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### End of

### Unit Two

### Pedagogy

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| Unit 2 |
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The Commercial Environment

Answers to Questions in the

Cumulative Business Hypothetical

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| This unit concludes with a section that introduces a hypothetical business firm and asks a series of questions about how the law applies to various circumstances involving the firm. To answer the questions, students apply legal principles discussed in the unit. Suggested answers to these questions are included in theAnswers to Questions and Case Problems to Accompany The Legal Environment Today.We repeat these questions and answers here as a convenience to you. |
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| This series of hypothetical situations and questions can be used as a springboard for a review of the topics covered in the unit, or as a basis for other forms of class discus­sion. For example, students could be divided into small groups, with each group given one of the sets of facts to consider and respond to. Alternatively, any or all of the ques­tions might be assigned as an in-class quiz or a take-home test. |
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Samuel Polson has an idea for a new software application. Polson hires an assistant and invests a considerable amount of his own time and funds developing the application. To manufacture and market his application and develop other software, Polson needs financial capital.

1. Polson borrows $5,000 from his friend Michael Brant. Polson promises to repay Brant the $5,000 in three weeks. Brant, in urgent need of funds, borrows $5,000 from his friend Mary Viva and assigns his rights to the $5,000 Polson owes him to Viva in return for the loan. Viva notifies Polson of the assignment. Polson pays Brant the $5,000 on the date stipulated in their contract. Brant refuses to give the $5,000 to Viva, and Viva sues Polson. Is Polson obligated to pay Viva $5,000 also? Discuss. Yes, Polson is obligated to pay Viva $5,000. Until an obligor (Polson, here) has notice of the obligee’s (Brant’s) assignment, the obligor can discharge his or her obliga­tion by performance to the assignor (also Brant), and performance by the obligor to the as­signor constitutes a discharge to the assignee (Viva). Once the obligor receives proper no­tice, only performance to the assignee can discharge the obligor’s obligations. Because Polson ren­dered performance to Brant, not Viva, Polson remains obligated to Viva.

2. Polson learns that a competitor, Trivan, Inc., has already filed for a patent on a nearly identical program and has manufactured and sold the software to some customers. Polson learns from a reliable source that Trivan paid Polson’s assistant a substantial sum to obtain a copy of the program. What legal recourse does Polson have against Trivan? Discuss fully. In terms of legal recourse against Trivan, Polson might base a civil suit against Trivan on a charge based on patent in­fringe­ment. If a firm makes, uses, or sells another’s patented design, product, or pro­cess without the patent owner’s permission, it commits the tort of patent infringement. That Trivan has already filed for a patent and has sold the software to some customers is not fatal to Polson’s case: patent protection is granted to the first person to invent a product, not to the first person to file a patent application, and patent infringement may occur even though the patent owner has not put the patented product on the market.

Polson might add a charge to its suit against Trivan for misappropriation of trade se­crets. Unlike patents, trade secrets, which include research and development, have no reg­istration or filing requirements. Theft of confidential business data by in­dustrial espi­onage is theft of trade secrets.

In terms of recourse on grounds discussed earlier in this book, Polson might base a civil suit on charges of conversion and trespass to personal property. Conversion is any act depriv­ing an owner of personal property without that owner’s permission and without just cause. Con­version is the civil side of crimes related to theft. When conversion occurs, trespass to per­sonal property usually occurs as well. If the initial taking of the property was unlaw­ful, there is trespass; retention of that property is conversion.

If theft is proven, if there has been more than one offense, and if these activities con­tinued over a sufficiently long term, Polson may also have grounds for civil charges under RICO.

Polson might also include in its suit against Trivan a charge based on wrongful in­ter­ference with a contractual relationship for inducing Polson’s assistant to break his or her employment contract with Polson by selling company secrets.

Polson could also file a criminal complaint against Trivan for larceny.

3. While Polson is developing his idea and founding his business, he has no income. To meet expenses, Polson and his wife begin a home-based baking business for which he orders and has installed a new model X23 McIntyre oven from a local company, Western Heating Appliances. One day, Polson is baking croissants. When he opens the oven, part of the door becomes detached. As he struggles with the door, his hands are badly burned, and he is unable to work for several months. Polson later learns that the hinge mechanism on the door was improperly installed. He wants to sue the oven’s manufacturer to recover damages, including consequential damages for lost profits. In a product liability suit against the manufacturer, under what legal principles and doctrines might Polson recover damages? Discuss fully. According to Section 2(a) of the Restatement (Third) of Torts: Products Liability, a product “contains a manufacturing defect when the product departs from its intended design even though all possible care was exercised in the preparation and marketing of the product.” This standard imposes liability on a manufacturer whether or not it acted “reasonably.” This is strict liability, or li­ability without fault. This principle can apply to a single unit, such as the oven door in this case.

