

APPENDIX C

Business Law, Regulation, and Taxation

LEARNING OBJECTIVES

1. Define and explain the differences between common law and statutory law and between public law and private law.
2. Discuss the federal and state court systems.
3. Define contract and list the requirements of a valid contract.
4. Explain what may happen if a contract is breached.
5. Discuss sales agreements and warranties and list the assumptions a buyer is entitled to make.
6. Explain how property law, laws relating to negotiable instruments, agency law, and bankruptcy law affect business.
7. List and briefly explain the major government regulations that encourage competition.
8. Explain the effects of deregulation on businesses.
9. List the various taxes imposed by federal and state governments on business.

INSIDE BUSINESS

Jenny Craig, Inc.: Fighting More Than Weight

Jenny and Sidney Craig opened their first weight-loss center in the United States in 1985. By the early 1990s, Jenny Craig, Inc. had over 700 company-owned or franchised weight-loss centers throughout this country as well as in Australia, New Zealand, Canada, Mexico, and Puerto Rico. By the mid-1990s, the company had plans to open an additional hundred centers to cater to the aging, health-conscious baby boomer generation. But plans became threatened because Jenny Craig, the corporation, found itself weighed down under the burden of investigations and lawsuits.

When the Federal Trade Commission began to probe into whether the advertising practices of weight-loss centers were deceptive, Jenny Craig—as well as Weight Watchers, Nutri/System, Diet Center, and Physician's Weight Loss Centers—asked the commission to issue industrywide standards. These requests were denied until the FTC concluded its investigation. Because of the publicity, former clients filed lawsuits claiming that Jenny Craig's diets caused health problems ranging from stomach disorders to gall bladder disease.

To make matters worse, the Jenny Craig organization was sued by disgruntled shareholders. The class action lawsuits claimed that Jenny Craig expanded too fast at shareholder expense. Shareholders argued that the value of their shares decreased and that dividend payments were suspended because of corporate overexpansion.

Then, as a result of another class action lawsuit, even the balance of corporate power came under investigation. The Jenny Craig organization employed 4,300 nationwide. Since 91 percent of those

employees were female, it raised the question of whether males were prevented from climbing the corporate ladder. Eight male former employees brought allegations of sex discrimination against Jenny Craig. They called themselves the “Boston Eight,” and hired a team of female attorneys to represent them in reverse discrimination suits. The Massachusetts Commission Against Discrimination ruled that there was probable cause that in three of the lawsuits the men were passed over for promotion. The commission ordered that the men and Jenny Craig submit their case to mediation in order to resolve the discrimination issue.

While all this was happening, Jenny Craig continued to operate its centers under the weight of litigation and controversy—spending money and time in court instead of spending its money and time on its primary purpose—to help people lose weight.

RETURN TO INSIDE BUSINESS

Jenny Craig, Inc.: Fighting More Than Weight

The Jenny Craig organization faced legal action from several sectors. On behalf of the government, the Federal Trade Commission’s investigation into Jenny Craig as well as other well-known weight-loss organizations focused on deceptive advertising. At the same time, former customers filed suit claiming that the diets caused other health-related problems. Shareholders sued because of disappointing dividends that they blamed on mismanagement, and finally several male employees in the Boston area filed a breach of contract and reverse discrimination suit. Although not all of this litigation has been resolved, at least two have.

The FTC probe resulted in a consent decree. A consent decree requires that the party involved cease the activity in question. In this case it meant that the advertiser (Jenny Craig and the other weight-loss firms) had to include the following statement in their advertising: “For many dieters, weight loss is temporary. Dieters should not expect to lose the same amount of weight as the individual in the testimonial.”

In the Boston-based employees’ suit, which included charges of breach of contract, misrepresentation, and discrimination on the basis of gender, the process was a little more complicated. The initial finding was in favor of the defendant, Jenny Craig. The plaintiffs appealed. The Appeals Court determined that the original judgment on contract and tort claims in favor of Jenny Craig was appropriate and that the claims of gender-based discrimination were unsupported. On the employment contract issue, the employees had all signed a standard employment agreement that stated they were employees at will and could be terminated at any time. Jenny Craig maintained that because in some of the weight-loss centers business was slow and because some of the people in question were frequently late for work, they had been let go. Further, in the gender discrimination portion of the appeal, the male employee who claimed female employees had been unfairly promoted over him could not identify one single less qualified female in the company. It was all finally settled in November 1998.

Questions

1. Have you ever seen a disclaimer statement like the one that weight-loss centers must now provide? Where? Would it prevent you from buying or using a product or service?
2. How did the employment contract help Jenny Craig show it did not breach the contract?
3. Although it is admittedly a female-dominated organization, how might Jenny Craig avoid gender-based suits in the future?

