CHAPTER 1

Law: Importance, Purposes, and Sources

Chapter Outline

Chapter Preview

As you begin your study of business law, two questions arise immediately. First, how does the law affect the people and organizations engaged in business activities? Second, what does the word *law* mean? The search for answers to these two questions forms the basis of this text. By way of introducing our subject matter, this first chapter attempts to answer, in very broad terms, each of these questions.

Perhaps you are asking yourself, "Why should I study business law? Is the legal environment of business really that important?" The answer is clear. Legal concepts, principles, and rules provide the foundation for the conduct of business. The law determines who may conduct business, how it is to be conducted, and what sanctions are to be imposed if its requirements

are not met. Thus, knowledge of the law, as it relates to business, is an indispensable ingredient in any successful business venture.

Now, more than ever before, law affects business decisions. Laws written to solve many of society's problems are directed at business, regulating its activity and its processes. This text attempts to create an awareness of the role of law in business. A sampling of business decisions that probably will be influenced by the law is presented in Exhibit 1-1.

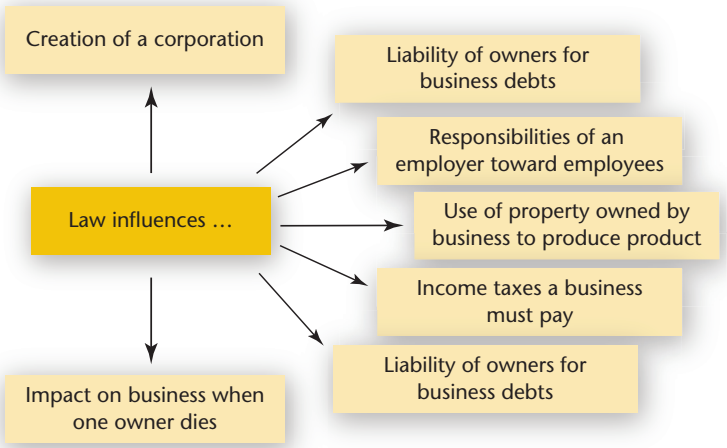


EXHIBIT 1-1
Sampling of Areas Where Law Influences Business Decisions

Business Management Decision

Your import-export business becomes subject to new legislation regulating international trade transactions. A particular provision of the new law is unclear in its application to your business. You consult your company lawyer for advice. He informs you that he is not sure what the law means.

Should you hire a new lawyer?

1.1 Importance of Law to Business

1.1a Why Study the Legal Environment of Business?

➢ *The Importance of Law to Modern Business*

Why study the legal environment of business? The short answer: because understanding the law is, has been, and no doubt will continue to be an important dimension to consider in conducting business. Today we see the law and business intersect in two ways. First, the law controls the relationships between parties. For instance, what happens when something unexpected occurs in business? We often turn to the law to establish rights and duties of parties. Consider this illustration. Angela owns and operates a mobile kitchen specializing in Mexican food. After stocking her truck for the day, Angela drives to a place at the corner of two busy streets she has used for six years. Just as Angela finishes opening the side panels on the truck that will be used for individuals to order and pick-up their food, a car driven by Stan drives through a red light, swerves to avoid oncoming traffic, and crashes into Angela's truck, inflicting moderate damage to the front of the truck. If there was no law, what might be the consequences? Perhaps a physical fight between Angela and Stan would occur, with the loser of the fight determining who is responsible for damages. In such a system the strongest, or perhaps the one with superior martial arts talents, prevails. In the alternative, perhaps a neighborhood commission is impaneled to examine evidence for the purpose of determining who should pay for damage done to Angela's business and Stan's car. However, such a commission's conclusion is only advisory, thus leaving the parties without any means to enforce the judgment of the neighborhood commission.

Fortunately, we live under a legal system capable of establishing the rights and duties of both individuals. In this situation, Stan's failure to act as a reasonable person in driving his car means he is responsible for the resulting damage to Angela's truck—and to his own car. Should Stan fail to compensate Angela for the loss as provided by law, Angela can avail herself of the court system, which would allow her to apply the legal standard of liability to the facts in this case. Should Stan fail to honor the judgment, the court also provides a means by which she can secure the amount owed from Stan. These mechanisms might include obtaining a lien on property owned by Stan or garnishing his wages. Thus, the law provides a means to determine the rights and duties of both Angela and Stan, along with a process to enforce those rights and duties.

In addition to establishing relationships between parties, the law today also provides the mechanism by which government regulates business behavior. Business—from a small business securing a county permit to open a bakery to billion dollar corporations attaining permission from government to merge—is regulated by government. While the function of law relating to controlling the relationship between parties (described above) is of ancient origin, the role of the law devoted to creating a regulatory environment within which business functions is a far more modern phenomenon.

For many centuries, business functioned with little economic or social control emanating from government. As long as a business had the support of a monarchy, for example, the business could flourish—so long as appropriate taxes were paid to the monarchy. Within the past hundred years or so, however, governments began to infuse broader societal interests into the environment within which business functions. In effect, economic and social policy is given force through the law. Early laws regulating commerce were aimed at declaring illegal unreasonable restraints of trade, including the situation where competitors would gather to establish the price of their products instead of letting the market control the price. Regulation has spread from the economic realm into the social realm during the past fifty years in the United States. Laws that forbid discrimination in employment based on an employee's race, that limit the amount of pollution that can be released into the air from a manufacturing facility, and that require a list of ingredients be placed on jars of pre-made spaghetti sauce are examples of social regulation. Many leaders of business bemoan the reach of the law into the operation of business, but society continues to impose legal restrictions, both in United States and on international fronts.

Touchstone

Economic regulation gone too far?

Louisiana law requires that a business possess a state-issued license to sell caskets. An order of Benedictine monks in Louisiana made wooden caskets for generations, primarily for use within their denomination. In 2007, however, the monks decided to become entrepreneurs by selling caskets to the public. Their business did not last long, however, because the State of Louisiana forbade the monks from selling the caskets. Operating on a complaint from a government-licensed funeral director, the state told the monks that they could obtain a license only if they transformed their monastery into a funeral home. Such a process would include the monks building an embalming room and requiring at least one of the members of the order to become a licensed funeral director.

While the monks asked the state legislature to change the law on several occasions, the funeral-industry lobby killed the reform legislation. Then the monks turned to the courts. In a recent decision, the Fifth Circuit Court of Appeals ruled for the monks. They held that the United States Constitution prohibited "naked transfers of wealth" to an industry cartel. The United States Supreme Court has declined to hear the case.

State governments often enact economic regulations, and special economic advantages commonly are garnered by particular groups at the expense of other groups. When does this type of economic protectionism go too far? This case indicates there are limits.

[*St. Joseph Abbey v. Castille,* 700 F. 3d 154 (United States Court of Appeals for the 5th Circuit, 2012)]

➢ *The History of Business Reveals the Prominence of Law.*

An examination of history supports the critical role law has played in business; law and business have been intertwined for centuries, both formally and informally. Take the example of a loan agreement. From early Roman times money was loaned for the purpose of operating business. Early legal thinker Justinian writes in the sixth century AD about how certain types of arrangements for repayment were legal, while others were not. Conditions for a loan that could be enforceable in a court, including repayment of the principal and payment of interest, were controlled by the legal principles based on the law of contracts. Thus the law was involved in the creation of the loan arrangement and in its enforcement if there was default. Therefore, formal aspects of law were predominate in ancient Roman times, just as they are to those operating business today.

However, commercial enterprise also has operated *outside* of a formal legal system and created, in effect, its own "law." The most prominent example of this process, which left a profound impact on current United States legal principles relating to business, is a mechanism called the ***law merchant***. The law merchant is various rules of commerce and trade used by business people to deal with one another beginning in the Middle Ages and enforced by merchant guilds. Functioning as the international law of trade and commerce for businesses located in Europe for several centuries, the law merchant system was used by merchants by invoking the power of specific guilds (called merchant courts) located along major trade routes to settle disputes. Individual nations and cities, recognizing that this system devised by business and administered by business was quite successful, did not interfere with the law merchant. Judges, selected because of their expertise in business, could settle trade disputes quickly and practically. A great deal of the law relating to commerce today, whether conducted within the United States or in the international realm, can trace its roots to the law merchant.

➢ *Educators Today Emphasize the Role of Law in Preparing Tomorrow's Business Leaders.*

Given the historical importance of law to business, it should not be surprising to learn that the study of law has been a central topic studied by university-level students pursuing degrees in business or related fields since the inception of the business curricula. The critical role of law to conducting business was implicitly acknowledged in the hiring of the first business professor at the Wharton School of the University of Pennsylvania, considered the world's first business school affiliated with an institution of higher education. Beginning in the early 1880s, the Wharton School hired Albert Bolles, a prominent attorney, as its inaugural faculty member. The prominence of law to those early students of business became explicit when founder Joseph Wharton specified that the curriculum include five subjects, among them a course on the law of business. (The remaining subjects were accounting, taxation, "money and currency," and "industry, commerce and transportation.")

