

1. Introduction to Law and Types of Legal Systems

1.1 Introduction to Law and Types of Legal Systems

LEARNING OBJECTIVES

1. Understand the nature and sources of law.
2. Know the types of modern legal systems in the world.
3. Understand the various functions of a legal system.
4. Learn the primary sources of law in the United States.

It is important for business people to understand the legal environment in which they are operating. To be successful, businesses must understand how law and economic principles influence each other. Businesses want to be successful, which usually means they want to be profitable. While a basic economic principle is that businesses act in their own self-interest, they must do so within the parameters of the law. Sometimes businesses weigh the penalties of violating the law against the chances of getting caught to determine how they should behave. In both instances, the law is a restraint on behavior.

Most people want to conduct their business legally. Following the rules saves money, time, and frustration, and it preserves individual and professional reputations. So, if businesses have

an incentive to operate legally, why are do so many legal disputes occur? There are many reasons for this, including that many of our laws are poorly written, and reasonable people may disagree about what is “right.” Legal injuries happen even under the best of circumstances, and parties need a method to be compensated for their damages.

A common theme in the study of law is responsibility. Law seeks to answer the questions:

1. Who is responsible, and what is their liability? and
2. How does a business limit exposure to liability in the first place?

A solid understanding of business law minimizes the risk of liability and avoids legal disputes. The law provides a reasonable expectation of how things will be in the future based on how they have been in the past. It provides predictability and stability.

This book does not teach how to practice law or conduct legal research. The goals of this book are practical. Think about studying business law as a map by which to navigate business dealings. We want to help you minimize the risk of legal liability and avoid serious legal disputes. This book serves as an introduction to legal topics that affect businesses. By understanding the legal landscape, you will have a better opportunity for business success.

Counselor’s Corner Even if a business is not officially “international,” it is important to understand the legal systems of the world because consumers come from all over. Consumers, business partners,

and competitors are products of their environments, including their societies and legal systems. Therefore, their expectations and how they interact with each other are influenced directly by their legal systems of origin. The most successful businesses take this into account. Not only for avoiding legal liability, but also for enhanced consumer satisfaction.

~Arham M.,
attorney

1.2 What Is Law and What Functions Does It Serve?

Law is the system of rules which a particular nation or community recognizes as regulating the actions of its members and which it may enforce by the imposition of penalties. In a nation, the law can serve to (1) keep the peace, (2) maintain the status quo, (3) preserve individual rights, (4) protect minorities, (5) promote social justice, and (6) provide for orderly social change. Some legal systems serve these purposes better than others.

Although a nation ruled by an authoritarian government may keep the peace and maintain the status quo, it may also oppress minorities or political opponents (e.g., China, Zimbabwe, or Syria). Under colonialism, European nations often imposed peace in nations whose borders were created by those same European nations. With regard to the functions of the law, the empires may have kept the peace—largely with

force—but they changed the status quo and seldom promoted the native peoples' rights or social justice.

In nations with various ethnic and tribal groups, it is often difficult for a single, united government to rule effectively. In Rwanda, for example, power struggles between Hutus and Tutsis resulted in the genocide of the Tutsi minority. In nations of the former Soviet Union, the withdrawal of a central power created power vacuums that were exploited by local leaders. When Yugoslavia broke up, the different ethnic groups—Croats, Bosniaks, and Serbs—fought bitterly rather than share power. In Iraq and Afghanistan, the blending of different groups of families, tribes, sects, and ethnic groups into an effective national governing body continues to be a challenge.

These situations highlight the struggle of a nation to implement and maintain the Rule of Law. The **Rule of Law** is a system in which laws are public knowledge, are clear in meaning, and apply equally to everyone. These systems uphold national political and civil liberties. Rule of law systems establish authority, create expectations for behavior, and establish redress for grievances and penalties for deviance. Governance of conflict and the attainment of peace among the governed are its primary goals. One of the greatest benefits of the Rule of Law is that it allows people to understand what is expected of them.

The United States is a Rule of Law System. The US Constitution is based on the principle that people have rights that cannot be taken away by the government. Instead, the role of the government is to protect the individual rights of its citizens. The US Constitution's preamble states, "We the People...in Order to...insure domestic Tranquility." This is just one example of how the US legal system was established to address the functions of a legal system.

1.3 Modern Legal Systems of the World

There are four main legal systems in the modern world:

1. Common law;
2. Civil law;
3. Religious law; and
4. Customary law/monarchy.

As the world becomes more interdependent, a fifth category of legal systems has developed — the hybrid legal system, which is a legal system that is a combination of two or more legal systems.

