

Legal, Ethical, & Social Environment  
BSAD 8010-001 Spring 2005

*note: a fuller set of Key Slides in Spring 2003  
note: an abbreviate set in Summer 2004*

Thursday nights  
with multiple punctuation changes  
Roskens Hall 214

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**NOTICE**

Each student is expected  
to **obtain** and to **sustain actual knowledge**  
of the contents of all of these slides.

Key Slides

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1

The law favors the **objective**  
(e.g., reasonable person)  
over the **subjective**  
(e.g., scienter).

To function as theorized,  
both USA law and Capitalism require  
transactions where the actions of all participants are  
both **knowing** and **voluntary**.

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**KNOWING** is critical  
to both the law and to economics.

Broadly, the law uses three levels of knowledge.  
Generically, all that is required is the  
lowest level of objective knowledge  
(i.e., **reason to know**).

However,  
to set a higher transaction cost and/or  
to increase liability for the actor, the law might  
require a higher level of objective knowledge  
(i.e., **receipt of notice**) or  
require the highest level, subjective knowledge  
(i.e., **actual knowledge** [e.g., scienter]).

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**CAPITALISM**

**ELEMENTS** (means) and **FUNCTIONS** (ends)

private property

embody self interest

prices

measure self interest

markets

coordinate self interest

competition  
and  
government

regulate self interest  
and  
facilitates  
p.p., p., m., & c.

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**NON-PRICE DETERMINANTS OF**

**SUPPLY**

# & size of sellers  
horizontally sum

costs for inputs

prices of related goods

substitutes (A or B)

compliments (A and B)

taxes

technology

expectations

**DEMAND**

# & size of buyers

horizontally sum

income

prices of related goods

substitutes (A or B)

compliments (A and B)

tastes

expectations

Expectations are volatile

(i.e., capable of fast and large changes).

Technology is dynamic (i.e., volatile network effect).

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The "**reasonable person**" is a legal fiction.  
The reasonable person is a **legal standard for behavior**.

An actor's behavior  
that fails to satisfy the reasonable person standard  
creates legal liability for the actor.

The law seeks to satisfy **reasonable expectations**  
based on what a reasonable person  
would have objectively known at the time of an action.

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Seeking to be **objective**, both contracts and evidence can be either express or implied.

When referring to contracts, **EXPRESS** contracts have all terms known by the parties'

**WORDS**

(oral  
or  
written);

**IMPLIED** contracts have all terms known by the parties'

acts,  
words, and/or  
circumstance.

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**Separation of Powers**, in order of importance and power, ranks the participants from top to bottom and from left to right.

**Individual v. Government**

**Federal v. State**

then within a government's three branches:  
**legislature v. executive v. judiciary**

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The function of the legislature is to **make** law, the function of the executive is to **enforce** the law, and the function of the judiciary is to **interpret** the law.

The USA has a **weak** separation of powers and Nebraska has a **strong** separation of powers between the branches.

**JUDICIAL REVIEW**

is the power of the judiciary to **declare unconstitutional** an act of any branch of government that is contrary to the *Constitution*.

Judicial Review is **implied** in the USA *Constitution* and **express** in most State constitutions.

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**The law (as a system) reacts to problems.**  
The law (as a system) can not anticipate.

The **legislature tends to react** when:

1. unequal bargaining power;
2. history of abuse; **and/or**
3. disparate impact.

Economics assumes anticipation (e.g., futures market).

Economics assumes **rational expectations**.

The law seeks to serve **the People's reasonable expectations**.

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Each State has the Police Power. The federal government has very little of the Police Power (*e.g., general welfare*).

A State's **POLICE POWER** is the power of the State to regulate to **protect the People's**  
**health,**  
**safety,**  
**morals,**  
and  
**general welfare.**

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All governments in the USA owe all legal persons in the USA the duty of procedural due process; but, private persons do not owe that duty.

**PROCEDURAL DUE PROCESS** is **notice** and **hearing**, with **both** the notice and the hearing **proportional** to the interest(s) involved.

Both the USA *Constitution's* 5<sup>th</sup> and 14<sup>th</sup> Amendments list the core interests as **life, liberty, and property**

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One of the federal government's greatest powers is the USA *Constitution* Art. I, sec. 8, cl. 3 **COMMERCE CLAUSE**.

Domestically, the Commerce Clause reads, Congress shall have the power ... to regulate commerce among the several States.

The Court's interpretation of the word among has varied materially.  
pre – 1937 direct Effect (i.e., result)  
on commerce between the several States

post- 1937 close and substantial Affect (i.e., cause)  
on commerce between the several States

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The law often uses triads for the purpose of analysis of lawful power. When doing so the law uses the word core to identify the greatest power, then penumbra to identify medium power, and emanation to identify the weakest power. In the context of the Commerce Clause it looks like the table below. Note, this method of analysis calls for identifying who has the discretion.

