1989

The Legal Environment of Business (1989)

Jethro K. Lieberman

George J. Seidel

Follow this and additional works at: https://digitalcommons.nyls.edu/fac_books
## Contents

Preface iii
To the Student vi
About the Authors ix

**Part One BUSINESS AND THE LEGAL SYSTEM: INTRODUCTORY THEMES** 1

1. Law and the Legal System
   - What is Law? 3
   - Classification of Types of Law 8
   - Sources of Law 12
   - Purposes of the U.S. Constitution 15
   - The Development of the Common Law 23
   - Nature of the Judicial Process 32
   - Chapter Summary 35
   - Problems 36

2. Business and the Constitution
   - Introduction 38
   - Regulating Business: Federal Regulation of Interstate Commerce 39
   - Regulating Business: The Constitutional Rights of Business 55
   - The Right to Property: Eminent Domain and Just Compensation 61
   - The Right to Unimpaired Contracts 64
   - Chapter Summary 65
   - Problems 66

3. Courts and the Legal Process
   - The Relationship of the State and Federal Court Systems 68
   - Legal Procedure 74
   - Who May Bring a Lawsuit 85
   - Comparative Review of Legal Systems 90
   - Chapter Summary 92
   - Problems 93

4. Relations with Lawyers and Alternative Dispute Resolution
   - Introduction 94
   - Relations with Lawyers 95
   - Alternative Means of Resolving Disputes 96
   - Chapter Summary 120
   - Problems 122

5. Administrative Law
   - Administrative Agencies: Their Structure and Powers 124
   - Controlling Administrative Agencies 126
   - The Administrative Procedure Act 128
   - Administrative Burdens on Business Operations 130
   - The Scope of Judicial Review 135
   - Chapter Summary 138
   - Problems 139

6. Business Ethics and Social Responsibility
   - Convergence of the Law and Business Ethics 141
   - Divergence of the Law and Business Ethics 146
   - The Law and Social Change 153
   - Chapter Summary 158
   - Problems 161

7. Criminal Law
   - The Nature of Criminal Law 162
   - Methods of Classifying 164
   - Types of Crimes 164
   - The Nature of a Criminal Act 173
   - Responsibility 178
   - Procedure 184
   - Constitutional Rights of the Accused 186
   - Chapter Summary 188
   - Problems 189

**Part Two FOUNDATIONS OF BUSINESS** 191

8. Contracts
   - General Perspectives on Contracts 193
   - Sources of Contract Law 195
   - Basic Contract Taxonomy 201
   - Contract Formation 203
   - Remedies 217
   - Chapter Summary 223
   - Problems 224

9. Torts
   - Purpose of Tort Law 226
   - Intentional Torts 229
   - Negligence 233
## CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.</td>
<td>Consumer Credit Transactions</td>
<td>296</td>
</tr>
<tr>
<td></td>
<td>Entering Into a Credit Transaction</td>
<td>297</td>
</tr>
<tr>
<td></td>
<td>Consumer Rights After a Credit Transaction</td>
<td>308</td>
</tr>
<tr>
<td></td>
<td>Debt-collection Practices</td>
<td>310</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>317</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>318</td>
</tr>
<tr>
<td>12.</td>
<td>Bankruptcy</td>
<td>319</td>
</tr>
<tr>
<td></td>
<td>Alternatives to Bankruptcy</td>
<td>320</td>
</tr>
<tr>
<td></td>
<td>The Bankruptcy Reform Act</td>
<td>321</td>
</tr>
<tr>
<td></td>
<td>Liquidation</td>
<td>323</td>
</tr>
<tr>
<td></td>
<td>Adjustments of Debts of an Individual with Regular Income—Chapter 13</td>
<td>340</td>
</tr>
<tr>
<td></td>
<td>Reorganization—Chapter 11</td>
<td>343</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>349</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>350</td>
</tr>
<tr>
<td>13.</td>
<td>Relationships Between Principal and Agent</td>
<td>353</td>
</tr>
<tr>
<td></td>
<td>Introduction</td>
<td>355</td>
</tr>
<tr>
<td></td>
<td>Types of Agents</td>
<td>357</td>
</tr>
<tr>
<td></td>
<td>Independent Contractors</td>
<td>359</td>
</tr>
<tr>
<td></td>
<td>Creation of Agency</td>
<td>361</td>
</tr>
<tr>
<td></td>
<td>Agent's Duties to Principal</td>
<td>363</td>
</tr>
<tr>
<td></td>
<td>Principal's Duties to Principal</td>
<td>369</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>378</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>379</td>
</tr>
<tr>
<td>14.</td>
<td>Liability of Principal and Agent; Termination of Agency</td>
<td>381</td>
</tr>
<tr>
<td></td>
<td>Principal's Contract Liability</td>
<td>381</td>
</tr>
<tr>
<td></td>
<td>Principal's Tort Liability</td>
<td>387</td>
</tr>
<tr>
<td></td>
<td>Principal's Criminal Liability</td>
<td>398</td>
</tr>
<tr>
<td></td>
<td>Agent's Personal Liability for Torts and Contracts</td>
<td>398</td>
</tr>
<tr>
<td></td>
<td>Termination of Agency</td>
<td>402</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>403</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>404</td>
</tr>
<tr>
<td>15.</td>
<td>Labor—Management Law</td>
<td>406</td>
</tr>
<tr>
<td></td>
<td>A Brief History of Labor Legislation</td>
<td>406</td>
</tr>
<tr>
<td></td>
<td>The National Labor Relations Board—Organization and Functions</td>
<td>410</td>
</tr>
<tr>
<td></td>
<td>Labor and Management Rights Under the Federal Labor Laws</td>
<td>411</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>425</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>426</td>
</tr>
<tr>
<td>16.</td>
<td>Employment Law</td>
<td>428</td>
</tr>
<tr>
<td></td>
<td>Employment Discrimination</td>
<td>428</td>
</tr>
<tr>
<td></td>
<td>Erosion of the Employment-at-Will Doctrine</td>
<td>446</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>449</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>452</td>
</tr>
<tr>
<td>17.</td>
<td>Forms of Business Organization</td>
<td>456</td>
</tr>
<tr>
<td></td>
<td>Partnership</td>
<td>456</td>
</tr>
<tr>
<td></td>
<td>Corporations</td>
<td>464</td>
</tr>
<tr>
<td></td>
<td>Other Forms</td>
<td>476</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>481</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>482</td>
</tr>
<tr>
<td>18.</td>
<td>Securities Regulation and Corporate Governance</td>
<td>484</td>
</tr>
<tr>
<td></td>
<td>Nature of Securities Regulation</td>
<td>484</td>
</tr>
<tr>
<td></td>
<td>Securities Regulation and Corporate Governance</td>
<td>498</td>
</tr>
<tr>
<td></td>
<td>Chapter Summary</td>
<td>517</td>
</tr>
<tr>
<td></td>
<td>Problems</td>
<td>518</td>
</tr>
<tr>
<td>19.</td>
<td>Antitrust 1: Restraints of Trade</td>
<td>523</td>
</tr>
<tr>
<td></td>
<td>Introduction to Government Regulation</td>
<td>523</td>
</tr>
<tr>
<td></td>
<td>History and Basic Framework of the Antitrust Laws</td>
<td>524</td>
</tr>
<tr>
<td></td>
<td>“Horizontal” Restraints of Trade</td>
<td>532</td>
</tr>
<tr>
<td></td>
<td>“Vertical” Restraints of Trade</td>
<td>539</td>
</tr>
<tr>
<td></td>
<td>Price Discrimination</td>
<td>548</td>
</tr>
<tr>
<td></td>
<td>Discrimination by the Seller</td>
<td>550</td>
</tr>
<tr>
<td></td>
<td>Seller's Defenses</td>
<td>555</td>
</tr>
<tr>
<td></td>
<td>Other Prohibitions</td>
<td>556</td>
</tr>
</tbody>
</table>
Law and the Legal System