Type of Legal System	Characteristics
Common Law	<ul style="list-style-type: none"> • Written judicial decisions of appellate courts are binding legal authority on lower courts when interpreting and applying the same or similar questions of law • The legal system is adversarial • The outcome of a case is often decided by a jury of the parties' peers
Civil Law	<ul style="list-style-type: none"> • All legal rules are in comprehensive legislative enactments often called Codes • Written judicial decisions of appellate courts are not binding legal authority • The legal system is inquisitorial
Religious Law	<ul style="list-style-type: none"> • Religious documents are used as legal sources • All major world religions have a religious legal system • Most nations that have religious legal systems use them to supplement a secular national system
Customary Law	<ul style="list-style-type: none"> • Legal system used by a monarchy or tribe • Grants specific legal powers to kings, queens, sultans or tribal leaders as heads of state • Monarchs and leaders often seen to be “above the law”
Hybrid Law	<ul style="list-style-type: none"> • Combination of 2 or more legal systems within a nation

Common Law Systems

The legal system in the United States comes from the English common law tradition and the US Constitution. English

common law is a system that gives written judicial decisions the force of law. As a result, the US legal system recognizes an appellate court's ability to interpret and apply the law to future litigants through precedent. **Precedent** is a judicial opinion that is considered legal authority for future cases involving the same or similar questions of law. The benefit of this system is consistency and resolution of disputes without requiring the parties to take legal matters to court.

A famous example of how precedent works is the US Supreme Court case *Brown v. Board of Education of Topeka*. In this landmark 1954 case, the Justices unanimously ruled that racial segregation of children in public schools is unconstitutional. *Brown v. Board of Education* is one of the cornerstones of the Civil Rights Movement and helped establish the precedent that "separate-but-equal" education and other services were not, in fact, equal at all. The case required all racially segregated public schools to integrate, not just in Topeka, Kansas. In addition, *Brown* has been cited as legal precedent in thousands of cases nationwide involving racial equality.

The common law legal system is adversarial. This means that the parties bring their cases to the court for resolution. The judge or jury hears the parties' evidence and arguments before making a final decision. It is the parties' burden to investigate the facts, argue the law, and present their best case. Judges and juries do not do independent investigations nor are they responsible for helping parties argue their cases. It is a party's responsibility to raise all legal issues.

Another characteristic of common law systems is that cases are often decided by juries of the parties' peers. In both civil and criminal matters, the parties usually have a right to have a jury pulled from local citizens to resolve the dispute. When a jury determines the outcome of a case, the judge acts as a "gatekeeper," who decides what evidence and legal arguments

the jury can properly consider. The judge ensures the parties receive a fair trial while the jury decides the outcome of the trial.

The common law tradition is unique to England, the United States, and former British colonies. Although there are differences among common law systems (e.g., whether judiciaries may declare legislative acts unconstitutional and how frequently juries may be used), all of them recognize the use of precedent, and none of them relies solely on the comprehensive, legislative codes that are prevalent in civil law systems.

Civil Law Systems

Civil law systems were developed in Europe and are based on Roman and Napoleonic law. Civil law systems are also called code systems because all the legal rules are in one or more comprehensive legislative enactments. During Napoleon's reign, a comprehensive book of laws—a code—was developed for all of France. The code covered criminal law and procedure, non-criminal law and procedure, and commercial law. The code is used to resolve only cases brought to the courts, which are usually decided by judges without a jury.

Civil law systems are inquisitorial systems in which judges actively investigate cases. Judges have the authority to request documents and testimony, as well as to shape the parties' legal claims. In addition, judges are not required to follow the decisions of other courts in similar cases. The law is in the code, not in the cases. The legislature, not the courts, is the primary place to enact and modify laws.

Civil law systems are used throughout Europe, Central and South America, Asia and Africa. France, Germany, Holland,

Spain, and Portugal had colonies outside of Europe, and many of these colonies adopted the legal practices that were imposed on them by colonial rule.

There are also communist and socialist legal systems that differ significantly from traditional civil law systems. Legal scholars debate whether this is a separate type of legal system or a subset of modern civil law systems. In a communist or socialist legal system, the nation has a code but most property is owned by the government or agricultural cooperatives. In addition, the judiciary is subservient to the Communist party and is not an independent branch of government.

