

9<sup>th</sup> Edition

# MANAGERS AND THE LEGAL ENVIRONMENT

STRATEGIES FOR BUSINESS



*Answers to A Manager's Dilemma and  
Questions and Case Problems  
to Accompany*

## **MANAGERS AND THE LEGAL ENVIRONMENT STRATEGIES FOR BUSINESS**

Ninth Edition

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# Chapter One

## Law, Value Creation, and Risk Management

### A MANAGER'S DILEMMA: PUTTING IT INTO PRACTICE

#### JPMorgan and Its Hiring Practices in China: Networking or Bribery?

***Issue Presented:*** What procedures should a new manager of a company with operations in China put in place to ensure that your company does not violate the Foreign Corrupt Practices Act (FCPA) when making hiring decisions? How will you respond if you learn that a non-U.S. competitor has offered to hire “qualified” sons and daughters of government officials for summer internships?

Whenever engaging in international business development, managers are expected to exercise their responsibilities according to the laws and practices of the countries where they conduct business. However, a manager should also consider the ethical standards in the home country, where the firm is headquartered and where the board of directors will review his or her performance, as well as what the shareholders would consider ethically acceptable.

The manager must comply with the U.S. Foreign Corrupt Practices Act, which is discussed in Chapter 24. The manager should consult with qualified counsel to ensure that the firm’s hiring practices fall within the scope of both U.S. and Chinese law. The FCPA prohibits any payment by a company, its employees, or its agents directly or indirectly to a foreign government official or a foreign political party for the purpose of improperly influencing government decisions to obtain business abroad. The statute is violated even if the bribe is only offered but never paid. Although managers may be tempted to carry out illegal practices by using agents or intermediaries (who may include shipping and customs agents, vendors, and contractors who are under less direct control and supervision by the company making the payment), the FCPA attempts to stem this practice by establishing two sources of intermediary liability: (1) The act’s anti-bribery provision makes it unlawful to make a payment to an intermediary knowing that all or part of that payment is going to be made to a foreign official for the purpose of influencing that official to obtain business; and (2) the act’s record-keeping provisions require companies to exercise due diligence and implement internal controls to ensure that payments to intermediaries are properly classified and not disguised bribes.

Hiring the children of government officials is common in China, particularly in the banking industry, and that business practice must be carefully weighed against the strictures of the FCPA and American expectations of ethical business conduct. Even though it might be difficult to establish that hiring a particular individual resulted in business with a government official who was related to that individual, U.S. regulators are increasing their investigations in this arena. For example, it would likely be easier to prove a violation of the FCPA where “hard” evidence, such as invoices or receipts, showed that lavish dinners or gifts had been given to government officials and that business contracts with those officials subsequently arose. This situation involves the benefit of human relationships, something that is difficult to measure. As such, all aspects of the firm’s hiring practices could potentially be scrutinized by government regulators both in the United States and China, including its recruitment strategies, the prior experience and performance evaluations of the individuals hired, and email correspondence with the government officials. A manager should also review the firm’s code of conduct and take full advantage of

any ombudsperson available. Although some firms apply different ethical standards depending on the country in which they are doing business, others (such as General Electric) have uniform global standards they apply to all their operations. Finally, while often difficult in practice, the manager should not sacrifice his or her personal integrity.

If a manager learns that a non-U.S. competitor has offered to hire “qualified” sons and daughters of government officials for summer internships, the manager should not sacrifice his or her personal integrity or violate the law to win future business. Although it may be difficult at times to maintain market share or compete successfully, the consequences of not complying with the FCPA are serious. If a manager becomes aware that “qualified” relatives are being hired by other firms, he or she should use such knowledge to make sure that the hiring practices in his or her own company are “squeaky clean,” as the U.S. Department of Justice aggressively pursues offenders of the act.

JP Morgan Chase ultimately paid \$264 million in fines to settle charges that it won business from clients and corruptly influenced government officials in the Asia-Pacific region by giving jobs and internships to their relatives and friends in violation of the FCPA. Press Release, SEC, JP Morgan Chase Paying \$264 Million to Settle FCPA Charges (Nov. 17, 2016), <https://www.sec.gov/news/pressrelease/2016-241.html>. According to the SEC,

investment bankers at JPMorgan’s subsidiary in Asia created a client referral hiring program that bypassed the firm’s normal hiring process and rewarded job candidates referred by client executives and influential government officials with well-paying, career-building JPMorgan employment.

The SEC characterized the hired children as “typically unqualified for the positions on their own merit,” and stated that “[t]he misconduct was so blatant that JPMorgan investment bankers created ‘Referral Hires vs Revenue’ spreadsheets to track the money flow from clients whose referrals were rewarded with jobs. The firm’s internal controls were so weak that not a single referral hire request was denied.”