The study of the legal aspects of conducting business remains a central aspect of any high-quality business education program today, at both the undergraduate and graduate level. Business educators across the country emphasize legal perspectives within current curricula as they prepare tomorrow's business leaders. Distinct courses are often devoted to a survey course (e.g., "Business Law" or "The Legal Environment of Business") in such curricula. Because the role of law is so critical to understanding business, it is not uncommon for a business program to require at least a one-semester course in business law or the legal environment in business. Moreover, specifically focused law courses are popular within business schools. Courses such as "Real Estate Law," "Marketing Law," "Employment Law," "Intellectual Property Law," and "Law for the Entrepreneur" are routinely offered. Finally, offerings within specific disciplines of business often have a heavy legal component, including courses in taxation, human resource management, finance, and marketing.

Now more than ever law permeates the world of business. The complexity of legal relationships pertaining to actions within a firm, to those between firms, and to those brought about by governmental action continue to increase. The optimal practice of accounting, finance, marketing, management, operations, information systems, and every other aspect of business is dependent on firmly understanding the legal environment within which business functions. Truly, without law, there is no business!

Law merchant
Medieval legal system prevalent in Europe that established practical rules of commerce and trade

1.1b Addressing Risk and Achieving Strategic Integration

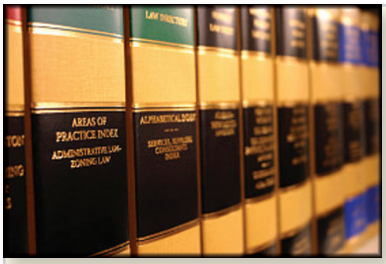
Possessing an understanding of legal rights and duties serves to enhance one's ability to function in the world of business on two principal fronts. First, legal risks abound when conducting business. Knowledge of *the law allows one to identify legal risks and effectively reduce or eliminate liability* flowing from those risks. Some legal risks are internal in nature. A claim of sexual harassment from a sales representative working for your firm, for example, creates a potential liability that has ramifications in terms of lost time working on productive endeavors, an emotional toll on all employees involved in an investigation, and financial loss if the claim is proven and the firm is held liable. Knowing the legal risks associated with sexual harassment provide the starting place for management to reduce or eliminate liability by responding appropriately to the existing legal landscape. In the arena of sexual harassment, this might mean creating a policy document defining sexual harassment and providing a mechanism for reporting claims, training employees about the legal definition of sexual harassment and the company's policy regarding sexual harassment, and conducting thorough investigations of allegations of sexual harassment. In those instances were harassment is found, appropriate disciplinary measures should be undertaken. When management takes appropriate action, legal liability can be positively affected.

Other risks are external in nature. An entrepreneur is contemplating starting a business with four associates, with all five individuals being owners of the enterprise. Should the entrepreneur select the general partnership as the form for conducting the business, each owner could be individually liable for losses created by the business. That is, should the assets of the business be insufficient to satisfy the claim of the creditor, the creditor of the business most likely can proceed against the individual assets of the partners (e.g., personal bank account). In the alternative, if the founders of the enterprise decided to form a corporation, then most likely a creditor of the business can only select payment for a debt from the assets of the business; personal assets of the owners are shielded from liability for business losses. For the individuals who start a business, knowing the risks associated with different types of legal forms of conducting a business can be a critical piece of legal knowledge. Therefore, knowledge of the law can assist a member of the business community in identifying legal risks and effectively reduce or eliminate legal liability that potentially flows from those risks.

In addition, business leaders can *use the law to their strategic advantage*. Examine the area of intellectual property, for example, where the astute business person can create and manage intellectual property assets of a firm. The list of legal protections available to a business allows a business to capitalize on the firm's intellectual property. A firm can secure a patent for an invention, create a copyright for a written work, or craft protection for a trade secret. All of these are legal processes that secure legal rights in specific property. The law does not simply work to create legal rights at the time intellectual property is created. Perhaps more important from a strategic standpoint, the law provides the mechanism that allows the intellectual property of a business to be licensed. A license of intellectual property is a contract which allows one firm to use the intellectual property of another in return for payment.

The perceptive business leader also can employ the law in a strategic manner at the firm level. Suppose two businesses wish to jointly develop a mutually beneficial project. One firm may possess technical expertise, while another possesses an excellent marketing and distribution network. The law acknowledges a process, known as a joint venture, where the two firms can arrange to share assets to develop a project. A joint venture contemplates an understanding between the parties that outlines the processes that the two firms will undertake to share their strengths, minimize their weaknesses, and increase their competitive advantage through the development of their project. Given the closeness that the parties must work with one another, the law imposes on the members of the joint venture a duty of trust and confidence. Therefore, firms that participate in the joint venture must put the interests of the joint venture ahead of their own interests. The joint venture arrangement also illustrates the approach often taken in the law: legal relationships create both rights and duties.

Consider the following famous case decided by the Supreme Court. Portions of the majority opinion, signed by five justices, and a minority opinion, approved by four justices, are presented. The opinion captured below considers the proper reach of a long-established constitutional principle. At the opinion's core, the court considers the extent to which government can transfer land from one private owner to another for the purpose of furthering economic development activities that should benefit the public. Knowledge of this legal precedent could allow many real estate firms to change their strategic direction and expand the scope of their development activities. It might also put on notice smaller, well-established businesses of a potential risk. Consider carefully the arguments advanced in both the majority and dissenting opinions.



CASE 1.1

Susette Kelo et al. v. City of New London, Connecticut, et al.

545 U.S. 469 (2005)

Supreme Court of the United States

The city of New London (hereinafter City) sits at the junction of the Thames River and the Long Island Sound in southeastern Connecticut. Decades of economic decline led a state agency in 1990 to designate the City a "distressed municipality." In 1996, the Federal Government closed the Naval Undersea Warfare Center, which had been located in the Fort Trumbull area of the City and had employed over 1,500 people. In 1998, the City's unemployment rate was nearly double that of the State, and its population of just under 24,000 residents was at its lowest since 1920.

These conditions prompted state and local officials to target New London, and particularly the Fort Trumbull area, for economic revitalization. To this end, respondent New London Development Corporation (NLDC), a private nonprofit entity established some years earlier to assist the City in planning economic development, was reactivated. In January 1998, the State authorized a $5.35 million bond issue to support the NLDC's planning activities and a $10 million bond issue toward the creation of a Fort Trumbull State Park.

The city council approved a redevelopment plan in January 2000, and designated the NLDC as its development agent in charge of implementation. The city council also authorized the NLDC to purchase property or to acquire property by exercising eminent domain in the City's name. The NLDC successfully negotiated the purchase of most of the real estate in the ninety-acre area, but its negotiations with the petitioners failed. As a consequence, in November 2000, the NLDC initiated the condemnation proceedings that gave rise to this case.

Petitioner Susette Kelo has lived in the Fort Trumbull area since 1997. She has made extensive improvements to her house, which she prizes for its water view. Petitioner Wilhelmina Dery was born in her Fort Trumbull house in 1918 and has lived there her entire life. Her husband Charles (also a petitioner) has lived in the house since they married some 60 years ago. In all, the nine petitioners own 15 properties in Fort Trumbull—4 in parcel 3 of the development plan and 11 in parcel 4A. Ten of the parcels are occupied by the owner or a family member; the other five are held as investment properties. There is no allegation that any of these properties is blighted or otherwise in poor condition; rather, they were condemned only because they happen to be located in the development area.

In December 2000, petitioners brought this action in the New London Superior Court. They claimed, among other things, that the taking of their properties would violate the "public use" restriction in the Fifth Amendment.

We granted certiorari to determine whether a city's decision to take property for the purpose of economic development satisfies the "public use" requirement of the Fifth Amendment.

Majority Opinion. Justice Stevens delivered the opinion of the Court.

Two polar propositions are perfectly clear. On the one hand, it has long been accepted that the sovereign may not take the property of A for the sole purpose of transferring it to another private party B, even though A is paid just compensation. On the other hand, it is equally clear that a State may transfer property from one private party to another if future "use by the public" is the purpose of the taking; the condemnation of land for a railroad with common-carrier duties is a familiar example. Neither of these propositions, however, determines the disposition of this case.

The disposition of this case, therefore, turns on the question of whether the City's development plan serves a "public purpose." Without exception, our cases have defined that concept broadly, reflecting our longstanding policy of deference to legislative judgments in this field.