POWER	ANALOGY	COMMERCE APPLICATION
core powers	tree	transportation
penumbras	shadow	manufacturing
emanations	breeze	retail

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Federal preemption of a State's laws is NOT favored, but MAY be allowed IF:

1) clear intent (silence?) of Congress AND national interests outweigh State interests;

OR

2) express intent of Congress AND need for uniformity.

**CONCURRENT POWERS UNLESS DIRECT CONFLICT.**

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A plaintiff must have **STANDING TO SUE** the defendant. Standing to sue requires the plaintiff to have an **injury in fact** and to be **within zone of protected interests**.

In the USA, civil trials require proof at the level of the **preponderance of the evidence** (e.g., 50.1% sure).  
In the USA, criminal trials require proof at the level **beyond a reasonable doubt** (e.g., 99% sure).

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In a crime, the plaintiff is the State.

In a crime, the injured party is the State.

*The victim does not have standing to sue for a crime.*

The victim probably has standing to sue for a tort.

The elements of all crimes are:

1. bad deed, aka *actus rea*
2. bad thought, and aka *mens rea*
3. no defense.

Only the legislature has the power to create a crime.

A legislative attempt to create a crime is **void for vagueness**

if a reasonable person who did read the statute would not know what was prohibited.

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A trial court finds fact & applies law, while an appellate court: finds error & interprets law.

Upon appeal, the appellate court will **AFFIRM** the trial court **UNLESS** the appellate court finds  
1. clear error of fact by the trial court  
2. non-harmless error of procedure by the trial court, and/or  
3. any error of law by the trial court.

Because of the different burdens of proof, most non-harmless errors of procedure are in criminal trials. Persons ignorant of the separations of power and the law call them "technicalities".

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The law recognizes real property (*e.g. fixtures*) and personal property (*e.g., securities*), as well as tangible property (*e.g., goods*) and intangible property (*e.g., intellectual property*). Each form of property has its own array of rights.

If the defendant **interferes with reasonable use and enjoyment** of the plaintiff's real property, then the defendant has created a **nuisance**.

Governments in the USA have the power of **Eminent Domain**, which is the power of government to **take private property for a public purpose upon due process and upon payment of just compensation**.

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The four main forms of intellectual property are:

**PATENTS** protect **ideas** reduced to physical practice;  
**COPYRIGHTS** protect **expressions** of ideas;  
**TRADEMARKS** protect marks that **identify** a source of goods or services;  
**TRADE SECRETS** protect **commercially valuable generally unknown information**.

All knowledge starts in the **public domain**, a fraction of it always remains in the public domain during its capture as IP, and it always returns to the public domain.

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EXCLUSIVE **COPYRIGHTS** LIMITED BY:

**FAIR USE** (a major limitation),

1. **purpose** of copy (e.g., non-profit in-class educational use);
2. **nature** of the work (e.g., books get more protection than data);
3. **substantiality of the copying** (e.g., small portions versus whole); and (*but, in effect, an "and/or"*)
4. **effect on the market** (e.g., portion of the potential market for copies).

Fair use is part of the **public domain** during the duration of the copyright.

**Parody** is a constitutional right.

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ELEMENTS OF A **CONTRACT**

Agreement,  
Consideration,  
Capacity,  
Reality of Assent,  
Form, and  
Legal Subject Matter.

ELEMENTS OF **COMMON LAW FRAUD**

The defendant **knowingly and intentionally** misrepresents a **material fact** thereby inducing the plaintiff's **justifiable reliance** **AND** causing the plaintiff's **injury**.

**material** = big enough would have changed mind

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**Statute of Frauds**

**IF** a contract is for the

1. sale of "goods" of at least \$5,000,
2. sale of land,
3. **must** last more than one year,
4. guarantee debts of another, **OR**
5. in consideration of marriage;

**THEN** the contract must include a

**written memorandum of material terms**  
(i.e., **parties** (*one signature*),  
**consideration**,  
**time**, **AND**  
**subject matter**)

**with sufficient definiteness to support the court's enforcement.**

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An "agent" **acts for and acts instead of** the "principal"  
**when** the "agent" acts **within the "agent's" scope of authority.**

The "agent", legally, is **not acting personally**, rather, the "principal" is acting, and thus the "principal" is **vicariously liable**.

*But, ethically the "agent" always acts personally.*

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Every partner is **simultaneously a principal and an agent** for the other partners.

Absent an express agreement to the contrary, a the law imposes a presumed **equal division** of partnership **profit, management, and assets** on the partners.

**Any agreement between the partners that changes the presumptive equal division only binds the partners: it does not bind third parties (unless the third party consents).**

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The law uses three standards of **GOOD FAITH**.

**consumer** (*always a natural person*)

subjective: honesty in fact

objective: objectively know nothing

**merchant**

subjective: honesty in fact

objective: commercial reasonableness

**fiduciary** duty: aka **UTMOST GOOD FAITH**

subjective: honesty in fact

objective: personalized objective

but note: **new UCC** both consumer & merchant have both honesty in fact and commercial reasonableness

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#### GENERAL ELEMENTS OF ALL TYPES OF **TORTS**

1. **duty of care**,
2. **breach** of the duty,
3. **injury**,
4. **proximate cause**, and
5. **no defenses**.

