

1.4 Importance of Rule of Law to Business

LEARNING OBJECTIVES

1. Determine why the rule of law is important to business.
2. Identify several areas of law that are especially relevant to business and the importance of the rule of law to those areas.
3. Identify how the rule of law limits government.
4. Identify how the rule of law protects people from harmful business practices.

As you may have guessed by now, the rule of law is important to business. Can you imagine trying to do business without being able to have any reasonable expectations of other people's behavior? Would you be willing to conduct business if you had no legal means by which to protect your property interests? And in the case of a dispute, without a rule of law system, there would be no established way of resolving it. Without the rule of law, business would be chaotic. This section provides some overarching examples of why the rule of law is important to business.

Before getting to those examples, imagine this: What if you did not know how to play chess, but you tried to play anyhow? You would probably become frustrated very quickly, because you would see no logic in the movement of your opponent's pieces, and you would not be permitted to move some pieces like you might wish to. Sometimes you would see your opponent move his or her knight two spaces in one direction and then one space in another. Other times, you would see your opponent move his or her bishop diagonally. Moreover, you would not understand what you were and were not permitted to do. You would also not know how to penalize an opponent who moved his or her pieces incorrectly to gain advantage or to take something of yours. This is analogous to what it's like to do business without understanding the rules of the game.

The rule of law establishes rules that people—and businesses—must follow to avoid being penalized. The rule of law not only allows people to understand what is expected of them in their personal capacities but also sets forth rules for businesses so that they, too, know what is expected of them in their dealings and transactions. In addition, it restrains government and others from infringing on



property rights. Should disputes arise, the rule of law provides a peaceful and predictable means by which those disputes can be resolved.

The rule of law provides guidance and direction in every area of business. For example, it provides a means to bring a complaint against another party to a neutral decision maker so that a decision can be made regarding the dispute. Because of our rule of law system, we know that we are permitted to file a complaint in the proper court to commence litigation. Or we can try an alternative method of dispute resolution if we do not wish to engage in litigation. We know that we are permitted to do these things because our rule of law system allows us to do them. Moreover, we can expect some sort of resolution when we institute such a proceeding. This expectation is reasonable only because we have a rule of law.

Additionally, in the United States, the rule of law provides a sophisticated system of federalism, where state and federal laws coexist. This allows people and businesses to determine which system of government pertains to them and which jurisdiction they belong to. Imagine that you sell firearms in a retail capacity. You would be subject to both state and federal laws. You would be required to carry a federal permit from the federal administrative agency known as the Bureau of Alcohol, Tobacco, Firearms, and Explosives. You would be forbidden from engaging in illegal arms trading. According to state laws, you would likely have to ensure that each purchaser of a firearm held a valid permit for a firearm. You would be required to check identification, enforce waiting periods, and refuse to sell guns to people who were not permitted to carry them according to your state's laws. If we did not have a rule of law system, you might be uncertain how to conduct your business, and you would be subject to arbitrary enforcement of unstated or ex post facto (retroactive) laws that affected your business.

The rule of law also governs contracts between people and between merchants. Under the common law system, certain elements of a contract must exist for the contract to be enforceable. Under the Uniform Commercial Code (UCC), merchants are governed by a separate set of rules that anticipate and allow for flexibility in contractual terms, to facilitate business needs. In the event that terms conflict in an offer and acceptance between merchants, the UCC allows "gap fillers" to complete the terms of the contract without need for the contract to be rewritten or for formal dispute resolution.



Moreover, businesses rely on the rule of law to help them enforce contracts against contractors who fail to perform.

Additionally, because we have a rule of law system, employers know the rules of the game regarding their relationship to employees, and employees know the rules with respect to their obligations to employers. Likewise, business partners, members of boards of corporations, and members of limited liability companies all know what is expected of them in their roles vis-à-vis the business and other people within their organizations. When someone does something that is not permitted, there is legal recourse.

The rule of law also provides protection for property. Imagine if we did not have protection for nontangible property, such as intellectual property like trade secrets, trademarks, or copyrights. It would be very difficult to protect this type of property if we did not know the rules of the game. People would not have the incentive to create or share new intellectual property if they had no reasonable expectation of being able to protect it or of being rewarded for their creations. Likewise, the rule of law allows us to protect tangible property without having to go to extraordinary measures. For instance, if we had no rule of law system to convey and maintain legal ownership to us for our real or personal property, we might be forced to hire expensive private security forces to guard our property when we could not be there to physically protect it ourselves.

Businesses also rely on the rule of law to govern their debtor and creditor relationships. And, if financial matters do not go as anticipated, our legal system allows businesses to ask the court for protection from creditors under our bankruptcy law. This allows businesses to protect their property from creditor repossessions or foreclosures while they get back on track financially.

The rule of law also protects people from businesses. For example, Congress has enacted antitrust legislation that prevents certain anticompetitive practices, such as colluding and price fixing. Additionally, businesses are prohibited from using deceptive advertising and are held responsible when they manufacture or sell defective products that cause injury.

The rule of law also protects businesses from government. Since everyone is subject to the rule of law, this means that government itself may not overextend its reach when regulating or investigating



businesses. Government must play by the rules, too. For example, imagine that our government could do anything, without any limits or jurisdictional restraints. A business operating in such a climate might find itself subject to government closure on a whim, or excessive taxes, or requirements to pay bribes to gain permits to do business. Our rule of law system prevents such abuses.

Without a rule of law system, people would have to exact satisfaction for the wrongs committed against them on their own. They would have to physically protect their own property. This would lead to a breakdown in social structure, and it would result in vigilante justice and physical strength playing primary roles in dispute resolution.