Those who govern the City were not confronted with the need to remove blight in the Fort Trumbull area, but their determination that the area was sufficiently distressed to justify a program of economic rejuvenation is entitled to our deference. The City has carefully formulated an economic development plan that it believes will provide appreciable benefits to the community, including—but by no means limited to—new jobs and increased tax revenue. As with other exercises in urban planning and development, the City is endeavoring to coordinate a variety of commercial, residential, and recreational uses of land with the hope that they will form a whole greater than the sum of its parts. To effectuate this plan, the City has invoked a state statute that specifically authorizes the use of eminent domain to promote economic development. Given the comprehensive character of the plan, the thorough deliberation that preceded its adoption, and the limited scope of our review, it is appropriate for us to resolve the challenges of the individual owners not on a piecemeal basis, but rather in light of the entire plan. Because that plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment.

In affirming the City's authority to take petitioners' properties, we do not minimize the hardship that

(continues)

(CASE 1.1 continued)

condemnations may entail, notwithstanding the payment of just compensation. We emphasize that nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power. Indeed, many States already impose "public use" requirements that are stricter than the federal baseline. Some of these requirements have been established as a matter of state constitutional law, while others are expressed in state eminent domain statutes that carefully limit the grounds upon which takings may be exercised. As the submissions of the parties and their amici make clear, the necessity and wisdom of using eminent domain to promote economic development are certainly matters of legitimate public debate. This Court's authority, however, extends only to determining whether the City's proposed condemnations are for a "public use" within the meaning of the Fifth Amendment to the Federal Constitution.

Because over a century of our case law interpreting that provision dictates an affirmative answer to that question, we may not grant petitioners the relief that they seek.

Dissenting Opinion. Justice O'Connor, dissenting.

Over two centuries ago, just after the Bill of Rights was ratified, Justice Chase wrote:

> "An Act of the Legislature (for I cannot call it a law) contrary to the great first principles of the social compact, cannot be considered a rightful exercise of legislative authority. A few instances will suffice to explain what I mean. … [A] law that takes property from A. and gives it to B: It is against all reason and justice, for a people to entrust a Legislature with such powers; and, therefore, it cannot be presumed that they have done it." *Calder v. Bull,* 3 U.S. 386, 3 Dallas 386, 1 L. Ed. 648 (1798) (emphasis deleted).

Today the Court abandons this long-held, basic limitation on government power. Under the banner of economic development, all private property is now vulnerable to being taken and transferred to another private owner, so long as it might be upgraded in the process—i.e., given to an owner who will use it in a way that the legislature deems more beneficial to the public. To reason, as the Court does, that the incidental public benefits resulting from the subsequent ordinary use of private property render economic development takings "for public use" is to wash out any distinction between private and public use of property—and thereby effectively to delete the words "for public use" from the Takings Clause of the Fifth Amendment. Accordingly I respectfully dissent.

The petitioners claim that the NLDC's proposed use for their confiscated property is not a "public" one for purposes of the Fifth Amendment. While the government may take their homes to build a road or a railroad or to eliminate a property use that harms the public, say petitioners, it cannot take their property for the private use of other owners simply because the new owners may make more productive use of the property.

The public use requirement, in turn, imposes a more basic limitation, circumscribing the very scope of the eminent domain power: Government may compel an individual to forfeit her property for the public's use, but not for the benefit of another private person. This requirement promotes fairness as well as security.

Where is the line between "public" and "private" property use? We give considerable deference to legislatures' determinations about what governmental activities will advantage the public. However, were the political branches the sole arbiters of the public-private distinction, the Public Use Clause would amount to little more than hortatory fluff. An external, judicial check on how the public use requirement is interpreted, however limited, is necessary if this constraint on government power is to retain any meaning.

Here, in contrast, New London does not claim that Susette Kelo's and Wilhelmina Dery's well-maintained homes are the source of any social harm. Indeed, it could not so claim without adopting the absurd argument that any single-family home that might be razed to make way for an apartment building, or any church that might be replaced with a retail store, or any small business that might be more lucrative if it were instead part of a national franchise, is inherently harmful to society and thus within the government's power to condemn.

Affirmed.

Case Concepts Review

1. Economic development projects and community planning efforts result in a mix of potential opportunities for developers and potential challenges to established businesses and homeowners. Does the majority opinion recognize sufficiently the role of private property rights in light of the need for bettering the public?
2. The majority opinion gives considerable deference to the power of local and state governments to determine a public use. Is this a good approach for members of the business community?
3. Does the dissenting opinion argue in favor of stability, of relying on the status quo? Why or why not?
4. In light of the decision, how might real estate development firms alter their business strategy?

1.2 An Overview of Our Legal System

1.2a Definitions of Law

In everyday conversation, people use the word *law* in many different ways, but it is a word that is very difficult to define. In its broad context, it expresses a variety of concepts. Law has been defined as rules and regulations established by government and applied to people in order for civilization to exist. Law and legal theory, however, are far too complex for such a simple definition.

Civilization is governed by law. (iStock)

In attempting to define *law,* it is helpful to look at its purposes or functions. A basic purpose of law in a civilized society is to maintain order. This is the prime function of that body of law known as *criminal law.* Another role of law is to resolve disputes that arise between individuals and to impose responsibility if one person has a valid, legal claim against another, as in a suit for breach of contract. It is important that we bear in mind that the law is not simply a statement of rules of conduct but also the means whereby remedies are afforded when one person has wronged another.

In one sense, almost every issue or dispute in our society—political, social, religious, economic—ultimately becomes a legal issue to be resolved by the courts. Thus it can be said that law is simply what the courts determine it to be as an expression of the public's will in resolving these issues and disputes.

In still another sense, *law* has been defined as the rules and principles applied by the courts to decide controversies. These rules and principles fall into three categories:

1. *Legislative* law These are laws, including the federal Constitution and state constitutions, that have been passed by legislative bodies.
2. *Judicial pronouncements* These are legal statements made by courts. They can be interpretations of statutes, or they can be based on common law principles that were created by the courts decades or centuries ago.
3. *Procedural law*s Most often this type is the product of the legislative branch, aimed at determining how lawsuits are handled in the courts. These laws include such matters as the rules of evidence and related issues.

The first two elements provide the rules of *substantive law* that the courts apply to decide controversies. The third provides the machinery whereby these rules of substantive law are given effect and applied to resolve controversies.

Many legal scholars have defined law in relation to the *sovereign*. For example, Blackstone, a great legal scholar of the eighteenth century, defined law as "that rule of action which is prescribed by some superior and which the inferior is bound to obey." This concept of law as a command from a superior to an inferior is operative in many areas. For example, the tax laws command that taxes shall be paid to the sovereign.

Another view of law is that it is a method of *social control*—an instrument of social, political, and economic change. Law is both an instrument of change and a result of changes that take place in our society. The law brings about changes in our society; society brings about changes in the law. The law—responding to the goals, desires, needs, and aspirations of society—is in a constant state of flux. Sometimes the law changes more rapidly than the attitudes of the majority. In this event, the law and our legal system provide leadership in bringing about changes. At other times society is ahead of the law in moving in new directions, and the people bring about changes in the law. In the field of ecology, for example, various groups have put pressure on legislators to clean up the air and water. As a result, laws have been enacted requiring devices to be installed to control pollution. Here, public pressure resulted in the enactment of laws, and the law was a follower rather than a leader. It is important to note that the law is not static. It is constantly changing, and the impetus for the changes may come from many different sources.

As Oliver Wendell Holmes, Jr., one of the most influential justices ever to serve on the United States Supreme Court, wrote in a famous *Harvard Law Review* article more than one hundred years ago the law is an "instrument … of business" because it assists members of the business community to *predict the future*. In essence, the law provides a large degree of stability for the business community. At the same time, we recognize society is changing, business is changing, and the law is changing. While the law is ever changing, what change occurs in the

law generally occurs slowly. The unhurried pace of change in the law reflects the importance that the law provide stability. The astute business leader, therefore, needs to not only understand time-honored foundations associated with the legal aspects of business but also must stay abreast of relevant legal changes.

1.2b Objectives of a Legal System

A legal system provides the rights and duties between parties, the powers and responsibilities between governmental entities and non-governmental parties (e.g., individuals, businesses, and non-profit organizations), a mechanism for creating laws, and a process for enforcing laws. Among others, the goals of such a system should be the following:

➢ *Promote Order.*

As indicated previously, efficiency in life, generally, and in business, specifically, declines if chaos exists. One way to create confusion in society is for the law to be so hidden or difficult to attain that few individuals, if any, know what the law is at any point in time. Therefore, a legal system must be *open* so that legal knowledge is disseminated appropriately. Those who are lawyers must be able to access relevant legal areas to a level of sophistication to adequately represent their clients. In a similar vein, order is also promoted where members of society, at least for matters of common interest, can access sufficient legal information to become educated as to their legal rights and duties. For many, the Internet has opened up our legal system with ready access to web sites sponsored by interest groups and governmental agencies that do an excellent job of informing the public.