**Proximate cause** is legal cause, *not factual cause*.

Proximate cause exists if, *at the time of defendant's breach*, a reasonable person would have **reasonably foreseen** the plaintiff's injury.

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The most powerful and generic defense in USA law is the **ASSUMPTION OF THE RISK** defense.

The defendant has a good defense of Assumption of the Risk if the **plaintiff knowingly AND voluntarily** exposes the plaintiff to the risk of the harm created by the defendant's breach of the duty of care.

**RISK CAN NOT BE ZERO.**

**Muda CAN NOT BE ZERO.**

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By statute, both the federal and the State governments make it both criminally and civilly actionable to **injury competition** or to **destroy competition** (e.g., antitrust laws).

The common law has long recognized as lawful some **Covenants not to Compete**.

A CntC is lawful if **ancillary** to the parties' **legitimate business interest(s)** (i.e., **reasonable time and area** [e.g., Nebraska: one year & one county]).

A CntC must be contract in Nebraska.

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The courts interpret the antitrust statutes using the **Rule of Reason**.

The Rule of Reason allows any restraint of trade that is **proportional** to the parties' **legitimate business interest(s)**.

There are four restraints of trade that **experience** teaches are **always disproportionate** to the parties' legitimate business interests, and thus are **Per Se Unreasonable**:

**price fixing**,  
**horizontal division of territories**,  
**group boycotts**, and  
**tying**.

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UCC (*i.e.*, *Uniform Commercial Code*) contracts are special contracts, and often UCC contracts replace the requirement of consideration with a requirement for **value**.

A **signature** is any mark with the current intent to authenticate the document.

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A **negotiable instrument** is a UCC contract that accepts all third parties.

The requirements of an instrument, must be **on the face** of the instrument:  
writing,  
**signed by maker or drawer**,  
**unconditional promise or order to pay**,  
**payable to order or bear**,  
**fixed amount of money**, and  
**on demand or a definite time**.

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A security agreement creates a security interest (*i.e.*, **attachment**) that establishes the creditor's ownership rights in the collateral.

**Priority** of creditor ownership rights goes first to creditors based on sequence of perfection, and second to creditors based on sequence of attachment.

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**Security Interest** can be created by a **written** agreement (*or by creditor possession*) (*signature of debtor*) that describes the collateral to **grant** and to allocate **ownership interests**, and debtor has rights to collateral.

**Perfection** of a security interest can be automatic (*e.g.*, *proceeds*) or by a **Financing Statement** that is **written** (*signature of debtor*) describes collateral to **put world on notice** and of potential claims to ownership, and provides the **names and addresses** of the debtor and the creditor.

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**Hierarchy of laws** and rules controlling corporations:  
USA Constitution  
USA laws  
USA regulations  
State's Constitution  
State laws  
State regulations  
Articles of Incorporation  
Corporate By Laws  
Board of Directors' Resolutions

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Corporations allow investors to limit personal liability to the amount of their investment. To **Pierce the Corporate Veil** is to impose unlimited personal liability on a shareholder or a director.

This suit always is in **equity** and often is a **derivative lawsuit**.

The Court of Equity will grant a suit to Pierce the Corporate Veil if the shareholders or directors used the corporate form to commit **fraud, illegality, or injustice**; **thinly capitalized** the corporation; **ignored the formalities** of the corporate form; and/or **commingled assets**.

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The **Business Judgment Rule** immunizes both Directors and officers, but to different degrees. Directors and officers are **not insurers**: they have no liability for **honest mistakes**.

The BJR requires the Directors and officers to use their **best judgment** to obtain **corporation's best interests**.

Directors and officers must have **no conflict of interests** with the corporation. To avoid conflicts, the **Directors** must **disclose and abstain**, while **officers** must **disclose and obtain approval**.

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The Business Judgment Rule requires the Directors and officers to make **informed decisions**, which means they **must seek out information**.

The decision must be made **within the scope of authority** and upon a **reasonable basis** using the care of **ordinarily prudent person** in a **like position and circumstances**

Accordingly, officers get less protection from the BJR because **officers objectively know more** than Directors.

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### SECURITY

is an investment of **money** in a **common** enterprise with a **reasonable expectation** of profit with profit derived from the undeniably **significant** (sole?) efforts of others.

### SECURITY LAW FRAUD

1. **MISREPRESENTATION OR OMISSION OF MATERIAL FACT** and
2. causing **INJURY**

**material** = reasonably prudent investor would wish to know beforehand

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*not on Memorization Exam, but on Final Exam*

### SHUT DOWN RULE

$$TR < VC$$

which is the same as

$$TR/Q < VC/Q$$

which is the same as

$$P < AVC$$

### DESTRUCTIVE COMPETITION

TR is persistently less than TC, but more than VC.

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