The law touches every interest of man. Nothing that is human is alien to it.

—JUSTICE FELIX FRANKFURTER

The law is the witness and external deposit of our moral life. Its history is the history of the moral development of the race. The practice of it, in spite of popular jests, tends to make good citizens and good men.

—JUSTICE OLIVER WENDELL HOLMES, JR.

What Is Law?

The Nature of Law

Law is the instrument that people use to regulate their conduct in civilized society. It is a complex of rules, institutions, and ways of thinking about and interpreting those rules and institutions, that permits civilization to exist and people to live orderly lives. A more precise definition of law is difficult, if not impossible, to give. Philosophers have been debating the nature of law for thousands of years. One line of thought—that of the "positivists"—holds that law is simply the rule-like pronouncements of the sovereign, whether king or a democratically elected legislature. According to another approach—that of the "natural law" philosophers—law is a sys-
tem of reason, a set of deductions from principles of ethics, morals, or justice. Let us consider an actual case to see where the truth might lie.

Back in the 1840s in Illinois, a farmer named Seeley raised hogs on land next to that of a wheat farmer named Peters. Seeley’s farm had no fences, and his hogs were free to roam the countryside. Peters fenced his own property, but poorly, and Seeley’s hogs entered through breaks, trampling the crop. Peters sued Seeley, demanding that the court award him damages (a legal term meaning a sum of money that will recompense the victim for the injury he has suffered).

The question for the court was what law applied to the circumstances of this case. Now it should seem clear that some law would apply. If your neighbor breaks down your front door and walks out with your television set, common sense says that you should have a legal means of recovering for the damage done to your door and for the theft of your television. Common sense is right, of course; you are entitled to recover your legal damages. As the ancient maxim had it: for every (legal) wrong there is a remedy.

The case of Peters v. Seeley, however, was a bit more complex. A law could rationally put liability on the keeper of animals. Equally logically, however, the law could require a wheat farmer to fence his land. The trouble was that no clearly written law expressly declared one rule or the other. Instead, a law of Illinois enacted in the early part of the nineteenth century declared that the “common law” of England was thenceforth the law in Illinois as well. We consider the nature of common law in some detail later on (pp. 14–15); for now it is sufficient to say that common law is the body of court rulings that governs the legal relationships among people in the absence of explicit legislative enactment. The “reception statute”—so called because the law received the common law of England into Illinois—did not spell out the rights and duties of hog farmers and wheat farmers toward one another.

To resolve the case, the Illinois Supreme Court began as you would begin. It asked: What is the common law with respect to the mutual obligations of hog and wheat farmers? The English common law had no specific rule relating to hog and wheat farmers, but it did have a firm rule that if the owner of animals fails to fence them in, he is liable for damages done by them to the property of others. Peters, the wheat farmer, thought that should be the end of the case, for the legislature had declared that the law to be used in Illinois was the common law of England, and by the common law of England, Peters was entitled to damages.