APPENDIX REVIEW

Summary

1. Define and explain the differences between common law and statutory law and between public law and private law.

Government derives its laws from two major sources. Common law, which is also known as case law or judicial law, is created by court decisions as rendered by judges. These decisions provide precedents for other similar cases that may come up later. Statutory law consists of all the laws that have been passed by judicial bodies, including the U.S. Congress, a state legislature, or a local government. Public law is the body of law that deals with the relationships between individuals or businesses and society. A violation of public law is a crime. Private law is the body of law that governs the relationships between two or more individuals or businesses. A violation of private law is a tort.

2. Discuss the federal and state court systems.

The United States has two separate court systems. The federal court system includes the U.S. Supreme Court, the U.S. courts of appeal, and the U.S. district courts. The federal courts generally hear cases that involve questions of constitutional law; violations of federal statutes; high-value property disputes between citizens of different states or between a U.S. citizens and foreign country; bankruptcy; IRS; postal laws; copyright, trademark, and patent laws; and admiralty and maritime cases. The state court system is organized similarly and includes the state courts of original jurisdiction, the state intermediate (appellate) courts, and the state supreme court.

3. Define contract and list the requirements of a valid contract.

A contract is a legally enforceable agreement between two or more competent parties who promise to do, or not to do, a particular thing. In order for a contract to be valid, it must meet five specific requirements: voluntary agreement, consideration, legal competence of all parties, lawful subject matter, and proper form. Proper form means that the contract contains names of the parties involved, the purpose of the contract, and all terms and conditions to which the parties have agreed. Business contracts are generally written so that differences can be resolved more easily if a dispute develops.

4. Explain what may happen if a contract is breached.

A breach of contract is the failure of one party to fulfill the terms of a contract when there is no legal reason for that failure. The other party (or parties) may then bring legal action to discharge the contract by mutual assent or agreement, to obtain damages in the form of a monetary settlement, or to require specific performance, which means that the parties must fulfill their obligations.

5. Discuss sales agreements and warranties and list the assumptions a buyer is entitled to make.

Sales agreements are a common, but special form of contract. It transfers ownership from a seller to a buyer. The UCC provides much of the law regarding sales and includes the rights of buyers and sellers, acceptance and rejection of an offer, inspection of goods, delivery, transfer of ownership, and warranties. Warranties may either be express, which includes a written explanation of the responsibilities of the seller in the event that a product is defective or otherwise unsatisfactory, or implied, which is a guarantee imposed or required by law. A buyer is entitled to assume that the merchandise offered for sale has a clear title and is not stolen, that the merchandise is as advertised, and that the merchandise will serve the purpose for which it was manufactured and sold.

6. Explain how property law, laws relating to negotiable instruments, agency law, and bankruptcy law affect business.

Property law covers anything that can be owned, including real property and personal property. Businesses are affected by laws that cover land and buildings, inventories, equipment, fixtures, vehicles, patents, and copyrights. The right to transfer ownership of property is guaranteed by the Constitution. The transfer of real property must be done in writing and be accompanied by a deed or a lease. Transfer of ownership of personal property may be done when the buyer pays full cash price at the time of purchase, or may be done using an installment plan. A negotiable instrument is a written promise to pay a stated sum of money. It can be transferred one person or firm to another but only if it carries an endorsement. Agency law deals with business arrangements in which one party, called the principal, appoints a second person, called the agent, to act on its behalf. Most agents are hired to use their special knowledge for a specific purpose. Bankruptcy is a legal procedure designed both to protect an individual or business that cannot meet its financial obligations and to protect the creditors involved. Bankruptcy proceedings may be initiated either by the person or business in financial difficulty or by the creditors. Various chapters of the Bankruptcy Reform Act allow a business to reorganize or set up a plan for repaying debts or have its assets liquidated.

7. List and briefly explain the major government regulations that encourage competition.

Most laws that encourage competition have been created to eliminate trusts. The Sherman Antitrust Act was enacted to prevent monopolies. It prohibits any agreement designed to restrain trade. The Clayton Act prohibits price discrimination, tying agreements, binding contracts, interlocking directorates, and community of interests. The Federal Trade Commission act created the Federal Trade Commission, charged with investigating illegal trade practices and enforcing antitrust laws. The Robinson-Patman Act focuses on “quantity discounts” and prohibits price differentials that substantially weaken competition and advertising and promotion allowances unless they are offered to all buyers. The Celler-Kefauver Act prohibits mergers through the acquisition of assets of a firm and requires all mergers to be approved by the FTC and Justice Department.