A determination that a product has a design defect can affect all of the units of a product. A product “is defective in design when the foreseeable risks of harm posed by the product could have been reduced or avoided by the adoption of a reasonable alternative design by the seller or other distributor, or a predecessor in the commercial chain of distribution, and the omission of the alternative design renders the product not reasonably safe.” To succeed in a product liability suit alleging a design defect, a plaintiff has to show that there is a reasonable alterna­tive design (such as a better, available hinge). In other words, a manufacturer is liable when the harm was reasonably preventable. This would likely be the case, here. According to the Official Comments accompanying the new Restatement, factors that a court may consider on this point in this case, include “the magni­tude and probability of the foreseeable risks of harm.”

4. During the course of the events in the preceding questions, the payments on Polson’s mortgage, his various credit-card debts, and some loans that he took out to pay for his son’s college tuition continue to come due. As his software business begins to generate revenue, Polson files for Chapter 7 liquidation. Polson hopes to be rid of his personal debts entirely, even though he believes he could probably pay his creditors off over a four-year period if he scrimped and used every cent available. Are all of Polson’s personal debts dischargeable under Chapter 7, including the debts incurred for his son’s education? Given that Polson could foreseeably pay off his debts over a four-year period, will the court allow Polson to obtain relief under Chapter 7? Why or why not? Most debts can be dischargeable under Chapter 7. Debts that are not dis­charge­able include student loans, unless payment of the loans imposes an undue hardship on the debtor and his or her dependents. Because it appears that the only hardship to Polson of requiring that he pay off the loans would be to “scrimp and use every cent available to pay his creditors” over a four-year period, it seems unlikely that a court would grant him a discharge of those debts. For the same reason, it appears un­likely that a court would grant him a discharge under Chapter 7 at all.

**5.** Denied a discharge in bankruptcy under Chapter 7, Polson still needs funds to pay his debts and capital to sustain his software business. His home is valued at $200,000. He owes $100,000 on a mortgage on the property. To obtain funds, Polson refinances the loan through Omni Bank, borrowing $200,000 for twenty years at an interest rate of 5.25 percent. During the lending process, Omni’s loan officer fails to provide Polson with all of the required disclosures. On the day of the loan, a twenty-year Treasury bond is yielding 2.25 percent. Polson pays $5,500 in fees to the bank. Three months later, with a sudden spike in the software business, Polson wants to cancel the mortgage. Can he rescind the loan? Why or why not? Federal law that may apply to Polson’s mortgage include the statutes with the acronyms TILA, HOEPA, HPML, and HAMP. The Truth-in-Lending Act (TILA) applies to residential real-estate loans. The Home Ownership and Equity Protection Act (HOEPA), which is p[art of TILA, covers mortgage loans that carry a high rate of interest or impose high fees on borrowers. HOEPA applies if the annual percentage rate (APR) exceeds the interest rate on Treasury bonds of comparable maturity by 8 points for a first mortgage, or when the loan fees exceed the loan amount by 8 percent. To qualify as a Higher-Priced Mortgage Loan (HPML), a mortgage must secure a borrower’s principal home and have, if the loan is a first lien, an APR that exceeds the average prime offer rate for a comparable transaction by 1.5 percentage points or more. The U.S. Treasury Department’s Home Affordable Modification Program (HAMP) encourages private lenders to modify mortgages to lower the monthly payments of borrowers in default.

In this question, Polson’s mortgage is a residential loan, and thus TILA applies. The loan is a first mortgage—there was a previous mortgage, but Polson paid it with the funds that he obtained through the loan from Omni. The APR exceeds the interest rate on Treasury bonds of comparable maturity by only 3 points and the fees are not more than 8 percent of the loan, however. Thus, HOEPA does not apply. The mortgage is a first lien and is secured by the borrower’s home, but the APR does not most likely exceed the average prime offer rate for a comparable transaction by 1.5 percentage points or more. Thus, the loan does not qualify as an HPML. And Polson is not in default, so the loan is not eligible for HAMP.

TILA imposes disclosure requirements on lenders. When the required disclosures are provided, a borrower’s right to rescind is limited to three business days (not including Sunday) after a loan is finalized. If a lender fails to provide material required disclosures, the borrower has a right to rescind the transaction for up to three years. Here, the loan falls under TILA, and Omni’s loan officer failed to provide Polson with all of the required disclosures. Thus, the right to rescind the mortgage is extended for up to three years. Three months after the date of the loan is not too late for Polson to cancel it.