Similarly, disorder can occur when there is a lack of finality. Legislation that takes years to develop or court appeals that last for a decade provide no certainty for those that may be impacted by pending legislation or litigation. A legal system promotes order by making sure that *legal controversies come to an end and the process concludes as quickly as possible*. Where a dispute occurs, for example, our adversarial system pits one party against another. Alternative dispute resolution systems, like arbitration, can work to resolve disputes more quickly than proceeding through the court system. Even if a trial and appeals are needed, however, a legal system is respected if the system is structured and performs in such manner that the parties can attain resolution within a reasonable time.

➢ *Allow Justice to Be Attained.*

Often defined in terms of "fairness," a principal objective of a legal system is to provide a set of rules that will allow individuals and entities to believe not only that they will be treated fairly by the legal system but also that the operation of the system will generate a fair result.

It is important to recognize that a good legal system provides a *fair process* for obtaining a legal result. Often we hear, in legal discussions, the term "due process." The notion of "due process" is at the heart of our legal system, for it recognizes that in order for us to respect our legal system, not only must those who work within the legal system believe the system is fair but the general public must also acknowledge that the mechanisms employed to attain justice are deemed appropriate.

We also desire a legal system that, when engaged, delivers a *fair result*. Often we see what is fair through an objective lens; we believe that if a result were fair, everyone would agree that the result is fair. However, the nature of what is fair can be highly subjective. One's perspective can influence what is considered fair. Consider an example from the workplace. A supervisor may treat a subordinate in a manner she believes is fair, but the subordinate may see matters differently and conclude that he was treated unjustly. Therefore, while the objective of a legal system should be to generate a fair result, we do realize there can be a subjective element to the notion of what is fair.

Wealth also can tip the scales. Individuals with money might have the financial ability to hire an attorney and fight a particular legal battle all the way the to the United States Supreme Court, whereas someone with more meager means may not be able to even hire an attorney. It is, therefore, quite critical that the legal system provides a mechanism to keep various factors, including financial disparity between parties who can improperly influence a result, at bay. Judges, specifically, are charged with the responsibility for making sure a fair process is followed in litigation.

BVT Lab

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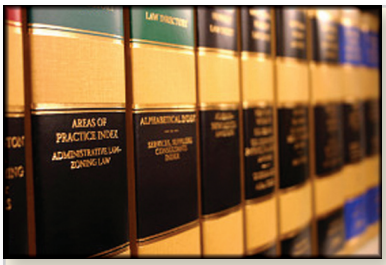
➢ *Cultivate a Sense of Reasonableness.*

While various economic, social, and political forces can influence the law and its application, in order for a legal system to be respected today, it must generate a *sense of reasonableness*. For example, members of society may not agree with a particular law passed by Congress or a specific decision of the United States Supreme Court; in general, however, the public must see, especially over time, that laws and decisions are reasonable.

A legal system should affect a balance between the rights of individuals and entities to be free from governmental interference in their activities and the necessity for government to act for the good of all, even where such actions restrict rights. If a legal system is too weak, it can breed anarchy. If too strong, government will stifle innovation, competition, and individual liberty.

Society should be watchful of its legal system to ensure it is delivering on the objectives to promote order, achieve justice, and further a perception of reasonableness. In Case 1.2, consider how the law should be involved in this controversy, if at all. Think about your concepts of order, justice, and reasonableness. Then apply them to the facts of the case.



CASE 1.2

In the Matter of Julianne Delio, on Behalf of Daniel Delio v. Westchester County Medical Center, et al.

510 N.Y.S.2d 415 (1986)

Supreme Court of New York, Westchester County

Anthony J. Cerrato, Justice

"Vex not his ghost, O, let his pass! He hates him
That would upon the rack of this tough world
Stretch him out longer."
Shakespeare, *King Lear,* act V, scene iii

Daniel Delio, age 33, once a fine specimen of a man, is now, according to Dr. Robert Strobos, Director of the Department of Neurosurgery at the Medical Center, in a state of chronic vegetation with neocortical death—and no hope for improvement. This vegetative condition followed cardiac arrest which occurred during a surgical procedure for the repair of an anorectal fistula. A malpractice action has been commenced against St. Agnes Hospital and physicians concerned with that operation. Following the ill-fated operation, Mr. Delio was transferred to the Westchester County Medical Center and has been there since. While there is no respirator attached to Mr. Delio, he does receive nutrition and hydration through a tube connected directly to his stomach. He could live indefinitely in such state as long as nutrition and hydration via the feeding tube are maintained. This opinion by Dr. Strobos was corroborated by Dr. Sidney Carter and Dr. Paul Rosch, who were retained by the court-appointed guardian ad litem, James D. Hopkins, esteemed lawyer and former Judge. Julianne Delio, the wife of Daniel Delio, supported by Mr. Delio's mother, seeks an order authorizing her to direct Westchester Medical Center, or some institution willing to comply with her instructions, to remove the feeding tube, stop all feeding and nutrition, and stop treatment of all type for Daniel Delio.

At a hearing, Julianne Delio, as well as other relatives and friends, all testified that Daniel Delio was a person, who, occasionally in conversation, remarked that he never would want his life prolonged by artificial means if he were in a chronic vegetative state with no hope of recovery. Many of these conversations occurred when the Karen Ann Quinlan case was in the news. Again he made these remarks when his father had a stroke. This testimony was most compelling and satisfies in the mind of this court "the clear and convincing standard" established by the Court of Appeals in cases such as this. The types and number of these conversations, the occasions when they were said, and to whom, all point to a very physical man who, on some occasions, contemplated death, and in particular, dying with dignity.

The question before this court now is whether the law in New York will permit the termination of care, and eventual death, for Daniel Delio in accordance with his previously announced wishes.

Daniel Delio can exist indefinitely in the vegetative state awaiting, perhaps, some future medical breakthrough, where an aged and terminally ill patient cannot. It should be reiterated, however, that at present there is no form of medical treatment that can either cure or improve Mr. Delio's condition.

Not one of the three medical doctors in this case described Daniel Delio as terminally ill. All three indicated that though he lies in an irreversible chronic vegetative

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(CASE 1.2 continued)

state, with no cortical functions, he is otherwise in good health and could live, as just noted, indefinitely if fed through a tube.

In this most difficult area there seems to be but one unanimous conclusion—Legislatures are better suited than courts to balance the various interests involved in determining whether to permit termination of care. The Legislature, possessing as it does the broad plenary power to make laws and regulations for the public health, safety and welfare, are the elected representatives of the people and, as such, reflect the collective will of the people. The Legislature is empowered to define "death" and "homicide" and can prescribe substantive rules and the procedural framework within which courts can decide the merits of each particular case. In that area, the Legislature in New York is found wanting.

My personal sympathies in this human tragedy are with the anguished wife, mother, and relatives of Daniel Delio. Moreover, the prevailing view in our society, as recently reported in the *New York Times,* appears to support the withdrawal of artificial means of prolonging the life of a person in a chronic vegetative state with no hope of recovery. I do not doubt that "for many years physicians and members of patients' families, often in consultation with religious counselors, have in actuality been making decisions to withhold or to withdraw life support procedures from incurably ill patients incapable of making the critical decisions for themselves." However, placing a judicial imprimatur on a decision to terminate the care in this case, in the absence of clear legislative or judicial guidance, is fraught with danger. The undersigned is of the view that judicial activism in cases such as this, can only involve the courts in a yet unsanctioned broad scale policy of euthanasia.

Accordingly, I am constrained to deny the petition to terminate.

Petition denied.

Case Concepts Review

1. Why did the court refuse to approve the petition to terminate?
2. Why did the court want guidance from the legislature?
3. Did the judge employ an ethical standard in making the decision presented above? Is the legislature in a better position to meld law and ethics in cases like that presented above?

1.2c Classification of Legal Subjects

Legal subjects may be classified in a variety of ways. Laws and legal principles are sometimes classified as either substantive or procedural. As described above, the law that is used to decide disputes is **substantive law**. The legal procedures that determine how a lawsuit is begun, how the trial is conducted, how appeals are taken, and how a judgment is enforced are called **procedural law**. Substantive law is the part of the law that defines rights; procedural law establishes the procedures by which rights are enforced and protected. For example, assume that A and B enter into an agreement and A claims that B breaches the agreement. The rules that provide for bringing B into court and for the conduct of the trial are rather mechanical, and they constitute procedural law. The enforceability of the agreement and A's right to a remedy are matters of substance. The courts, applying the substantive law of contracts, resolve these issues.

Law is also frequently classified into areas of public and private law. *Public* law includes those bodies of law that affect the public generally. Public law may be further divided into three general categories:

1. *Constitutional law* concerns itself with the rights, powers, and duties of federal and state governments under the U.S. Constitution and the constitutions of the various states.
2. *Administrative law* is concerned with the multitude of administrative agencies, such as the Federal Trade Commission and the National Labor Relations Board.
3. *Criminal law* consists of statutes that forbid certain conduct as being detrimental to the welfare of the state or the people generally and provides punishment for their violation.