Religious Law Systems

Religious law systems arise from the sacred texts of religious traditions and usually apply to all aspects of life, including social and business relations. In religious legal systems, a religious document is used as a primary legal source. All major world religions—Judaism, Christianity, Islam, Buddhism and Hinduism—have a religious legal system. The Islamic legal system (Sharia) with Islamic jurisprudence (Fiqh) is the most widely used religious legal system in the world. Most nations that have religious legal systems use them to supplement their secular national system. Only Saudi Arabia (Islamic) and the Vatican (Christian) are pure theocracies that have only a religious legal system in their nations.

Customary Law Systems

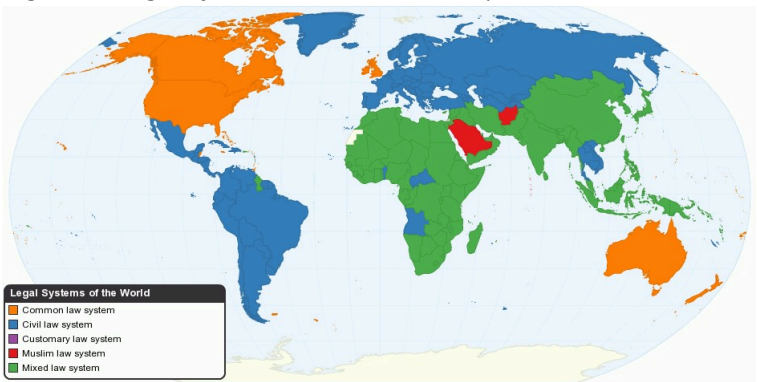
Customary legal systems are becoming increasingly less common. A customary system is used by a monarchy and grants specific legal powers to the kings, queens, sultans or

tribal leaders as heads of state. A challenge of a customary system is that the ruler is seen to be “above the law” because the laws do not apply equally to the ruler and subjects. There are only a handful of monarchies remaining in the world, and most of them have evolved into hybrid legal systems or have adopted a different type of legal system.

Hybrid Law Systems

Hybrid legal systems are a combination of two or more legal systems within a nation. India is a classic example of a nation with a hybrid legal system. As a former British colony, India has a common law legal system, which recognizes the power of the Supreme Court and High Courts to make binding judicial decisions as a form of precedent. However, most of its laws are integrated codes found in a Napoleonic code system. In addition, India has separate personal codes that apply to Muslims, Christians, and Hindus. As a result, India has a hybrid system made up of common law, civil law and religious law systems.

Figure 1.1 Legal Systems of the World Map



1.4 Sources of Law

Where does law come from? How do individuals and businesses know right from wrong? Not all actions that are considered “wrong” or inappropriate are violations of the law. They simply may represent social norms. So what is the difference? There are two types of rules in our society—social norms and laws.

Social norms are the informal rules that govern behavior in groups and societies. Social norms and cultural expectations may be violated with negative social or professional consequences for doing so. However, no legal repercussions follow violating social norms alone.

Violations of law are different. Violating the law carries penalties, such as civil liability, fines, or loss of liberty. While it is optional to conform to social customs, people are compelled to obey the law under threat of penalty.

Laws are generally classified as public law or private law. **Public law** applies to everyone. It is law that has been created by a legitimate authority with the power to create law, and it applies to the people within its jurisdiction. In the United States, the lawmaking authority itself is also subject to those laws, because no one is “above” the law. If the law is violated, penalties may be levied against violators. Examples of public law include constitutions, criminal laws, and administrative laws. For example, if someone steals items from a store, the thief is violating public law. He committed the crime of theft which affects the community as a whole (not just the store owners), and the crime is defined in public legislation.

Private law is law that is binding on specific parties. For instance, parties to a contract are involved in a private law agreement. The terms of the contract apply to the parties of

the contract but not anyone else. If the parties have a contract dispute, the terms of the contract and the remedy for breach will apply only to the parties of the contract. In addition to contracts, other examples of private law include tort and property laws. For example, if someone installs an industrial smoker on his property and the smoke creates a dense haze in the neighbor’s yard, there may be a violation of private law because the smoke is interfering with the neighbor’s right to peacefully enjoy one’s property.

Laws are also classified as civil or criminal. **Civil law** is usually brought by a private party against another private party. For example, one company decides to sue another for breach of contract. Or a customer sues a business when injured by the company’s product. Most laws affecting businesses are civil.