But the court went further with its analysis. The English common law rule had developed in a country where land was scarce and people lived close by one another. In the United States, however, the situation was quite the reverse, and the custom of fencing in animals had never taken hold. The court gave as the reason for this difference in custom the boundless land that the people of Illinois enjoyed. So much land and so little timber was available that “it must be many years yet before our extensive prairies
can be fenced," and the grain would rot unless the cattle could feed on it. [Seeley v. Peters, 10 Ill. 130 (1848)] The court thus overrode the legislature's law and substituted its own judgment in order to conform law to the conditions and customs of the people in the state. Peters had to fence in his wheat, not Seeley his hogs.

We can see in this example a notion that law is not only the commandment of political authority, but a statement of rule that must comport in some way with reason and common sense. You might object that the example proves no such thing—that the political authority, in this case, was the court itself and that the law is whatever the court says it is. The noted jurist Oliver Wendell Holmes, Jr., a member of the Massachusetts Supreme Judicial Court for more than twenty years and of the United States Supreme Court for thirty (1902–1932), was of this view. In a lecture given in 1897, he declared (in a passage often quoted):

Take the fundamental question, What constitutes the law? You will find some text writers telling you that it is something different from what is decided by the courts of Massachusetts or England, that it is a system of reason, that it is a deduction from principles of ethics or admitted axioms or what not, which may or may not coincide with the decisions. But if we take the view of our friend the bad man we shall find that he does not care two straws for the axioms or deduction, but that he does want to know what the Massachusetts or English courts are likely to do. I am much of his mind. The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law. (emphasis added)

Holmes's view was adopted by an influential school of American scholars known as the "legal realists." They wanted to dispense with metaphysical notions of law and study what lawmaking bodies such as legislatures and courts really do.

The difficulty with this viewpoint is that if law is a prophecy of what courts do, then there must be some basis on which to make the prophecy, some underlying set of rules, or else the law is simply the outpouring of a dictator acting on whim. Suppose Seeley's lawyer had told his client: "Your case looks bad, because the common law of England clearly requires you to fence in your hogs. But here in this country the law is really what I can prophesy the courts will do. And I predict that the Illinois Supreme Court will rule in your favor because I am going to transmit to them a large bribe, which you will pay, and it is well known that they rule in favor of bribers." Obviously, this view of the law—that it is whatever anyone can cajole out of a court by any means, fair or foul—is not sustainable. There must be some set of social, political, and moral norms on which law and lawmaking are based. These norms will occupy us throughout most of this chapter and will be reflected in much of the discussion throughout the text.

1 For a description of legal citations and how to read them, see Appendix A at the end of this book.
Law Distinguished from Morals and Justice

In exhorting his listeners to think about what courts actually do, Holmes was not speaking nonsense. He was attempting to clarify an important point in the debate about the nature of law—namely, that law is not the same as "what is right" or "what is just." To be sure, legal principles and principles of morality and justice overlap. Most, but not all, of the Ten Commandments are also legal precepts as well. It is morally wrong to steal and kill; it is also illegal to do so. But it is not unlawful to take the Lord's name in vain, though it may be blasphemous, and the sin of envy is no crime.

Immorality is not always unlawful, and neither is illegality always immoral. The law requires us to drive on the right side of the road, but nothing is intrinsically evil about driving on the left, and the British are not an immoral nation because they follow a different rule.

In general, the law concerns itself with the lowest common denominator of human conduct, not the highest. Law imposes on all of us certain duties and obligations to refrain from interfering with others and from injuring them by our own actions. But it does not require us to act to prevent any harm from befalling another. A common example is that of the drowning person. A child who cannot swim is thrashing about close to shore in a lake next to which you are walking. The child is a stranger to you, and you have nothing to do with the child's being in the water. You could probably save the child simply by wading several feet out, and in any event you are a strong swimmer. But you prefer not to get your Sunday clothes wet, so you walk on, and the child dies. Your failure to rescue the child would rightly be condemned as immoral, but there is no legal duty to save him. In short, the law does not tell us so much to do our best as it does to refrain from doing our worst. However, as Box 1-1 indicates, one state has changed this ancient rule.

Likewise, law and justice overlap frequently, but not always. It is unjust to punish a man for an act that was not illegal when he committed it, and the law prohibits the government from doing so. But a law that imposes a penalty of ten years' imprisonment on a starving man who stole a shopping cart full of groceries may be woefully unjust, yet it is nevertheless the law. Legislatures enact many laws that someone thinks are unjust, and courts do not invalidate laws or refuse to enforce them simply because one or more people demonstrate that they are harsh or unfair as applied.

The Language of Law

The law is frequently couched in obscure terms, jargon, and mystifying phraseology. Lawyers like to claim that this is because they write precisely, that their special words are required in order to state exactly the necessary qualifications, exceptions, and distinctions that make up so complex a subject as the law. In part this is true. Every discipline has its special language,
Box 1-1 A Statutory Duty to Act

Minnesota Law Mandates Bystander Help in Crises

ST. PAUL, Aug. 2 (AP)—Being a “Good Samaritan” is now a duty, not an option, in Minnesota, where a new provision in state statutes provides up to a $100 fine for people who fail to aid in anemergency.

The amendment to an older law went into effect Monday. It is designed to prevent incidents such as one last week in St. Louis, where a 13-year-old girl was raped over 40 minutes by two youths as several people stood by. Police finally were summoned by an 11-year-old boy.