Substantive law
Laws that regulate and control the rights and duties of persons and are used to resolve disputes

Procedural law
Laws that establish the process by which litigation is conducted

Private law is that body of law that pertains to the relationships between individuals in an organized society. Private law encompasses the subjects of contracts, torts, and property. Each of these subjects includes several bodies of law. The law of *contracts,* for example, may be subdivided into the subjects of sales, commercial paper, agency, and business organizations.

The law of *torts* is the primary source of litigation in this country and is also a part of the total body of law in areas such as agency and sales. A *tort* is a wrong committed by one person against another or against another's property. The law of torts is predicated on the premise that, in a civilized society, people who injure other persons or their property should compensate them for their loss.

TABLE 1-1 Classification of Legal Subjects

Public Law	Private Law
1. Constitutional Law	1. Contracts
2. Administrative Law	2. Torts
3. Criminal Law	3. Property

The law of *property* may be thought of as a branch of the law of contracts, but in many ways our concept of private property contains much more than the contract characteristics. Property is the basic ingredient in our economic system, and the subject matter may be subdivided into several areas: wills, trusts, estates in land, personal property, bailments, and many more. Part IX of this text is devoted to a study of property.

Any attempt at classification of subject matter, particularly in the area of private law, is difficult because the law is indeed a "seamless web." For example, assume that an agent or a servant acting on behalf of his/her employer commits a tort. The law of agency, although a subdivision of the law of contracts, must contain a body of law to resolve the issues of tort liability of employer and employee. Likewise, assume that a person is injured by a product he/she has purchased. The law of sales, even though a part of the law of contracts, contains several aspects that could best be labeled a branch of the law of torts. Therefore, it is apparent that even the general classifications of contract and tort are not accurate in describing the subject matter of various bodies of law.

1.3 Sources of Law

1.3a Four Sources of Law

Our law comes from four basic sources: (1) constitutions; (2) legislation; (3) judicial decisions; and (4) rules, regulations, and decisions of administrative agencies. Assuming that administrative agencies are part of the executive branch of government, our law comes from all three branches. (Administrative law is treated in detail in Chapter 40 and will receive only a minimum amount of treatment in this chapter.)

Constitutional provisions establish the foundational principles upon which legislative, judicial and administrative agencies function. This most important source of law also describes the powers and limits of both federal and state governments. Next in importance is *legislation*. Legislative pronouncements (generally termed "statutes") may come from Congress or from a state legislature. They can also come from sub-divisions of a state (e.g., a city council). *Judicial decisions* are also quite important, for they both interpret statutes and add to the rich tradition of the common law (which is purely made by judges without legislative intervention). Each of these three areas is further developed below.

1.3b Basic Constitutional Principles

In our constitutional system, the Constitution of the United States and the constitutions of the various states provide the basis of our legal system and our supreme law. All other laws must be consistent with them, or they are void. Most state constitutions are modeled after the federal Constitution. They divide state government into executive, legislative, and judicial branches, giving each branch checks and balances on the others. Constitutions also define the powers and functions of the various branches.

Separation of powers
The doctrine that the legislative, executive, and judicial branches of government function independently of one another and that each branch serves as a check on the others

The Constitution of the United States and the constitutions of the various states are the fundamental written law in this country. A federal law must not violate the U.S. Constitution. All state laws must conform to, or be in harmony with, the federal Constitution as well as with the constitution of the appropriate state.

Two very important principles of constitutional law are basic to our judicial system. They are closely related to each other and are known as the doctrine of **separation of powers** and the doctrine of **judicial review**.

Judicial review
The power of courts to declare laws and executive actions unconstitutional

The doctrine of separation of powers results from the fact that both state and federal constitutions provide for a scheme of government consisting of three branches—legislative, executive, and judicial. Separation of powers has both a horizontal and a vertical aspect. The vertical aspect is that there is separation between the federal government and the state government. Each has its

own functions to perform. The horizontal aspect of separation of powers ascribes to each branch a separate function and a check and balance on the functions of the other branches. The doctrine of separation of powers implies that each separate branch will not perform the function of the others and that each branch has limited powers.

The doctrine of judicial review is the heart of the concept of separation of powers. This doctrine and the doctrine of supremacy of the Constitution were established at an early date in our country's history in the celebrated case of *Marbury v. Madison* (1803). In this case, Chief Justice Marshall literally created for the court a power that the founding fathers had refused to include in the Constitution. This is the power of the judiciary to review the actions of the other branches of government and to set them aside as null and void if in violation of the Constitution. In creating this power to declare laws unconstitutional, Chief Justice Marshall stated,

> Certainly, all those who have framed written constitutions contemplated them as forming the fundamental and paramount law of the nation, and consequently, the theory of every such government must be that an act of the legislature, repugnant to the constitution, is void. This theory is essentially attached to a written constitution and is, consequently, to be considered by this court as one of the fundamental principles of our society.

Justice Marshall then decided that courts have the power to review the actions of the legislative and executive branches of government to determine if they are constitutional. This doctrine of judicial review, to some extent, makes the courts the overseers of government and of all aspects of our daily lives.

The Constitution of the United States also provides checks against the power of government. The most important are included in the Bill of Rights (the first 10 amendments to the Constitution) and the Fourteenth Amendment to the Constitution that references due process and equal protection of the law.

1.3c Legislation

Much of our law is found in legislation. Legislative bodies exist at all levels of government. Congress, state assemblies, city councils, and other local government bodies create legislation. The term *legislation,* in its broad sense, also includes treaties entered into by the executive branch of government and ratified by the Senate.

Legislation enacted by Congress or by a state legislature is usually referred to as a **statute**. Laws passed by local governments frequently are called **ordinances**. Compilations of legislation at all levels of government are called **codes**. For example, we have local traffic codes covering all aspects of driving automobiles and state codes drawn from the Uniform Commercial Code that cover all aspects of commercial transactions. The statutes of the United States that attempt to regulate general conduct are known as the U.S. Code.

Legislative bodies have procedural rules that must be followed if a law is to be valid. Among the typical procedural rules are those relating to the way amendments are added to a proposed law, the way proposed statutes are presented for consideration (reading aloud to the members, etc.), and the manner of voting by the members of the legislative body.

Legislation at all levels contains general rules for human conduct. Legislation is the result of the political process expressing the public will on an issue. Courts also play a significant role in the field of statutory law. In addition to their power of judicial review, courts interpret legislation and apply it to specific facts. Courts interpret legislation by resolving ambiguities and filling the gaps in the statutes. By its very nature, most legislation is general, and interpretation is necessary to find the intent of the legislature.

Statute
A law passed by Congress or the legislative body of a state

Ordinance
Generally speaking, the legislative act of a municipality (A city council is a legislative body, and it passes ordinances that are the laws of the city.)

Code
A collection or compilation of the statutes passed by a legislative body on a particular subject

1.3d Interpreting Legislation

Theoretically, legislation expresses the will or intent of the legislature on a particular subject. In practice, this theory suffers from certain inherent defects. First, it is not possible to express the legislative intent in words that will mean the same thing to everyone. Statutes, by their very nature, are written in general language, which frequently is ambiguous.

Second, the search for legislative intent often is complicated by the realization that the legislative body, in fact, had no intent regarding the current issue in question, making the law incomplete. The matter involved is simply one that was not thought about when the law was passed. Therefore, sometimes the question about legislation concerns not what the legislature intended but what it would have intended had it considered the problem. Both of these problems result in an expanded role for courts in our legal system.

One technique of statutory interpretation is to examine the *legislative history* of an act to determine the purpose of the legislation or the evil it was designed to correct. Legislative history includes the committee hearings, the debates, the statements made, if any, by the executive in requesting the legislation. Legislative history does not always give a clear understanding of the legislative intent because the legislature may not have considered many questions of interpretation that confront courts.

Judges use several additional accepted rules of statutory interpretation in determining legislative intent. Many of these rules are based on the type of law being construed. For example, one rule is that criminal statutes and taxing laws should be strictly or *narrowly construed*. As a result, doubts as to the applicability of criminal and taxing laws will be resolved in favor of the accused or the taxpayer, whichever the case may be. Another rule of statutory construction is that remedial statutes (those creating a judicial remedy on behalf of one person at the expense of another) are to be *liberally construed* so that the statute will be effective in correcting the condition to be remedied.

There are also rules of construction that aid in finding the meaning of words used in legislation. Words may be given their plain or *usual meaning*. Technical words are given their technical meaning. Other words are interpreted by the *context* in which they are used. For example, if a general word in a statute follows specific words, the general word takes its meaning from the specific words.

TOUCHSTONE

What is a "sandwich"?

Courts often are asked to interpret statutory language. Determining the exact meaning of language, however, whether embedded in a statute or in a legal document, as in the following case, can be difficult. PR, a company that operates Panera Bread restaurants, entered into a ten-year commercial lease with a shopping center owned by White City, a limited partnership. PR asked that the lease include a provision that White City would not enter into new leases with any business that primarily sells sandwiches. There was not a specific definition of the term "sandwich" in the lease both parties ultimately signed.