## **QUESTIONS AND CASE PROBLEMS**

### **Question 1.1**

***Issues Presented:* What public policies are furthered by this law? To what extent are there conflicts among the policies served and how will they affect the way the law in this area is interpreted, applied, and changed?**

The laws and regulations applicable to U.S. business in the early twenty-first century further four primary public objectives: promoting economic growth, protecting workers, promoting consumer welfare, and promoting public welfare. Other major economic powers tend to have laws that further these same objectives, albeit with varying degrees of emphasis on the different objectives and varying ways of furthering them. Indeed, much of the current debate on what constitutes good corporate governance turns on how much weight each country gives to the interests of shareholders, debtholders, employees, customers, and suppliers and to the protection of the environment.

Sometimes those objectives may conflict. For example, intellectual property protection may promote economic growth by giving incentives to innovate but may also create barriers to entry and increase the likelihood of monopoly pricing, to the detriment of consumers.

### **Question 1.2**

***Issue Presented:*** What effect does this body of law or legal tool have on the competitive environment and the firm's resources?

Law helps shape the competitive environment and affects each of the five forces that determine the attractiveness of an industry (buyer power, supplier power, the competitive threat posed by current rivals, the availability of substitutes, and the threat of new entrants). Law also affects the allocation, marshaling, value, and distinctiveness of the firm's resources. Under the resource-based view (RBV) of the firm, a firm's resources can be a source of sustained competitive advantage if they are valuable, rare, and imperfectly imitable by competitors and have no strategically equivalent substitutes. Legal astuteness is a valuable dynamic capability. Constance E. Bagley, *The Value of a Legally Astute Top Management Team: A Dynamic Capabilities Approach*, in THE OXFORD HANDBOOK OF DYNAMIC CAPABILITIES (David J. Teece & Sohvi Leih eds., 2016), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2811424](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2811424). Conversely, failure to integrate law into the development of strategy and of action plans can place a firm at a competitive disadvantage and imperil its economic viability.

### **Question 1.3**

***Issue Presented:*** Where does this body of law or legal tool fit in the value chain?

Each activity in the value chain has legal aspects. From a firm's choice of business entity to the warranties it offers and the contracts it negotiates, law pervades the activities of the firm, affecting both its internal organization its external relationships with customers, suppliers, and competitors.

### **Question 1.4**

***Issue Presented:*** How can managers responsibly help shape this aspect of the legal environment?

Managers can responsibly help shape this aspect of the legal environment by promoting economic growth, protecting workers, promoting consumer welfare, and promoting public welfare. They can also lobby for stricter laws that raise ethical standards rather than lower them. For example, rather than try to water down the U.S. ban on bribes, a group of firms created Transparency International and fought for international conventions to ban bribery. (This is discussed further in Chapter 2.)

### **Question 1.5**

***Issue Presented:*** How could the managers in this case have avoided the litigation that ensued?

At its core, legal astuteness is the ability of the manager to communicate with strategically astute counsel and to work together to solve complex problems. For example, legally astute managers can (1) negotiate contracts as complements to trust building and other relational governance techniques to define and strengthen relationships and reduce transaction costs, (2) protect and enhance the realizable value of the firm's resources, (3) create options through contracts and other legal tools, and (4) convert regulatory constraints into opportunities. Court cases are akin to autopsy reports on transactions gone bad. When reading cases, students should be encouraged to ask how the managers involved could have avoided the dispute or resolved it without resort to litigation.

**Question 1.6**

***Issue Presented:*** What are the “moral aspects of choice” implicated by the conduct at issue?

The systems approach to business and society recognizes that “business decisions consist of continuous, interrelated economic and moral components” and that “moral aspects of choice” are the “final component of strategy.” It also builds on stakeholder theory’s insight that firms have relationships with many constituent groups, which both affect and are affected by the actions of the firm.

**Question 1.7**

***Issue Presented:*** Does this conduct meet societal expectations? If not, what new laws would be likely to result if a substantial number of firms acted this way?

Legally astute management teams appreciate the importance of meeting society’s expectations of appropriate behavior and of treating stakeholders fairly. They accept responsibility for managing the legal dimensions of business and recognize that it is the job of the general manager, not the lawyer, to decide which allocation of resources and rewards makes the most business sense. Complying with the law is just the baseline for determining what course of action to follow. As Ben Heineman, former general counsel of General Electric, put it: “If the first question is, ‘What is legal?’ then the last should be ‘What is right?’” The Foreign Corrupt Practices Act, the Sarbanes-Oxley Act, and the calls for further regulation in the wake of the subprime mortgage crisis are just several examples of how society responds to unethical behavior

**Question 1.8**

***Issue Presented:*** Did the manager in this situation exemplify the five components of legal astuteness? If not, what could the manager have done differently?