8. Explain the effects of deregulation on businesses.

Deregulation is the process of removing existing government regulations, forgoing proposed regulations, or reducing the rate at which new regulations are enacted. The goal is to minimize the complexity of regulations that affect business. Critics complain that the more than one hundred federal agencies increase the cost of compliance with their various regulations impose a burden, especially on smaller businesses. Advocates point out that every business simply must obey a large number of rules and that doing so is costly.

9. List the various taxes imposed by federal and state governments on business.

The U.S. government requires a lot of money to run. This money comes from the taxes paid by individuals and businesses. Federal taxes include individual income taxes, corporate income taxes, Social Security taxes, unemployment taxes, excise taxes, and customs duties. State and local taxes may vary by state and locality, but often include personal and business income taxes, sales taxes, real estate taxes, and some personal property taxes.

KEY TERMS

You should now be able to define and give an example relevant to each of the following terms.

law (A29)

common law (A29)

statute (A29)

statutory law (A29)
Uniform Commercial Code (UCC) (A29)
administrative law (A30)
public law (A30)
crime (A30)
private law (A30)
tort (A30)
negligence (A30)
court of original jurisdiction (A31)
appellate court (A31)
court of limited jurisdiction (A31)
contract (A32)
voluntary agreement (A32)
consideration (A32)
usury (A32)
performance (A33)
breach of contract (A33)
discharge by mutual assent (A33)
damages (A33)
specific performance (A34)
sales agreement (A34)
express warranty (A34)
implied warranty (A34)
property (A34)
real property (A34)
personal property (A35)
patent (A35)
copyright (A35)
deed (A35)
lease (A35)
negotiable instrument (A35)
endorsement (A36)
agency (A37)
power of attorney (A37)
bankruptcy (A37)

voluntary bankruptcy (A37)

involuntary bankruptcy (A37)

trust (A38)

price fixing (A39)

market allocation (A439)

boycott in restraint of trade (A39)

price discrimination (A39)

tying agreement (A39)

binding contract (A39)

interlocking directorate (A39)

community of interests (A39)

Federal Trade Commission (FTC) (A39)

deregulation (A41)

progressive tax (A42)

excise tax (A44)

customs (or import) duty (A44)

regressive tax (A44)

proportional tax (A45)

REVIEW QUESTIONS

1. What are the differences between common law and statutory law?
2. What is the difference between a crime and a tort? How does the law punish those who commit crimes? torts?
3. What are the three levels of courts in the federal and state court systems? What kinds of cases are heard at each level?
4. List and describe the conditions for a legally enforceable contract.
5. When a contract is breached, what remedies are available to the injured party or parties?
6. What are the differences between an express and an implied warranty? What does an implied warranty imply?
7. How does real property differ from personal property? Give a specific example of real property, intangible personal property, and tangible personal property all owned by an independent service station.
8. What requirements must be met for a financial instrument to be negotiable? Why is negotiability important?
9. Identify the three types of endorsements discussed in the appendix. Explain the advantages and disadvantages of each.
10. What is the relationship between an agent and a principal?

11. Briefly describe the three means of resolving a bankruptcy under current bankruptcy law.
12. How do federal antitrust regulations work to support American business?
13. In your own words, define the following: (a) price fixing, (b) market allocation, and (c) boycott in restraint of trade.
14. The Clayton Act specifically prohibits five practices. List these practices and briefly explain how each weakens competition.
15. What principal reasons propelled the deregulation movement?
16. Which single tax provides the largest amount of income for the federal government? For state and local governments?

DISCUSSION QUESTIONS

1. What services does Jenny Craig, Inc., offer its clients?
2. Most likely, more women than men use the services of Jenny Craig weight-loss centers. What reasons would the Jenny Craig corporation give for employing more women than men? Why might women be more successful than men?
3. Why should the law specifically require written contracts for exchanges of real estate, sales over \$500, and long-term contracts?
4. Suppose you are a party to a contract that has been breached by the other party. Under what circumstances would you sue for discharge? For damages? For specific performance?
5. Assume that you are the owner of a small business and you must choose an agent to purchase a piece of real estate on your behalf. What specific conditions should be included in your contract of agency? Why?
6. In your opinion, is there a social stigma attached to bankruptcy today? Should there be?
7. What benefits and what problems might result from the requirements that the FTC and the Justice Department approve mergers before they take place?
8. How might legislators and regulatory agencies determine whether deregulation is needed in a particular area? How might they determine where additional regulation is needed?

CASE

The City of Indianapolis and KPMG Peat Marwick Join Forces to Eliminate Government Waste

What does it cost to fill a pothole? To change a bulb in a streetlight? To paint a white line down the middle of a street? Although it would seem that any elected official or government employee should be able to answer such questions, in reality, most can't. Even in Indianapolis—a city that today is recognized as one of the most efficient in the nation—the questions would have gone unanswered until a few years ago. That's when Mayor Steven Goldsmith began exploring methods that would ultimately transform Indianapolis into a city that is run like a business. In his search for ways to reduce costs and make Indianapolis more entrepreneurial, Mayor Goldsmith eventually sought the help of KPMG Peat Marwick, one of the nation's largest accounting firms.