KEY TAKEAWAYS

The rule of law system in the United States sets the rules of the game for doing business. It creates a stable environment where plans can be made, property can be protected, expectations can exist, complaints can be made, and rights can be protected. Violation of the law can result in penalties. The rule of law protects business, protects consumers from harmful business practices, and limits government from engaging in abusive practices against businesses.

EXERCISES

1. Have you ever played a game in which you did not know all the rules? Have you ever tried to speak a language in which you weren't fluent? What was the outcome?
2. What incentive or motivation would exist to work for your employer if you were not certain that you would be paid for your efforts and your time? What incentive would you have to invent something new, create a work of art, or write a book if you had no legal expectation that you would be able to protect your creation?
3. Imagine that you are an entrepreneur. What type of business would you open? Would you know what types of permits were required to conduct your business and which government entities had jurisdiction over your business? If not, how could you find out?
4. What would business be like in a land without any rule of law system? Be specific.



1.5 How Law Affects Business Disciplines

LEARNING OBJECTIVES

1. Identify the relevance of law to business disciplines.
2. Understand the relevance of law to the study of business.
3. Identify how the rule of law protects people from harmful business practices.

Foundational courses taken by undergraduate business students usually include accounting, finance, management, and marketing. An understanding of the legal environment of business is relevant—indeed, essential—to functioning well within each of those disciplines. Additionally, a solid understanding of the legal environment can help avoid liability or at least minimize risk. In business, it is not enough to comport yourself and your business ethically. You must also ensure that you understand the legal environment in which you are working. Therefore, it is important to you, to your employer, and to all the other people who may be relying on your business expertise—such as your employees and your family—to understand the legal environment. Such an understanding will help you avoid or lessen the likelihood of liability exposure, enabling you to manage your business affairs successfully, unhampered by unmanaged legal liability risks. This section provides some examples of how law affects specific business disciplines.

During the last several years, accountants have been in the limelight due to culpable behavior of some members of the profession during well-known business scandals, such as Enron. Largely as a result of the fallout from the Enron case, Congress passed the Sarbanes-Oxley Act (SOX) of 2002, which imposed stringent oversight requirements on accounting and auditing firms. The requirements seek to ensure competence, compliance with security laws, and conduct consistent with generally accepted accounting principles.

Of course, the Enron scandal and SOX were both fairly dramatic examples of how law can affect accounting. Other ways in which law affects this discipline are through regulation. For example, the U.S. Securities and Exchange Commission's (SEC) mission is to protect investors and to maintain a fair market, among other things. Accordingly, the SEC enforces accounting and auditing policies to



allow investors to make decisions based on accurate information. The SEC pursues charges of accounting fraud and oversees private regulation of the accounting profession.

The law also affects finance. Like accounting professionals, many who work in finance are also regulated by the SEC. The SEC is concerned that investors receive accurate information to make investment decisions. Moreover, the SEC enforces prohibitions against insider trading and pursues claims of other types of securities fraud, such as Ponzi schemes.

Similarly, several statutes protect consumers in financial transactions. For example, the Truth in Lending Act (TILA) requires lenders to accurately provide information concerning the costs involved in offers of credit. TILA and its corresponding Regulation Z are administered by federal banking agencies.

Law also affects those in management. For instance, knowledge of employment law is essential to those in human resources. Title VII of the Civil Rights Act prohibits discrimination related to protected characteristics in hiring and employment practices. Those in management also must be aware of the potential liability that demands on employees might create. For example, in Oregon, McDonald's was found to be liable for injuries resulting when an off-duty, off-premises worker fell asleep while driving.^[1] The employee had worked three shifts during a twenty-four-hour period. The court held that employers have a duty to avoid conduct that creates a foreseeable risk of harm to others.

If your field is marketing, the law also relates to your work. Marketers must be particularly attuned to tort law, consumer protection law, and intellectual property law. For example, to avoid charges of libel, those in advertising need to take care not to defame another person, business, or product. It might be tempting to do so, especially if you were engaged in serious competition with another company that sold a similar product. Likewise, marketers must take great care not to engage in deceptive advertising practices, lest their employer run afoul of the Federal Trade Commission's (FTC) policies or the FTC Act. Additionally, marketers must be aware of other people's intellectual property to avoid copyright or trademark infringement in their own work product.



These are a few examples of how the law relates to specific business disciplines. Of course, this is just an overview. It is incumbent on each business professional to become familiar with the legal environment in his or her profession. Employers may provide training regarding legal environment issues, such as anti–sexual harassment training or anti–insider trading training, but ultimately, becoming familiar with the legal environment is each person’s individual responsibility. Remember that a defense of “I didn’t know the law!” is no defense at all.

KEY TAKEAWAYS

The law is relevant to every business discipline. Minimizing liability exposure is a primary concern of business, and an understanding of the legal environment relevant to each disciplinary perspective helps business practitioners minimize their risk of incurring liability to themselves or to their employers.

EXERCISES

1. Which business discipline is your favorite? Find a newspaper article that illustrates a legal problem pertaining to that discipline that could have been avoided with a better understanding of the legal environment of business.
2. How can employers use knowledge of the legal environment of business to minimize liability exposure? Identify three concrete ideas.
3. How can employers stay current with the legal environment of business? For example, how would other employers in Oregon find out about the case of the off-duty, off-premises worker mentioned in this section? If you were an employer in Oregon, how might this case change your business practices?
4. Do you think that if employers train their employees how to behave on the job, those employers should be absolved from legal liability resulting from employees’ actions? For example, imagine that an employer provides training to its employees regarding how to avoid sexual harassment in the workplace, but an employee ignores the training and sexually harasses a colleague. Should the employer bear liability in that situation? Why or why not?

[1] *Faverty v. McDonald’s*, 892 P.2d 703 (Or. Ct. App. 1995).