After PR and White City executed the lease, White City entered into negotiations with Chair 5, who desired to lease space within the shopping center for the purpose of selling tacos, burritos, and quesadillas as part of the menu offered by a Qdoba restaurant. PR, upon learning that the Mexican-style restaurant was being considered, wrote White City and objected based on the proposition that tacos, burritos, and quesadillas are "sandwiches"—and therefore a restaurant that sells such items cannot become a tenant.

White City did not respond to PR and proceeded to sign a lease with Chair 5. PR filed suit, asking a judge to issue an injunction prohibiting White City from leasing the premises to Chair 5. The basis of the request for the injunction was that a reasonable interpretation of the term "sandwich" in the lease between White City and PR would include Mexican-style food products that Qdoba would ultimately sell.

The court, however, found that the word "sandwich" is subject to interpretation drawing from the ordinary meaning of the word. Consulting a dictionary, the court found that a "sandwich" is defined as "two thin pieces of bread with a thin layer spread between them." Thus, according to the court's decision, the dictionary definition and "common sense" do not include burritos, tacos, and quesadillas, which are typically made with a single tortilla and then stuffed with a filling. Therefore, the lease language does not bar White City from leasing to Chair 5 and an injunction is not proper.

[*White City Shopping Center, LP v. PR Restaurants, LLC doing business as Bread Panera,* 2006 Mass Super. LEXIS 544 (Superior Court of Massachusetts, at Worcester, 2006)]

Statutory construction is not always based on the type of statute or the words used. For example, if a statute contains both specific and general provisions, the specific provision controls. A frequently cited rule provides that a thing may be within the letter of the statute and yet not within the statute because it is not within the statute's spirit or within the intention of the makers. This rule allows a court to have a great deal of flexibility and to give an interpretation contrary to the plain meaning. The power of courts to interpret legislation means that in the final analysis, a statute means what the court says it means.

1.3e Uniform State Laws

Since each state has its own constitution, statutes, and body of case law, there are substantial differences in the law among the various states. It is important to recognize that ours is a federal system in which each state has a substantial degree of autonomy; thus, it can be said that there are really fifty-one legal systems—a system for each state plus the federal legal structure. In many legal situations it does not matter that the legal principles are not uniform throughout the country. This is true when the parties to a dispute are *citizens* of the same state and the transaction or occurrence creating the dispute happened in that state; then the controversy is

strictly *intrastate* as opposed to one having *interstate* implications. However, when citizens of different states are involved in a transaction (perhaps a buyer in one state contracts with a seller in another), many difficult questions can arise from the lack of uniformity in the law. Assume that a contract is valid in one state but not in the other. Which state's law controls? Although a body of law called *conflict of laws* (see Section 1.4d) has been developed to cover such cases, more uniformity is still desirable.

Two methods of achieving uniformity in business law are possible: (1) having federal legislation govern business law, or (2) having states' legislatures adopt uniform laws concerning at least certain phases of business transactions. A legislative drafting group known as the National Conference of Commissioners on Uniform State Laws uses this latter method. This group of commissioners appointed by the governors of the states tries to promote uniformity in state laws on all subjects for which uniformity is desirable and practical. They accomplish this goal by drafting model acts. After their approval by the National Conference, proposed uniform acts are recommended to the state legislatures for adoption.

More than one hundred uniform laws concerning such subjects as partnerships, leases, arbitration, warehouse receipts, bills of lading, and stock transfers have been drafted and presented to the various state legislatures. The response has varied. Very few of the uniform laws have been adopted by all the states. Some states have adopted the uniform law in principle but have changed some of the provisions to meet local needs or to satisfy lobbying groups, which has, in effect, left those state laws non-uniform.

The most significant development for business in the field of uniform state legislation has been the Uniform Commercial Code. It was prepared for the stated purpose of collecting in one body the law that "deals with all the phases which may ordinarily arise in the handling of a commercial transaction from start to finish. …" The detailed aspects of the Code, as it is often called, make up a significant portion of this text; and sections of the Code are referred to in brackets throughout this text where appropriate. Its provisions are set forth in Appendix B.

The field of commercial law is not the only area of new uniform statutes. Many states are adopting modern procedures and concepts in criminal codes and other uniform laws dealing with social problems. In addition, the past few years have seen dynamic changes in both state and federal statutes setting forth civil procedures and revising court systems. The future will undoubtedly bring many further developments to improve the administration of justice. The trend, despite some objection, is to cover more areas of the law with statutes and to rely less on precedent in judicial decisions, or the common law, as a source of law.

1.3f Court Decisions

The concepts of decided cases as a source of law comes from England. This system of relying on the judiciary is referred to as the **common law**. In the United States, the common-law system is predominant. Since most of the colonists were of English origin, they naturally followed the laws and customs of their mother country.

Our common-law system, which relies on case precedent as a source of law, must be contrasted with **civil-law** systems, which developed on the European continent. The civil-law countries have codified their laws—reduced them to statutes—so the main source of law in those countries is in the statutes rather than in the cases. In Louisiana, and to some extent in Texas and California, the civil law has influenced the legal systems because of those states' French and Spanish heritage.

Even in our common-law system, legislation enacted by the federal government and the various state and local governments is an important source of law. Indeed, throughout our nation's history, the importance of legislation in regulating business activities has increased. Nevertheless, court decisions remain a vital source of law because of the difficulty of reducing all laws to writing before issues are addressed in court.

To help manage our complex legal system, the judiciary establishes a general priority among the various sources of law. Constitutions prevail over statutes, and statutes prevail over common-law principles established in court decisions. Courts will not turn to case decisions for law if a statute directly provides an answer to the issue being litigated.

Common law
That body of law deriving from judicial decisions

Civil law
A system of law based on legislation or codes, as in the European system of codified law

As you might conclude, a legal system focused strictly on statutes and rules flowing from court decisions could be considered overly rigid. To combat the inherent formality of this aspect of Anglo-American law, a complimentary set of legal principles supplement the strict rules of law. This area, known as the *law of equity,* drew historically on the power of the sovereign to offer legal solutions as an alternative. Today, we find both a common law legal system that provides the remedy of money damages and a parallel legal system that draws on the power of equity to provide equitable remedies, usually in terms of a judge ordering a party to do something or refrain from doing something.

Touchstone

Who should possess a dog?

Doreen and Eric ended their engagement to be married. Doreen alleged that an oral agreement gave possession of their dog to her. Doreen took the dog and cared for it, allowing Eric to take possession of the dog for short periods of time. After a post-separation visit, however, Eric retained the dog. Doreen sued for possession of the dog. The trial court found that because the agreement was only oral, however, it was not possible for the judge to draw on the powers of equity to grant specific performance of the contract. If specific performance was possible, then Doreen would receive the dog under terms of the oral agreement. But because the trial judge found that the law of equity was not available in this situation, the judge awarded Doreen $1,500, which was the dog's value. Eric retained possession of the dog.

Doreen appealed the decision in the hope of retaining possession of the dog. On appeal, the court reversed the trial judge. The appellate court found that the equitable remedy of specific performance is appropriate when an agreement concerns the possession of property for which there is a strong emotional attachment, regardless of whether the contract was in writing or oral. As such, no money damages are sufficient to compensate the injured party for the special subjective value drawn from the benefits derived by possession of the special property. The proper remedy in this case, according to the opinion, is to grant possession of the dog to Doreen.

[*Houseman v. Dare,* 966 A.2d 24 (Superior Court of New Jersey, Appellate Division, 2009)]

1.4 Case Law

1.4a *Stare Decisis*

Notwithstanding the trend toward adopting law in statutory form, a substantial portion of our law has its source in decided cases. This case law, or common law, is based on the concept of precedent and the doctrine of ***stare decisis***, which means "to stand by decisions and not to disturb what is settled." *Stare decisis* tells us that once a case has established a precedent, it should be followed in subsequent cases involving the same issues. Judicial decisions create precedent by interpreting legislation and by deciding issues not covered by legislation.

When a court decides a case, particularly on an appeal from a lower-court decision, the court writes an opinion setting forth, among other things, the reasons for its decision. From these written opinions rules of law can be deduced, and these make up the body of case law or common law.

Stare decisis gives both certainty and predictability to the law. It is also expedient. Through the reliance on precedent established in prior cases, the common law has resolved many legal issues and brought stability into many areas of the law, such as the law of contracts. The doctrine of *stare decisis* provides a system so businesspeople may act in a certain way, confident that their actions will have certain legal effects. People can rely on prior decisions and by knowing the legal significance of their actions can act accordingly. There is reasonable certainty as to the results of conduct.

