, and fairness, disclosure of information about the company, intrusion into the private lives of employees by management, and drug testing. In today’s world, it may not take much effort to find issues of conflict between the owners of a company and the employees.

8. (Student answers will vary.) In this case, we are talking about more than illegal drugs. Included would be prescription medications and even alcohol. There is a problem with drug abuse in this country today (the severity of the problem is open for discussion) and it is played up in the media. Real or not, it poses a problem for businesses when it comes to testing current employees who might be suspicious of having a drug problem. I would assume that some businesses will be responsive to the problems of its employees while others do not wish to have employees with a need for ongoing medical and psychological assistance. In this latter case, it could be costly to the company in terms of time lost on the job and medical coverage. So, the dilemma by a company is: test or don’t test? If a company decides to test its current employees, due process must be followed which includes prior notification of the testing and then, if necessary allowing for re-testing and appeals to management or the courts by those employees whose results are suspicious and may be fired.

9. (Answers will vary.) Possible advantages to employers are: attract good investors; attract less scrutiny from governmental agencies; discourage employees from doing unethical things as for example, falsifying number of hours worked; claiming credit for work done by another co-worker; padding a travel voucher with entertainment costs; or doing something as simple as stealing a fellow employees lunch purchased at a store and placed in a refrigerator in the employee lounge. Management might also be discouraged from using inferior materials in preparing goods for customers or placing employees in a poor HMO health plan just to save money.

10. Sentinel did not act ethically by any standard since the company was ripping off its customers. Sentinel probably settles out of court to avoid negative publicity and perhaps the company’s attorneys were able to strike a “better deal” with customers bringing lawsuits.

11. Ethically, no. Legally, yes. It is difficult to argue that it is ethical for a company to aggressively contest lawsuits that are filed against it even if it knows the company is responsible.

# LEGAL LITERACY

## Discussion Questions

1. Judges sometimes make decisions based on a precedent case. What is a precedent case and when might a judge not follow a ruling in a precedent case?
2. Why would a judge grant a plaintiff in a civil case an equitable remedy over a legal remedy?
3. Is the phrase “Ignorance of the law is no excuse” just a saying with no meaning or is the term of some significance?
4. What is the importance of the “doctrine of judicial review?

## Investigating the Law In or Out of Class

1. Using the section on “Ethical Challenges in the Workplace” as a starting point, discuss the many challenges faced by managers of a large corporation. How can managers of these large corporations encourage their employees to act in an ethical manner while on the job?

**(Response)** Set standards such as making good decisions to prevent ethical misconduct; show a commitment to ethical standards by personally acting ethically themselves.

2. Have students respond to the following question either by doing a short report or as part of a class discussion (or both): “Courts in arriving at legal decisions should be bound to prior precedents without exception.”

**(Response)** Prior common law precedents may not always keep pace with societal changes such as modern business practices and communities’ ethical standards. Courts today could be applying past rules to present situations. Judges who made decisions in what are now precedent cases, based these decisions on societal needs at that time. They may not even have envisioned what the future needs of society would be. Court decisions made today based on precedent cases could therefore be unfair to the parties involved in a lawsuit, or to other parties requiring a court ruling.

3. Have students draw up a code of ethics for a business of their choice enumerating four or five areas that they feel should be included in this code. Identify the type of firm, number of employees, what the company does, and other pertinent information. Let the information on page 22 of the text entitled, “Development of Business Codes of Ethics,” serve as a guide.

**SOLUTIONS**

**Ethics in a Business Setting**

1. Ethics is the study of what constitutes right and wrong.
2. Management feels that making a profit overrides any ethical responsibility to anyone.
3. Yes. Consumers have no desire to buy products from an unethical company and will likely boycott a company’s products, defect to other brands, initiate strongly worded letters to top official management and in some cases along with other consumers bring a class action lawsuit against a company.
4. No. An action may be legal but yet unethical.
5. No. Doing so often creates bad working conditions.

**You React**

1. No. Without law, there is a likely chance that violence and other illegal interruptions could occur.
2. Settle disputes; protect individuals and society; protect property; promote worth-while social objectives.
3. Criminal statutes.

**Legal Literacy**

1. A precedent case is a case decided in a court of law that becomes the basis for deciding future cases. A judge may not follow precedent if she feels that the precedent case no longer applies due to social and technological changes since the precedent case was decided.
2. A judge would grant equitable relief when the remedy at law is not suitable or adequate for the violation of rights that occurred. A relief in equity is based on what is fair and just rather than money damages which is what the winner receives as a remedy at law.
3. The term is significant in that the law does presume everyone should know it in spite of the fact that there are currently a large number o statutes and court decisions “on the books” that are often beyond the ability of every citizen to know and understand. There is also a saying namely “that what you don’t know about the law can hurt you—in some cases seriously.
4. The judiciary is the overseer of the executive and legislative branches of government. Under the doctrine of judicial review, the courts have the power to check and balance the exercise of power by the executive and legislative branches and to declare their acts and statutes unconstitutional and void. In turn, however, the judicial branch is subject to checks and balances on its activities by the other two branches. Consequently, in a real sense, each branch is an overseer of the government.