The resulting three-way partnership among elected officials, government employees, and the accounting officials at KPMG Peat Marwick has developed a state-of-the-art program designed to use

available tax dollars more effectively. To develop this program, one of the first moves by the people at KPMG Peat Marwick was to implement an activity-based costing (often referred to simply as ABC) system. Although ABC has been used by Boeing, Procter & Gamble, IBM, Dell Computer, Weyerhaeuser, and dozens of other large, successful U.S. corporations, its implementation by state and local governments is unusual.

The purpose of an ABC system, whether it is used by business or government, is to determine *all* of the costs associated with providing a product or service. Although traditional accounting systems examine costs, an ABC system digs deeper into hidden costs. For example, when determining the cost of street repairs for a city like Indianapolis, ABC looks not only at the obvious cash outlay required to repair a pothole, but also at the hidden cost of depreciation, overhead, and other expenses that governments traditionally do not measure.

Armed with information about the “true” cost of city services, Indianapolis officials could now decide whether it was more cost-effective to hire government employees or contract with outside private business firms to provide needed services. Some services, such as the sewer billing function and window washing, went to private firms. Other services, including street repair, went to government employees who were willing to compete with the private business firms in order to keep their jobs.

Was the ABC system used by Indianapolis successful? You bet! Within two years, the city had saved more than \$100 million by using KPMG Peat Marwick’s ABC system. According to Mayor Goldsmith, costs are down and the city is providing more value-added services to the people of Indianapolis than it did two years ago.

Questions

1. How can an activity-based costing system like the one that KPMG Peat Marwick introduced in Indianapolis help a state or local government become more cost-effective?
2. Steven Goldsmith, the mayor of Indianapolis, wants to run his city like a business. Do you believe that a city *should* be run like a business? Explain your answer.

BUILDING SKILLS FOR CAREER SUCCESS

1. Exploring the Internet

With every new presidential administration, there are efforts made to simplify the federal tax code and to make taxes fairer to all taxpayers. Some congressmen feel that a flat tax is the way to go. Others promote ideas that are intended to make taxes more or less progressive or regressive. On the state level, some states have no income tax; others have no sales tax. Most states have both.

Assignment

1. Use a search engine to find various legislators’ or senators’ positions on different tax bills. Use key words to narrow your search. Briefly summarize the primary arguments for and against the various proposals.
2. Choose three states to research: one that has no personal income tax, one that has no sales tax, and one that has both. Are the tax burdens relatively equal overall or are some significantly higher?

2. Developing Critical Thinking Skills

You know that an enormous amount of our legal system owes its basis to cases that have come before and set precedents. Find two or more articles describing a recent court case that involved two or more businesses. You may want to look into the Napster/MP3 copyright issue or a more local case.

Assignment

1. State the exact nature of the issue or issues involved in the case.
2. Describe how these issues were resolved and estimate how long it took to resolve them.
3. State whether the resolution seems fair, and justify your answer.

3. Building Team Skills

Homeowners, small businesspeople, and large corporations frequently enter into contractual arrangements. Obviously, large corporations are likely to do this more often than the average small business or homeowner. Unless it is something you do with regularity, it is easy to let something important slip by unnoticed. Work with a partner or in a small group to ensure that each party in the deal gets what they think they are getting.

Assignment

1. One partner draws up a standard contract form for a company that sells and installs burglar alarm systems in homes. The average cost of the alarm system, including installation, is \$800. Include everything required for a valid contract.
2. After ascertaining that the contract is valid, the other partner writes a check for the alarm system. The first partner verifies the various items that fulfill the requirements for negotiability.

4. Researching Different Careers

Local, state, and national governments employ people with a wide variety of skills and with a wide range of experience. Use the Occupational outlook to research the different kinds of positions currently available, possibly including city manager, economist, tax specialist, or regional or urban planner.

Assignment

1. Based on the information you find, what positions have the best growth projections? Are there certain parts of the country that have more opportunities?
2. What skills and educational background are required for these jobs?

5. Improving Communication Skills

Microsoft has been in the news because many of its competitors claim that it has a virtual monopoly on computer operating systems and Internet browser software. Suppose that you had to either defend Microsoft's position to the Congress, that it is not a monopoly and does not engage in noncompetitive practices, or take the role of a prosecutor and make the case that Microsoft has hurt competition. Review the underpinnings of federal antitrust statutes.

Assignment

1. Write a one-page essay where you make your point and support it with well considered arguments.
2. Take the role of a competitor and argue why you are unable to compete fairly.