Precedent affects trial courts more than courts of review; the latter have the power to make precedent in the first instance. However, even the appellate courts usually hesitate to renounce precedent. They generally assume that if a principle or rule of law announced in a former judicial decision is unfair or contrary to public policy, it will be changed by legislation. It is important to note that an unpopular court ruling can usually be changed or overruled by statute.

The doctrine of *stare decisis* must be contrasted with the concept of ***res judicata***, which means, "the thing has been decided." *Res judicata* applies when, *between the parties themselves,* the matter is closed at the conclusion of the lawsuit. The losing party cannot again ask a court to decide the dispute. *Stare decisis* means that a court of competent jurisdiction has decided a controversy and has, in a written opinion, set forth the rule or principle that formed the basis for its decision; thus that rule or principle will be followed by the court in deciding subsequent cases involving the same issues. Likewise, subordinate courts in the same jurisdiction will be bound by the rule of law set forth in the decision. *Stare decisis,* then, affects persons who are not parties to the lawsuit, whereas *res judicata* applies only to the parties involved.

Stare decisis
The doctrine that law should adhere to decided cases and "stand by the decision"

Res judicata
The legal doctrine that once a dispute is litigated and resolved, these parties are forever barred from litigating the same matter again—"the thing has been decided"

1.4b Problems Inherent in Case Law

The common-law system as used in the United States has several inherent difficulties. First is the unbelievably large volume of judicial decisions, each possibly creating precedent, which places "the law" beyond the actual knowledge of lawyers, let alone laypersons. Large law firms employ lawyers whose major task is to search case reports for "the law" to be used in lawsuits and in advising clients. Today, computers are being used to assist in the search for precedent because legal research involves examination of cases in hundreds of volumes. Because the total body of ruling case law is so extensive, it is obvious that laypersons that are supposed to know the law and govern their conduct accordingly do not know the law and cannot always follow it, even with the advice of legal counsel.

Another major problem involving case law arises because conflicting precedents are often cited to the court by opposing lawyers. One of the major tasks of the court in such cases is to determine which precedent is applicable to the present case. In addition, even today, many questions of law arise on which there has been no prior decision or in areas where the only authority is by implication. In such situations, the judicial process is "legislative" in character and involves the creation of law.

It should also be noted that there is a distinction between precedent and mere *dicta*. As authority for future cases, a judicial decision is coextensive only with the facts on which it is founded and the rules of law on which the decision is actually based. Frequently, courts make comments on matters not necessary to the decision reached. Such expressions, called *dicta,* lack the force of adjudication and strictly speaking are not a precedent the court will be required to follow within the rule of *stare decisis*. **Dicta** or implication in prior cases may be followed if sound and just. In fact, dicta that have been repeated frequently are often given the force of precedent.

Two additional problems that arise with our common-law, precedent-oriented judicial system are discussed in the next two sections. One acknowledges that courts do not always follow established precedent. The other problem involves which precedent is applicable to a multi-state transaction or occurrence.

1.4c Rejection of Precedent

The doctrine of *stare decisis* has not been applied in a fashion that renders the law rigid and inflexible. If a court, especially a reviewing court, finds that the prior decision was "palpably wrong," it may overrule and change it. By the same token, if the court finds that a rule of law established by a prior decision is no longer sound because of changing conditions, it may reverse the precedent. The strength and genius of the common law is that no decision is *stare decisis* when it has lost its usefulness or the reasons for it no longer exist. The doctrine does not require courts to multiply their errors by using former mistakes as authority and support for new errors. Thus, just as legislatures change the law by new legislation, courts change the law from time to time by reversing former precedents. Judges, like legislators, are subject to social forces and changing circumstances. As personnel of courts change, each new generation of judges deems it their responsibility to reexamine precedents and adapt them to the present.

The argument is frequently made that changes in the law should be left to the legislative process. If a rule of law does not represent the judgment of society, the people, through the political process, will cause the appropriate legislative body to change it. The argument that an issue is more appropriate for legislative resolution is often unpersuasive. Such an argument ignores the responsibility of courts to face difficult legal questions and to accept judicial responsibility for a needed change in the common law. Courts often meet changing times and new social demands by reexamining outmoded common-law concepts. Many cases produce changes that have a profound effect on social and business relationships. Many judges believe that it is the responsibility of the courts to balance competing interests. They recognize that the common law is judge-made and judge-applied. As a result, case law will be changed when altered conditions and circumstances establish that it is unjust or has become bad public policy. The dynamic quality of the law allows it to grow and meet changing conditions.

Stare decisis may not be ignored by mere whim or caprice. It must have more impact on trial courts than on reviewing courts. It must be followed rather rigidly in daily affairs. In the whole area of private law, uniformity and continuity are necessary. It is obvious that the same rules of tort and contract law must be applied from day to day. *Stare decisis* must take the capricious element out of law and give stability to a society and to business.

Dicta
Statements of the court that are not necessary to decide the controversy before the court

In the area of public law, however, especially constitutional law, the doctrine is frequently ignored. As United States Supreme Court Chief Justice John Marshall wrote in *McCullough v. Maryland* (1819), "It is a constitution which we are expounding, not the gloss which previous courts may have put on it." Constitutional principles are often considered in relation to the times and circumstances in which they are raised. Public law issues are relative to the times, and precedent is often ignored so that the dead do not govern us. Courts reexamine precedents and adapt them to changing conditions. Under a doctrine known as *constitutional relativity,* the meaning of the Constitution is relative to the time in which it is being interpreted. Under this concept, great weight is attached to social forces in formulating judicial decisions. As the goals, aspirations, and needs of society change, precedent changes.

1.4d Conflict of Laws

Certain basic facts about our legal system must be recognized. First, statutes and precedents, in all legal areas, vary from state to state. Second, the doctrine of *stare decisis* does not require that one state recognize the precedent or rules of law of other states. Each state is free to decide for itself questions concerning its common law and interpretation of its own constitution and statutes. (However, courts will often follow decisions of other states if they are found to be sound. They are considered persuasive authority. This is particularly true in cases involving uniform acts, when each state has adopted the same statute.) Third, many legal issues arise out of acts or transactions that have contact with more than one state. A contract may be executed in one state, performed in another, and the parties may live in still others; or an automobile accident may occur in one state involving citizens of different states.

Thus, courts often face a fundamental question: Which state's *substantive laws* are applicable in a multiple-jurisdiction case when the law differs from one state to the other? The body of law known as **conflict of laws**, or choice of laws, answers this question. It provides the court with the applicable substantive law in the multi-state transaction or occurrence. The law applicable to a tort is generally said to be the law of the state of place of injury. Thus, a court sitting in state X would follow its own rules or procedure, but it would use the tort law of state Y if the injury occurred in Y.

The following are several considerations used by courts on issues involving the law of contracts:

1. The law of the state where the contract was made
2. The law of the place of performance
3. "Grouping of contacts" or "center of gravity" theory, which uses the law of the state most involved with the contract
4. The law of the state specified in the contract

Many contracts designate the applicable substantive law. A contract provision that provides "This contract shall be governed by the law of the State of New York" will be enforced if New York has at least minimal connection with the contract.

It is not the purpose of this text to teach conflict of laws, but the reader should be aware that such a body of law exists and should recognize those situations in which the principles of conflict of laws will be used. The trend toward uniform statutes and codes has tended to decrease these conflicts, but many of them still exist. As long as we have a federal system and fifty separate state bodies of substantive law, the area of conflict of laws will continue to be of substantial importance in the application of the doctrine of *stare decisis* and statutory law.

The role of conflict of laws is exhibited in Case 1.3.

Conflict of laws
A body of legal principles used to determine the appropriate law to apply to a litigated case when more than one state is involved

CASE 1.3

The Estee Lauder Companies Inc. v. Shashi Batra

430 F. Supp. 2d 158 (2006)

United States District Court for the Southern District of New York

Sweet, District Judge

On March 13, 2006, Shashi Batra ("Batra") filed a complaint against Estee Lauder Companies, Inc. ("Estee Lauder") in California State Court seeking a declaratory judgment that a Non-compete Agreement was void under California Law.

On March 15, 2006, Estee Lauder filed its complaint in this (New York State) Court against Batra alleging: (1) breach of Batra's Non-compete agreement and (2) theft of trade secrets. Further, Estee Lauder has moved by order to show cause for a temporary restraining order and preliminary injunction from this Court to restrain defendant Shashi Batra ("Batra") from breaching the terms of his Confidentiality, Non-solicitation, and Non-competition Agreement with Estee Lauder the "Non-compete Agreement") and from engaging in employment with N.V. Perricone M.D. Ltd.

Plaintiff Estee Lauder is a corporation organized under the laws of the State of Delaware with its principal place of business located in New York, New York. Estee Lauder is engaged in the business of manufacturing and marketing skin care, makeup, fragrance, and hair care products.