Criminal law involves a governmental decision to prosecute someone for violating a criminal statute. If someone breaks a criminal law, he or she could lose their freedom (i.e. be sent to prison) or lose their life (i.e. if convicted of a capital offense). In a civil action, no one is sent to prison. Usually, liability results in the loss of property such as money or assets.

	Civil	Criminal
Source of Law	statute or common law	statutes defining crimes
Who files case?	business or individual suffering harm	the government (e.g. District Attorney)
Burden of Proof	preponderance of evidence	beyond a reasonable doubt
Remedy	damages, injunction, specific performance	punishment (e.g. fine or imprisonment)
Purpose	provide compensation or private relief	protect society

Additionally, some law is procedural and some law is substantive. **Procedural law** describes the legal process and

rules that are required and must be followed. For instance, parties who are sued in court must receive notice of the lawsuit before the court can impose judgment against them.

Substantive law refers to the actual substance of the law or the merits of the claim, case, or action. Substantive law embodies the ideas of legal rights and duties and is captured by different sources of law, including the Constitution, statutes, and common law.

For example, if someone drives fifty-five miles per hour in a forty mile-per-hour zone, she has broken the substantive rule of law of the speed limit. However, how and what gets decided in court related to the speeding ticket is a matter of procedural law. For example, whether the driver is entitled to a hearing before a judge, whether she has a right to be represented by legal counsel, whether the hearing takes place within a certain amount of time after the ticket was issued, and what type of evidence can be presented are procedural law issues.

Sources of Law

In the United States, our laws come primarily from:

- Federal and state constitutions;
- Statutory law from Congress, the state legislatures, and local legislative bodies;
- Common law from federal and state appellate courts;
- Administrative rules and regulations;
- Treaties and conventions; and
- Executive orders.

Constitutions

The most fundamental law in the United States is the US Constitution, which is the supreme law of the nation. Any law that conflicts with it is void. The Constitution serves three important functions. First, it establishes the structure of our national government and identifies the powers of the legislative, executive, and judicial branches. Second, it defines the boundaries of each branch's authority and creates "checks" on each branch by the other branches. For example, the president is the commander-in-chief of the armed forces, but does not have the power to declare war. That duty falls to Congress. And, third, the Constitution guarantees civil liberties and individual rights.

The power granted to the federal government by the Constitution is limited. Any powers not expressly granted to the federal government by the Constitution are reserved to the states. This means that if the Constitution does not give the federal government power over a particular area, then the states regulate it.

The first ten amendments to the Constitution are known as the **Bill of Rights**. Despite the limited power granted to the federal government by the Constitution, the Bill of Rights protects certain individual civil rights and liberties from governmental interference. These rights include the freedom of speech and religion, the right to bear arms, and the rights of individuals who are suspected and accused of crimes.

Figure 1.2 Separation of Powers of the Federal Government

One Federal Government

United States Constitution

- Establishes limited federal government
- Protects states' power
- Guarantees liberty of citizens



Congress

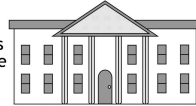
- Passes statutes
- Ratifies treaties
- Creates administrative agencies



Legislative Branch

President

- Proposes statutes
- Signs or vetoes statutes
- Oversees administrative agencies



Executive Branch

Federal Courts

- Interpret statutes
- Create (limited) federal common law
- Review the constitutionality of statutes and other legal acts



Judicial Branch

Administrative Agencies

- Oversee day-to-day application of law in dozens of commercial and other areas

Each state also has its own constitution, which serves essentially the same function for the state government as the US Constitution serves for the federal government. Specifically, they establish limits of state government power, establish the organization and duties of the different branches of government at the state level, and protect fundamental rights of state citizens. This dual system of government in the United States is called **federalism**, which is a governance structure whereby the federal government and the state governments coexist through a shared power scheme.

Figure 1.3 Separation of Powers of the State Governments

50 State Governments

State Constitution

- Establishes the state government
- Guarantees the rights of state residents



State Legislature

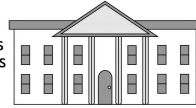
- Passes statutes on state law
- Creates state agencies



Legislative Branch

Governor

- Proposes statutes
- Signs or vetoes statutes
- Oversees state agencies



Executive Branch

State Courts

- Create state common law
- Interpret statutes
- Review constitutionality of statutes and other acts



Judicial Branch

Administrative Agencies

- Oversee day-to-day application of law in dozens of commercial and other areas

Statutes

Statutes are laws created by a legislative body. Congress is the federal legislative body, and each state also has its own legislative body. Almost all statutes are created by the same method. An idea for a new law is proposed in the legislature. This proposal is called a **bill**. The House of Representatives and Senate independently vote on a bill. If the majority of both chambers approves it, the bill is sent to the president or governor for approval. If the president or governor signs the bill, then it becomes a statute.