Previously, an expert lifeguard “could watch a 6-month-old baby crawl into the river and drown and sit by and do nothing about it and nothing would happen,” said State Representative Randy Staten, an author of the measure. “That is totally unacceptable conduct for civilized society.”

Many states have “Good Samaritan” laws that relieve a person of liability when they render aid in an emergency. The amendment to Minnesota’s law goes a step further by making it a duty to assist.

Linda Close, division manager of public safety and litigation in the Minnesota Attorney General’s office, said the amended statute “creates a duty to help somebody if a person is exposed to ‘grave physical harm.’”

Mr. Staten, a Minneapolis Democrat, says he believes the statute is the first of its kind in the country, and he said officials from other states appear interested in enacting similar laws. The amendment was prompted by incidents far from Minnesota, he said, citing the rape of a woman on a pool table in New Bedford, Mass., as a group of people watched, and the Kitty Genovese case of many years ago, in which the Queens, N.Y., woman was fatally stabbed as people watched from apartment windows.


and much of it is useful to the initiate. And the language of American law—a curious mixture of Old English, Old French, and a little Latin—is a lot less mystifying, a lot less given to archaisms, than it was even a few decades ago.

Nevertheless, mystifying words continue to abound. Lawyers’ prose is often bad. The student who reads through judicial opinions and lawyers’ briefs will find much to satisfy a taste for fuzziness. One reason is that, contrary to the usual assertion, the language of law is not so precise. Another is that words are beguiling; unfamiliar words that seem to have a fixed meaning can seduce the lazy or unwary into believing they say more than they do.

One reason for this is that much law is the product of political compromise. Legislators can be cajoled into backing each other’s bills if the bills contain language ambiguous enough to let each side suppose it is securing what it wants. In addition, no rule can possibly anticipate every possible set of circumstances. Therefore, lawmakers must resort in most instances to language that is inherently fuzzy: “deceptive,” “unreasonable,” and “substantial.”
Even words that seem to have a fixed meaning can be shown, on close inspection, to be susceptible to varying interpretations. Suppose that you are a legislator who wants to punish those who use guns and other weapons during the commission of a crime. You could specify each type of weapon of which you disapprove: handguns, rifles, shotguns, machine guns, bazookas, and so on. Since it is easy to omit a type you wished to include, you would probably add a phrase such as "and other dangerous weapons." But what is a weapon? Is a stick a weapon? A heavy-duty flashlight? It depends on why you were carrying the item and to what use it was put. No definitive list can be given.

Ultimately, any attempt to define with precision conduct that is to be outlawed must fail. A society in which all rules were absolute, stated without room for maneuver, would be an intolerable place to live for any who value freedom because the rules would almost invariably be overinclusive and restrictive. As Judge Jerome Frank noted in *Law and the Modern Mind* (1963, p. 7), "Much of the uncertainty of law is not an unfortunate accident: it is of immense social value."

Nevertheless, the uncertainty that arises through sheer linguistic sloppiness and unconscious semantic confusion is not of immense social value; to the contrary, it is of no value. Beginning in the late 1970s, a move to overcome the purely linguistic mystification of law gathered some steam. This is the "plain English" movement. Under an executive order of President Jimmy Carter in 1977, federal regulators were required to draft rules and regulations in simple English. Some simplification has resulted, though far from enough. Beginning with New York, a few states at the same time began to pass laws requiring contracts with consumers—insurance policies and leases, for example—to be written in straightforward language.

**Classification of Types of Law**

Because the "law" has so many different connotations, there is no one way to classify the different types of law. What follows is a simple fourfold classification scheme that presents law along its major dimensions: substantive, jurisdictional, governmental type, and procedural.

**The Major Types of Substantive Law**

Substantive law deals with the different ways people interact. On a family tree of law the broadest "kingdoms" are criminal and civil law. These are substantive branches of law because they deal with human conduct. **Criminal law** (Chapter 7) is that body of law that deals with violations of public order, including violent crimes (such as murder, rape, assault, and robbery), crimes against property (larceny, embezzlement), and crimes consisting of infractions of regulatory codes (income tax fraud, securities fraud, and the like). Penalties for violation of the criminal law include death,
imprisonment, and monetary fines. Serious crimes, usually those punisha-
ble by imprisonment of more than one year, are called felonies; less serious
crimes are misdemeanors.

**Civil law** governs the private relations among individuals. It might also
be defined as all branches of the law not included within the criminal law.
(“Civil” has a different connotation in legal systems outside the Anglo-
American tradition—in those countries, the civil law refers to codes en-
acted by the national legislatures.

Civil law can be divided into two main branches. One is public law—
for example, constitutional law (pp. 15–23 and Chapter 2) and adminis-
trative law (Chapter 5)—so called because this branch (along with criminal
law) deals with the relations between government and private citizens and
organizations. The most significant development in twentieth-century
American law is the growth of administrative or regulatory law. Examples
in this category include labor law—the relations between unions, their
members, and their employers (Chapter 15); antitrust law—the appropriate
form of competition (Chapters 19–20); securities law—the code governing
trading in corporate stocks (Chapter 18); and tax law—how the govern-
ment raises money to pay for its activities.