The five components of legal astuteness are: (1) a set of value-laden attitudes about the importance of law to the firm’s success, (2) a proactive approach to legal issues and regulation, (3) the ability to exercise informed judgment when managing the legal aspects of business, (4) context-specific knowledge of the law and the appropriate use of legal tools, and (5) partnering with strategically astute counsel. Legally astute managers recognize that compliance failures are what Max Bazerman and Michael Watkins call “predictable surprises” and constantly evaluate their products, processes, and business relationships to manage the risk of legal liability.

# CHAPTER 1

## LAW, VALUE CREATION, AND RISK MANAGEMENT

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This first chapter lays the foundation for the modern corporate manager who is swimming in a “sea of law.” It sets forth a framework for the legally astute manager to better understand the intersection between law and management, while introducing a systems approach to business, law, and society. It outlines the four primary public policies furthered by business regulation in the United States. It concludes with a discussion of why legal astuteness is a valuable dynamic capability.

### **1-1 THE SYSTEMS APPROACH TO BUSINESS AND SOCIETY**

Because we live in a social system, managers must anticipate, understand, and respond to changing policy and social perceptions of ethical management.

#### **1-1a Meeting Societal Expectations**

Business decisions are a series of interrelated economic and moral components, as well as systems of shareholders and community stakeholders.

#### **1-1b Effect of Law on the Competitive Environment and Firm’s Resources**

- (i) Law shapes competitive environment with five forces that determine a company’s attractiveness to customers: (1) buyer power, (2) supplier power, (3) the competitive threat posed by current rivals, (4) the availability of substitutes, and (5) the threat of new entrants.
- (ii) *Resource-based view (RBV)*: firm’s resources can sustain competitive advantage if they are valuable, rare, and hard or expensive to imitate by competitors.
- (iii) Consider the corporate scandals such as 2016’s JPMorgan Chase hiring practices and 2017’s Volkswagen installation of software on millions of diesel-powered cars for the sole purpose of cheating on Environmental Protection Agency (EPA) emissions tests.
- (iv) Legally astute management teams are proactive, and practice *strategic compliance management*.

#### **1-1c Law and the Value Chain**

Each activity in the value chain has legal aspects: design, manufacturing, distribution, sales and warranties.

#### **1-1d Law Is Dynamic**

Systems approach recognizes that the law is not static and changes based on court decisions, federal, or state laws. Managers should be proactively involved in lobbying for law that gives them competitive advantage, and be self-policing to



avoid unnecessary regulations. Self-regulation is not always a substitute for government regulation.

## 1-2 LAW AND PUBLIC POLICY

American law seeks to enhance economic activity, commerce, and for-profit corporations through the pursuit of four key public policy objectives:

### 1-2a Promoting Economic Growth

Protects and enforces private property rights, enforces contracts, allocates risks, facilitates the raising of capital; creates incentives to innovate; promotes liquid and skilled labor markets; provides subsidies, tax incentives, and infrastructure; and promotes free trade in the global markets.

### 1-2b Protecting Workers

This is accomplished by regulating certain terms and conditions of employment, requiring the employer to provide certain benefits, and protecting workers' civil rights.

### 1-2c Promoting Consumer Welfare

Encourages the sale of safe and innovative products and services at a fair price, prevents deceptive practices, and protects consumer privacy.

### 1-2d Promoting Public Welfare

Ensures the effective administration of justice, the collecting of taxes and spending money, the protecting of fundamental rights and the environment.

### 1-2e Policy Conflicts

#### CASE 1.1

#### *Sorrell v. IMS Health, Inc.*, 131 S. Ct. 2653 (2011).

Vermont statute prohibited pharmacies from selling prescriber-identifying information for marketing prescription drugs without the prescriber's consent. Vermont data miners and others challenged the statute as a violation of their free-speech rights under the First Amendment.

HELD: For the data miners. The statute violated the First Amendment because it was too broad and engaged in "content-based discrimination."

## 1-3 THE LEGALLY ASTUTE MANAGER

Legally astute managers (LAMs) know how to communicate and work with counsel to solve legally complex problems. LAMs have (1) a set of value-laden attitudes about the importance of law to the firm's success, (2) a proactive approach to regulation, (3) the ability to exercise informed judgment when managing the legal aspects of business, and (4) context-specific knowledge of the law and the appropriate use of legal tools.

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**THE RESPONSIBLE MANAGER: Teaching Suggestions**

1. How should the legally astute manager deal with gossip circulating around the company via emails about possible legal or ethical wrongdoing?
2. Discuss the cultural dilemmas that face managers in the global economy: Are gifts of money or services illegal or unethical, or culturally neutral? Discuss, for example, in China whether *Guanxi* is social networking, or is mere bribery. Or, in Latin America, whether paying officials directly is a way to “expedite” service, or whether it is bribery.
3. Discuss the possible conflicts between legally doing business and selling fast food, given the increasing evidence of how it is a significant contributing factor in public health, obesity, and diabetes facing many Americans. Do you agree with how McDonalds and the Disney Company are handling the issue? What ethical obligations, if any, do fast food companies have to consumers?