Local governments, such as counties, cities, and townships, may be authorized under a state constitution to create or adopt ordinances. An **ordinance** is a legislative act of a local

government entity. Examples of ordinances include building codes, zoning laws, and misdemeanors such as jaywalking.

Common Law

Binding legal principles also come from the courts. When appellate courts decide a case, they may interpret and apply legal principles in a way that are binding on lower courts in the future. The process of applying a prior appellate decision to a case is called **precedent**. Simply put, precedent is when judges use past decisions to guide them. The benefit of precedent is that it makes the law predictable and furthers the rule of law by applying legal principles to the greater community, not just the parties to a lawsuit. Businesses value common law systems because they reduce the cost of business. For example, if a business is unsure of how its contract rights will be applied by the court, it can understand its rights by learning how courts interpreted similar contract provisions in past lawsuits. This allows businesses to assess their risks, determine their liability, and make rational business decisions without the expense of litigation.

Administrative Rules and Regulations

Administrative law is the collection of rules and decisions made by agencies to fill in particular details missing from constitutions and statutes. For example, the Internal Revenue Service (IRS) is the federal agency responsible for collecting national taxes and administering the Internal Revenue Code enacted by Congress. All businesses and individuals must follow the IRS rules and regulations about how to report, file, and pay applicable taxes that Congress levies. Congress passes

statute defining “what” taxes need to be paid. The IRS adopts the rules about “how” those taxes are paid.

In the United States, many of the day-to-day regulation of businesses is done by administrative agencies. These agencies are created by the legislature to implement and enforce a particular statute. Agencies often report to the executive branch, but some are run by independent commissions. Legislative bodies give agencies the power to create rules and regulations that individuals and businesses must follow to comply with the statute. For example, the Environmental Protection Agency (EPA) was created to implement and enforce the Clean Air Act and the Clean Water Act.

Treaties and Conventions

A **treaty** is a binding agreement between two nations. A **convention** is a binding agreement among a group of nations. In the US, a treaty or convention is generally negotiated by the executive branch. To be binding, the US Constitution requires the Senate to ratify treaties by a two-thirds vote. Once ratified, a treaty becomes part of federal law with the same weight and effect as a statute passed by the entire Congress. Therefore, treaties and conventions have equal standing as statutes in US law.

Executive Orders

Article II, Section 1 of the US Constitution gives the president the power to “take care that the laws be faithfully executed.” Under this power, the president may issue **executive orders** requiring officials in the executive branch to perform their duties in a particular manner. State governors have the same

authority under state constitutions. Although they are not laws that apply directly to individuals and businesses, executive orders are important legal documents because they direct the government's enforcement efforts.

Hierarchy of Sources of Law

Priority	Source	Comment
1	Constitutions	Exist at both federal and state levels
2 (tie)	Statutes	Laws passed by the federal or state legislatures
2 (tie)	Treaties and Conventions	International agreements that have the same standing as statutes
4	Judicial Opinions	Court interpretation and application of constitutions, statutes, treaties, agency regulations, and executive orders
5	Agency Regulations	Rules and regulations adopted by administrative agencies at the federal, state, or local level
6	Executive Orders	Guidance from the president or governor to executive branch officials about how to perform their duty

1.5 Concluding Thoughts

Understanding business law is essential to successfully running any type of business because a solid understanding of laws and regulations helps avoid liability and minimizes risk. In business, it is not enough to conduct business ethically. Knowledge of business law is essential to successful business practices. Ultimately, business people should be able to recognize legal issues, minimize liability exposure, and know when to consult an attorney.

Legal systems vary widely in their aims and in the way they

resolve disputes. Common law systems are adversarial, use juries and adhere to precedent. Civil law systems are inquisitorial, do not use juries and do not recognize precedent. All major world religions have a legal system, although only two nations have a purely national religious system. Many nations have hybrid legal systems that combine two or more legal systems.

The legal system in the United States is composed of multiple jurisdictions at the local, state and federal levels. Local and state laws may not conflict with federal laws. Primary sources of law in the United States include constitutional law, statutory law, common law, administrative law, treaties, and executive orders.