The other principal branch is private law, which is the set of laws that
spell out the duties, obligations, and responsibilities that individuals and
organizations owe to each other. Within the sphere of private law are the
following:

**Tort Law** The word “tort” derives from Old French, meaning a wrong or
injustice, substantially the connotation it carries today. Tort law spells out
the duties of care that one person owes to another. Many intentional torts
are also crimes: murder, assault, rape, and robbery are torts, and the victim
or family can legally sue to recover damages. Other torts include false im-
prisonment (akin to kidnapping), trespass on property, theft (including the
stealing of business, known as unfair competition), defamation of character,
invasion of privacy—indeed, most acts that you would consider injurious
to another are probably torts. A tort need not be intentional. The biggest
class of tort lawsuits today—automobile accident litigation—involves neg-
ligent, or careless, actions that harm another. (Another type of negligent
tort is the malpractice action against a doctor or other professional.) During
the 1970s, a third type of tort involving neither intentional nor negligent
conduct—strict liability—began to gain ground in the courts as a means of
redressing injuries resulting from all sorts of defective products. Unlike
criminal law, which serves at least in part to punish the wrongdoer, tort
law serves to compensate the victim. We will consider tort law in more
detail in Chapters 9 and 10.

**Contract Law** Tort law spells out the rights that individuals have to re-
main unharmed by wrongful acts of others. It is the law that creates the
duty to refrain from wrongful conduct. But people may also create their
own sets of obligations toward each other by entering into contracts. A
contract may impose upon an individual a liability that he would not oth-
erwise legally have. Sometimes a contract can relieve an individual from a
liability that he would have under tort law. Contract law is discussed in
Chapter 8.

**Property Law** A third category of private law is that which deals with
property. In a narrow sense, the law of property deals with land and build-

ings (called *real property*) and personal possessions (called *personal prop-

erty*). The law of real property concerns the rights of buyers, sellers, lessors,
and lessees of land, houses, and other buildings (Chapter 23). The law of
personal property deals with a range of issues that arise from the way we
use our belongings—for example, the temporary possession of an auto-
mobile by a parking garage (bailment), the way we give control of money
or other assets to family members or others (trusts), how we dispose of
property after a death (wills and estates), and how we protect the fruits of
an invention (patent, trademark, and copyright, Chapter 24).

In a broader sense, property law deals with a host of issues that are also
affected by other types of law. It is usually closely bound up with contract
law, because much of what we contract about has to do with property.
Control and operation of the myriad organizations that make up modern
industrial life are steeped in property law but also are intimately bound up
in law that developed specifically for this purpose; these include *agency,
partnership*, and *corporation law*.

**Agency Law** Agency law treats the relations among individuals who un-
dertake to act on behalf of others—employees, agents, corporate officers,
and the like. Without agency law, no industrial life would be possible. We
study it in Part Four.

**Partnership and Corporation Law** The predominant forms of business
enterprise are the partnership and the corporation. Each is governed by a
complex set of laws that we study separately in Part Five.

**Jurisdictional Classification: Federal, State, Local, and International**

Law, as we use the term, is not a monolith. It does not spring whole from
a single source, like the pronouncements of some autocratic king. Modern
law is a complex affair that comes from a variety of political entities, de-

defined both geographically and institutionally.

Geographically, law comes from several types of "jurisdictions"—that
is, governments. In the United States, with its complex form of federal-

ism, there are three types of government: federal, state, and local. The first
two are semi-sovereign; the last, local government, is dependent on the
other two.
Federal Law  The federal government is the national government, with the power to make law for the country as a whole, though its lawmaking power does not extend to everything over which government is capable of making law. The federal government consists of Congress, which functions as the national legislature; the executive branch, headed by the president and including governmental departments and administrative agencies; and the federal courts, or judicial branch. Within its sphere, federal law is superior to that of state and local law.

State Law  The second semi-sovereign form of government is that of state government. The states also have legislative, executive, and judicial branches. Their legal power does not spring from the federal government but is rooted independently in the Constitution. Both federal and state governments are said to be “semi-sovereign” because, despite the persistence of the myth, there simply is no such thing as sovereignty in the United States—no law need forever be so, no person or institution is supreme. In our system of checks and balances, there is always a means of challenging law and political action.

Local Law  The third form of government is not, however, even semi-sovereign. This is local government: cities, towns, villages, counties, and other political districts within the states. The powers of these governments are delegated by the states and may be modified, limited, or removed by the states. To the extent that it is authorized to do so, local government also creates law (in the form of municipal ordinances and regulations).

International Law  This law is created by international organizations, by the customs and practices that prevail among nations, and by agreement. However, to the extent that international law is applicable within the United States, it is so generally because the nation has entered into treaties with other countries and the treaties are enforceable as part of federal law.

Law Classified by Governmental Branch Creating It

For historical as well as legal reasons, there are differences between law that comes from a legislature and law that emanates from other governmental bodies. Implicit in much of the discussion in this book is the relationship between the courts and the other branches and how that relationship affects the meaning and enforcement of law.

Statutes  A law enacted by a legislature is called a statute. It is written and published in various forms.

Regulations  Laws emanating from the executive branch—the source of administrative law—are called regulations or rules; they too are written and
published. The executive branch generally derives its power to promulgate regulations and rules from the legislature. Neither statutes nor regulations stand alone. They must often be interpreted by the courts. A judicial gloss on a statute or regulation rendered in the course of a lawsuit is in effect the meaning of the statute or regulation. In most cases, members of the legislature or executive agency can always amend the statute or regulation after the court has ruled, if they are dissatisfied with the court's interpretation. The amendment will then apply to future cases.