Defendant Batra is an individual who resides in San Francisco, California, and did from 2004 until March 10, 2006, when he was employed as a senior executive for two of Estee Lauder's brands, Rodan and Fields ("R+F") and Darphin. On or about March 13, 2006, Batra began employment as the Worldwide General Manager of Perricone.

At the commencement of his employment, Batra signed an employment agreement with Estee Lauder, which contained confidentiality, non-solicitation, and non-competition provisions. In return for signing the agreement (which all Estee Lauder executive employees are required to sign), Batra received a $100,000 signing bonus. In addition, Batra was provided with a compensation package of $300,000 per year, benefits, an automobile allowance, stock options, and bonus eligibility. On July 1, 2004, Batra's base salary was increased to $325,000. In July 2005, in conjunction with his new responsibilities for Darphin, Estee Lauder increased Batra's base salary to $375,000.

The non-competition clause, contained in Paragraph 4 of the employment agreement that Batra signed in January 2004, provides as follows:

> You recognize that the Company's business is very competitive and that to protect its Confidential Information the Company expects you not to compete with it for a period of time. You therefore agree that during your employment with the Company, and for a period of twelve (12) months after termination of your employment with the Company, regardless of the reason for the termination, you will not work for or otherwise actively participate in any business on behalf of any Competitor in which you could benefit the Competitor's business or harm the Company's business by using or disclosing Confidential Information. This restriction shall apply only in the geographic areas for which you had work-related responsibility during the last twelve (12) months of your employment by the Company and in any other geographic area in which you could benefit the Competitor's business through the use or disclosure of Confidential Information.

Finally, the Non-compete Agreement contained a choice of law provision, which states:

> This agreement shall be governed by, and construed and interpreted in accordance with, the laws of the State of New York without regard to the conflict of law rules thereof.

As a threshold matter, the Court first must determine which state's law controls—New York's or California's—as a court is to apply the choice-of-law rules prevailing in the state in which the court sits governs the choice of law determination.

To determine the appropriateness of the parties' choice of law, New York follows the "substantial relationship" approach, as stated in Restatement (Second) of Conflicts of Law § 187:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied … unless either
>
> (a) the chosen state has no substantial relationship to the parties … or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state …

(continues)

(CASE 1.3 continued)

Generally, "under New York law … a contract's designation of the law that is to govern disputes arising from the contract … is determinative if the state has sufficient contacts with the transaction." However, there is an exception to this rule when "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state." For this exception to apply, "the issue [must be] of such overriding concern to the public policy of another jurisdiction as to override the intent of the parties and the interest of [New York] in enforcing its own policies."

In other words, three conditions must be met in order to override the intent of the contracting parties. First, Batra must establish that in the absence of the choice of law provision, California law would apply. Second, he must demonstrate that the application of New York law would be contrary to a fundamental policy of California. Third, Batra must demonstrate that California has a materially greater interest than New York in the determination of this dispute.

Batra argues, in essence, that irrespective of the presence of the New York forum selection clause in the contract, California law should apply due to the presence of significant contacts in California and to California's strong public policy against the enforcement of non-compete agreements.

For the first element of the inquiry, New York courts employ the "substantial relationship" test. The New York Court of Appeals has addressed the 'substantial relationship' approach and held that while the parties' choice of law is to be given heavy weight, the law of the state with the 'most significant contacts' is to be applied."

The fact that Batra literally carried out many of his duties from California does not overcome the fact that work itself was the management of a New York-based brand with predominantly New York-based employees. Accordingly, while this may be a close call, New York has the most significant contacts.

Because, pursuant to California's fundamental policy against the enforcement of restrictive covenants, non-compete agreements, such as the one at issue in this case, are declared null and void under California law, the enforcement of Batra's agreement by this Court would be contrary to a fundamental policy of California, notwithstanding Estee Lauder's contention that there is no conflict between California's policy and the application of New York law. The Non-compete Agreement would not be enforceable under California law. However, in spite of the fact that the application of New York law would run contrary to the fundamental policy of California, it is concluded that California's interest in this dispute is not materially greater than that of New York and that therefore, New York law shall apply.

As set forth above, because the contacts point toward New York, it is concluded that California's interest is not materially greater than that of New York. Just as California has a strong interest in protecting those employed in California, so too does New York have a strong interest in protecting companies doing business here in keeping with New York's recognized interest in maintaining and fostering its undisputed status as the preeminent commercial and financial nerve center of the Nation and the world. That interest naturally embraces a very strong policy of assuring ready access to a forum for redress of injuries arising out of transactions spawned here. Indeed, access to a convenient forum which dispassionately administers a known, stable, and commercially sophisticated body of law may be considered as much an attraction to conducting business in New York as its unique financial and communications resources.

Accordingly, based upon New York's policy of enforcing restrictive covenants that are reasonable in time and scope and given New York's interest in having a predictable body of law that companies can rely on when employing individuals who will have close contact with trade secrets and confidential information, it is concluded that California's interest is not "materially greater" than New York's.

It is concluded that New York law will apply.

Case Concepts Review

1. Are the public policies of California and New York different regarding non-competition agreements in the employment arena? If so, how; and is one better than another?
2. With New York law applying, do you think Estee Lauder would win? Might the result have been different if a California court had decided the choice of law issue? Why?

Chapter Summary:
Law: Importance, Purposes, and Sources

Importance of Law to Business

Why Study the Legal Environment of Business?

1. The law is important to modern business.
2. The history of business reveals the prominence of law.
3. Educators today emphasize the role of law in preparing tomorrow's business leaders.

Addressing Risk and Achieving Strategic Integration

1. Knowing legal rights and duties enhances one's ability to identify legal risks and effectively reduce or eliminate resulting legal liability.
2. Knowing legal rights and duties allows business leaders to use the law to their strategic advantage.

An Overview of Our Legal System

Definitions of Law

1. There are many definitions of law, depending on the content and subject matter involved.
2. In some areas, the law is a command from the sovereign.
3. Law is a method of controlling society and implementing change.
4. Law consists of the principles used by courts to decide controversies.

Objectives of a Legal System

1. A legal system should promote order in society.
2. The ability for individuals and entities to achieve justice should be another objective of a legal system.
3. A legal system should cultivate a sense of reasonableness.

Classifications of Legal Subjects

1. One way to classify laws is by their purpose—substantive versus procedural.
2. Public law versus private law is another common way to distinguish between classifications of laws.

Sources of Law

Four Foundations of Law

1. Law today is based on a foundation of constitutional principles, legislation, court decisions, and administrative regulations.

Basic Constitutional Principles

1. Constitutional principles provide the foundation of our legal system.
2. One of the most important constitutional principles is the doctrine of judicial review.

Legislation

1. Legislation in the form of statutes, codes, and ordinances provides much of our body of law.
2. Courts have a major role to play in interpreting legislation.

Uniform State Laws

1. Uniform state laws such as the Uniform Commercial Code are an attempt to provide uniformity in business transactions throughout the country.

Court Decisions

1. Reliance on decided cases as precedents for present controversies is the foundation of our common-law system.
2. Common law must be contrasted with the civil-law system, which relies more on statutory law than on court decisions as a primary source of law.

Case Law

Stare Decisis

1. This means to stand by decisions and not disturb what is settled.
2. The goal is certainty and predictability.

Problems Inherent in Case Law

1. The volume of cases makes legal research difficult.
2. There are often conflicting precedents that are difficult to apply.
3. Precedent must be distinguished from mere dicta.

Rejection of Precedent

1. Case law may be changed if conditions change or its reasoning is no longer sound.
2. Precedent is given greater weight in private law than in cases involving public law issues.

Conflict of Laws

1. Principles of conflict of laws determine the appropriate statutes and case law to be used in litigation involving more than one jurisdiction.
2. A court in one forum may use the substantive law of another to decide a case.

Review Questions and Problems

1. Provide one reason why astute business leaders want to possess a good understanding of legal rights and duties.
2. Give a definition of law, and provide an example.
3. Assume you could create a legal system. What characteristics would you want in the system?
4. Classify the following subjects as public law or private law:
   a. Constitutional law
   b. Contract law
   c. Administrative law
   d. Criminal law
   e. Property law
   f. Tort law
   g. Sales law
   h. Business organization law
5. Compare and contrast the following:
   a. Public law and private law
   b. Civil law and common law
   c. Torts and crimes
   d. Substance and procedure
   e. Case law and legislation
6. Describe three advantages of the case-law system.
7. The basic characteristic of case law is that a case, once decided, establishes a precedent that will be followed by the courts when similar issues arise later. Yet courts do not always follow precedent. Why?
8. *Stare decisis* is of less significance in public-law subjects than in cases dealing with private-law subjects. Why?
9. Why is it necessary for each state to have a system of conflict of laws principles?
10. While in Missouri, Taylor, who was a resident of Kansas, became involved in an automobile accident with Stewart, a resident of Illinois. With respect to the appropriate substantive law being applied, does it matter whether Taylor sues Stewart in Missouri or Illinois? Why?