Common Law

The courts also produce a third kind of law, known as the common law or unwritten law. "Unwritten" is a misnomer: in fact, the common law has always been written down more or less, in the reports of the courts' decisions in individual cases. The vast body of judicial opinions constitutes the written record of the common law. Shortly, we will explore in some detail the authority of the courts to fashion the common law. For now it is enough to note that the authority is not a delegated one; it is inherent and assigned by the Constitution to the judiciary. The common law is not the exclusive province of the courts, however. The legislature may intrude and enact legislation modifying or even abolishing common law rules laid down by courts. The courts in turn have the authority to interpret the statutes that do so.

Substantive vs. Procedural Law

Still another way to classify law is by the person, group, organization, or institution to which it is addressed. Law addressed to actions and relationships among people is substantive law. Law that structures government by laying down procedures on how it must act—especially that which relates to the courts themselves—is known as procedural law or adjective law. For the most part, we will be concerned with that part of procedural law that shapes the legal-judicial process: how lawsuits begin and move through the courts. Every court system has its own rules of procedure, and there are often significant differences in procedure among different courts within the same system. Thus, the Federal Rules of Civil Procedure, promulgated by the Supreme Court and approved by Congress, apply to all federal courts. But each local federal court has its own set of supplementary rules with which lawyers—but not their clients—must be familiar.

Sources of Law

However law is defined and classified, it is a product of human institutions. At different times, different institutions—legislatures, courts, regulatory bodies, ad hoc conventions—create or shape laws that have varying imports and impacts on the population. Amid all this lawmaking, there are four general sources of law.
Constitutional Law

The United States Constitution is the supreme law of the land. No other law takes precedence over it, and any law that is inconsistent with it is invalid and void. In legal theory, the Constitution derives from “the people,” though of necessity it was drafted by a committee of the people—those who attended the Constitutional Convention of 1787—and ratified by the people through special conventions in each state called for that purpose. We examine the Constitution in more detail later.

Although the federal Constitution is supreme, it is not the only constitution. Each state has its own. State constitutions play precisely the same role within the state that the federal Constitution plays nationally. Cities and certain other forms of municipal government have “charters” granted by the states. These charters are akin to constitutions for the municipalities.

Statutes

Statutes—the enactments of legislatures—have become our most fertile source of law during the twentieth century. Congress, the state legislatures, and city councils (whose ordinances are akin to statutes) have legislated on virtually every imaginable subject, including the conduct of war, the structure of government, national price controls, environmental protection, economic relations, retirement benefits, civil rights, rent control—the list is endless.

In general, there are four types of statutes. A legislature may declare a particular act or type of conduct to be unlawful and subject to severe sanctions, such as imprisonment and substantial fines. Such statutes fall within the criminal law. A statute may establish standards for judging conduct or spelling out relations between individuals and groups. For example, the legislature may decide that in automobile accident lawsuits, the negligence of the defendant must be weighed against that of the plaintiff. Such statutes fall within the realm of civil law. Or a statute may establish a governmental body or restructure an existing one and delegate to it the power to promulgate specific rules for the regulation of an industry or type of activity. Frequently, all three types of enactment are combined within a single statute—for example, environmental-protection statutes prescribe standards that people and companies must follow, permit certain classes of people to sue civilly if the standards are not followed, prescribe criminal penalties for some violations, and grant existing and new agencies the power to police the environment. The fourth type of statute is that which raises tax revenues and spends the public monies.

Administrative Law

As we have seen, administrative agencies of the executive branch of the federal and state governments promulgate rules and regulations, pursuant
to power delegated by the legislatures. From at least the middle of this century, administrative law has probably been the most voluminous. Unless the agencies go beyond the scope of the power delegated to them, the rules they announce have the full force of law and are entitled to equal weight with statutes when the courts are called upon to enforce them.

Unwritten Law: The Common Law

The Constitution, statutes, and administrative law are all "written." The exact text of the rules can be consulted because they have all been published and are more or less easily accessible. But there is a vast body of law that has been called "unwritten" because it is not embodied in statutes and regulations. As we have noted, this is the common law, the body of law that emanates from courts. To understand why there is common law, let us consider three basic functions that courts perform.

The first function is "fact-finding." Did the accused kill the victim, as charged by the prosecutor? Did the defendant promise to complete construction on the plaintiff's house by June 30? The courts sift lies from truth and attempt to sort through the ambiguities. Someone has to perform this critical function; the courts, with their elaborate procedural protections for the claimants who appear before them, do so.

The second function is "law-applying." Suppose the plaintiff, a wholesale buyer of canned tomatoes, claims that a statute gives him the right to return a defective shipload to the seller. The seller retorts that the plaintiff's interpretation of the statute is incorrect and demands the purchase price. The court must decide what the statute means and whether it applies in the circumstances of the case before it.

In most cases, both fact-finding and law-applying are required. When there is a jury, it will be responsible not only for determining what the true state of affairs was but also for applying the law to the facts. It does this by following the judge's instructions on the law. After most jury verdicts, the case is at an end. The result is a decision for one side or the other, without elaboration of the reasons. But when there is no jury, or when a case is appealed to a higher court, there will usually be a written opinion by the judge. This opinion will often be published and will usually contain a statement about the meaning of the statute in question. This opinion is significant, because it too is a source of law.

By placing its own interpretation on the literal language of a statute, the court is adding something to the law and saddling it with a meaning for the future—unless the legislature chooses to amend the statute in view of the court's decision. Those who would "look up" a statute should be wary: rarely can anyone know what the law means simply by perusing the language in the statute books, because anywhere from a handful to hundreds of published judicial opinions may interpret a particular statutory provision. These decisions cannot be disregarded, for in future cases judges will look to them as precedents to be followed.
The third type of judicial function does not involve a statute: it involves deciding whether a plaintiff’s common law rights have been violated. As noted earlier, the common law is a body of legal principles enunciated by courts in the absence of statute during the past several centuries. It is not written in the statutory sense because each principle, with its corollaries and exceptions, is not set forth in one place. Rather, each principle is stated, often in lengthy prose, in judicial opinions discussing a particular case.

Where do these principles come from? The debate has been long, learned, and unending. Some say they come from God, others from reason. Still others suppose that the principles derive from the “character of the people.” It seems rather more likely that the common law is a tapestry woven from age-old customs, modified by experience and new conditions, and tempered by the dictates of reason and the promptings of moral concern—and sometimes by the biases and prejudices of judges, who, after all, are the oracles of the common law.

In short, judges make law. They have made most of tort law and contract law, although large portions of contract law have been superseded by the Uniform Commercial Code and other statutes. Many rules embodied in statutes are simply articulations of common law principles. Equally important, the rules that courts use to guide them in interpreting statutes are common law rules. Inherent in the judicial power of the courts is the power to determine how to interpret.

Because the courts over the years have written millions of opinions, the search for common law principles in library stacks would be arduous. To overcome this difficulty, and to help bring order and rationality to the many conflicting decisions (for judges frequently disagree with each other), a group of lawyers and academicians—members of a private group called the American Law Institute—sat down in the 1920s to write what has become a series of “Restatements.” The first was the *Restatement of the Law of Contracts*, published in 1932 after years of drafting and redrafting. Work began on its successor, *Restatement (Second) of Contracts*, in 1964; it was finally completed and published in 1981. Other Restatements include those on torts, agency law, remedies, and trusts.

The Restatements are not the law. They are statements of the law, in statutelike form, written by private citizens. But they have been extremely influential in helping to spark debate and to shape the law. They are frequently cited by judges in their opinions, and we will encounter their provisions frequently in this book.

**Purposes of the U.S. Constitution**

“The American Constitution is the most wonderful work ever struck off at a given time by the brain and purpose of man,” British Prime Minister William Ewart Gladstone is reputed to have said, and so it very well might be. It is short, readable, and durable. Its seven articles and the Bill of
Rights, as supplemented by sixteen other amendments, have endured for nearly two centuries, making it the oldest living written constitution in the world.

The Constitution performs two fundamental legal tasks: it structures the government, and it imposes limitations on the government's power to act.

The Structure of the Government

Articles I, II, and III of the Constitution set forth the structure and powers of the three branches of the federal government, as well as methods of electing or appointing officials to offices within these branches.

The first article, reflecting the Founding Fathers' belief in its paramountcy, deals with Congress, the national legislature. To Congress are given "all legislative powers herein granted." Among other powers, Congress has the authority to regulate money, enact uniform bankruptcy laws, borrow on the credit of the United States, regulate interstate and foreign commerce, and "make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof." Not surprisingly, this "necessary and proper" clause has been called the "elastic clause."

The second article of the Constitution vests the "executive power" in the president, spells out certain functions the chief executive must perform, and enumerates a few specific roles he must play (for example, commander in chief of the military).

The third article vests "the judicial power" in the Supreme Court and "in such inferior courts as the Congress may from time to time ordain and establish."

In vesting the legislative, executive, and judicial powers in separate branches of government, the makers of the Constitution gave the most precise expression ever made of the principle of "separation of powers." The theory, derived from the writings of the French social philosopher Baron de Montesquieu, is that freedom can be preserved by separating the types of governmental authority among the branches of government, which will check and balance each other, preventing any one branch from becoming too strong. It is noteworthy that the Constitution does not define "legislative," "executive," or "judicial" power. We could say that the legislative power is the power to make law, the executive power the power to carry it out, and the judicial power the power to decide cases arising under the laws. But that is too simple a view. The fact is that the powers overlap. Each branch has influence over the others. The president can veto congressional enactments and appoint judges. Congress can create executive departments. The courts can, in effect, make laws through statutory interpretation. Nor is it easy to see how it could be otherwise. But this fact
makes the statement and understanding of law difficult because the law is subject to so many pressures and changes from so many directions. The fourth article of the Constitution deals briefly with the states. It does not create the states; it accepts them as given. Under the terms of this article, each state must give “full faith and credit” to the “public acts, records, and judicial proceedings” in all the other states.

The fifth article deals with methods of amending the Constitution. The sixth article embodies the Supremacy Clause, stated here in full: “The Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” This critical clause establishes a hierarchy of law and permits some order to be fashioned out of a republic in which dual jurisdictions frequently clash.

The seventh article provided for the ratification of the Constitution and is no longer operative.

Since 1789, when these original seven articles became effective, twenty-six amendments have been adopted. The first ten, the Bill of Rights, were adopted in 1791, in response to cries during the ratification debate that the articles insufficiently protected individual freedom. Most others deal with the structure of government, specifically concerning the right to vote and election of the president. The Thirteenth Amendment abolished slavery. The Sixteenth gave Congress the power to enact an income tax. The Eighteenth—Prohibition—was repealed by the Twenty-first. Of all the subsequent amendments, only the Fourteenth has had an immense legal as well as political impact on the nation, as will be explored later in this chapter.

Constitutional Limitations

In the United States, government is not sovereign; in legal theory the people are. The Constitution establishes several important limitations on the powers of government, both federal and state, to enact and enforce laws that would interfere with individual liberty.

Article I prohibits both federal and state governments from enacting any “bills of attainder” or “ex post facto” laws. A bill of attainder is a statute that imposes a penalty on a named individual. It is a means that was exercised by British monarchs to avoid trial and was universally condemned. An ex post facto law is one outlawing a particular act already performed. It too was a means of jailing persons whom the government disliked, and was likewise condemned. (A retroactive tax law, changing the tax rates or imposing new taxes on income, sales, or other activities that have already taken place, is not considered ex post facto and is not barred by the Constitution.) Article I also prohibits the federal and state governments from
preferring one port of entry to another. Interstate shipments of goods are not subject to import duties, nor are foreign imports or exports subject to duties by the states. Finally, the states—but not the federal government—are prohibited from “impairing the obligation of contracts.”

Article VI prohibits any religious test from being administered to any official of the federal or state governments.

The remainder of the significant limitations on government appear in the Bill of Rights and the Fourteenth Amendment. Most of these limitations are concerned with rights of the accused in criminal trials and are explored in Chapter 7. The rest—the “preferred freedoms” of the First Amendment and the important principles of due process and equal protection of the law—we consider shortly.

Judicial Review

Before turning to these critical constitutional rights, it will be useful to consider the mechanisms by which they are secured to us as individuals. The Constitution is, after all, but a piece of paper, preserved in chemicals and under glass at the National Archives in Washington, D.C. Suppose Congress enacts a law that conflicts with a provision in the Constitution. What then?

The short answer is that we possess the right to challenge actions of the government in lawsuits—either by raising constitutional objections if we are defendants or by pleading constitutional rights as plaintiffs. If the courts conclude that the constitutional provision and the statute conflict, they are required to invalidate the statute and give priority to the Constitution. This authority is known as judicial review, and it distinguishes the legal system of the United States from that of every other nation in the world. Through its power to review, the U.S. Supreme Court becomes embroiled to an extent unknown by courts outside the United States in the most difficult and delicate questions of public policy. As Alexis de Tocqueville noted in a celebrated line in his Democracy in America (1835): “There is hardly a political question in the United States which does not sooner or later turn into a judicial one.”

How the federal courts, and the Supreme Court in particular, came to claim and use this power is an oft-told tale, but one that bears repeating. In 1800, John Adams, a Federalist and advocate of strong central government, was defeated for reelection by Thomas Jefferson, an anti-Federalist whose sympathy lay toward local government. In January 1801, when the Chief Justice’s seat on the Supreme Court opened up, President Adams appointed John Marshall, then secretary of state, and the Federalist Senate promptly confirmed him. Five days before the end of Adams’s term,
Congress rushed through a bill creating judgeships in the District of Columbia, and Adams appointed forty-two justices of the peace. The Senate confirmed the nominees on Adams's last day of office. Commissioning papers needed to be signed by the President to make their appointments official, and so into the evening Adams signed the documents (thus the term "midnight judges"). In the rush, four commissions were never dispatched. Thomas Jefferson found them the next day and forbade them to be delivered.

One of the disappointed men, William Marbury, went to the Supreme Court in December 1801 and filed suit, asserting that he was entitled to his office. He sought a writ of mandamus, a judicial order directing a government official to take a specific action—in this case, an order to James Madison, then secretary of state, to hand over the commission to Marbury.

The Supreme Court's answer in the case of Marbury v. Madison, in an opinion by Chief Justice Marshall, was a bombshell and remains both the classic statement of the principle of judicial review and the classic example of judicial statesmanship. Marshall said that three questions had been raised. (1) Did Marbury have a right to the judicial commission he demanded? (2) If Marbury had a right to it and that right was violated, did the laws of the United States afford him a remedy? (3) If they did afford him a remedy, was it by a "mandamus issuing from the Supreme Court"?

The first two questions Marshall answered in the affirmative: (1) Marbury had been properly nominated and confirmed by the Senate, and nothing more was necessary to make Marbury a judge. (2) "The very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws, whenever he receives an injury." The law required Madison to deliver the commission, and officers of the government are bound by the law. The proper method of compelling a government official to obey the law is by a writ of mandamus.

The third question, however, Marshall answered in the negative. Marbury had a legal remedy, but the Supreme Court could not constitutionally provide it. The Judiciary Act of 1789 authorized the Supreme Court to issue writs of mandamus "in cases warranted by the principles and usages of law . . . to persons holding office under the authority of the United States." That law certainly would permit the Court to mandamus Madison, unless the law itself was invalid. The problem, Marshall said, was that Article III of the Constitution did not give the Supreme Court original jurisdiction over such a case. That is, in all but a rare category of cases the Constitution prohibits the Supreme Court from conducting trials, determining the facts, and applying the law to them; it can only hear appeals from trials conducted by lower courts. This prohibition certainly applied to Marbury's case. Yet here was Marbury appearing before the Supreme Court, asking it to hold a trial and issue a remedy. This, Marshall said, the Supreme Court could not do. Marbury would have to find another court to issue the writ of mandamus.