

THE  
Legal Environment  
OF  
Business

---

S E V E N T H   E D I T I O N

---

Robert N. Corley

O. Lee Reed

*Seventh Edition*

# THE LEGAL ENVIRONMENT OF BUSINESS

Robert N. Corley

---

Distinguished Professor of Legal Studies  
University of Georgia

O. Lee Reed

---

Professor of Legal Studies  
University of Georgia

With the assistance of

**Russell L. Welch**

North Texas State University

This book was set in Baskerville by Better Graphics, Inc.  
The editor was Sam Costanzo; the cover was designed by Joan Greenfield;  
the production supervisor was Diane Renda.  
Project supervision was done by The Total Book.  
R. R. Donnelley & Sons Company was printer and binder.

## THE LEGAL ENVIRONMENT OF BUSINESS

### Library of Congress Cataloging-in-Publication Data

Corley, Robert Neil.  
The legal environment of business.

"The appendixes include the United States  
Constitution and excerpts from the antitrust laws  
and labor laws"—P.

I. Trade regulation—United States. I. Reed, O.  
Lee (Omer Lee) II. Welch, Russell L. III. Title.  
KF1600.C6 1987 346.73'07 86-15171  
ISBN 0-07-013256-9 347.3067

Copyright © 1987, 1984, 1981, 1977, 1973, 1968, 1963 by McGraw-Hill, Inc. All  
rights reserved. Printed in the United States of America. Except as permitted under  
the United States Copyright Act of 1976, no part of this publication may be re-  
produced or distributed in any form or by any means, or stored in a data base or  
retrieval system, without the prior written permission of the publisher.

1 2 3 4 5 6 7 8 9 0 DOCDOC 8 9 4 3 2 1 0 9 8 7 6

ISBN 0-07-013256-9

# THE LEGAL ENVIRONMENT OF BUSINESS

## **McGraw-Hill Book Company**

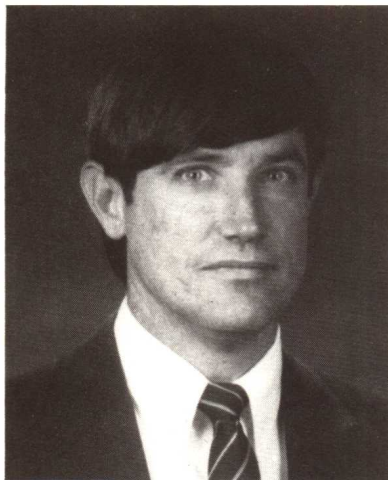
New York  
St. Louis  
San Francisco  
Auckland  
Bogotá  
Hamburg  
Johannesburg  
London  
Madrid  
Mexico  
Milan  
Montreal  
New Delhi  
Panama  
Paris  
São Paulo  
Singapore  
Sydney  
Tokyo  
Toronto

---

# ABOUT THE AUTHORS



**Robert N. Corley** is currently Distinguished Professor of Legal Studies at the University of Georgia. He received J.D. and B.S. degrees from the University of Illinois, where he taught for eighteen years. He was admitted to the Illinois Bar in 1956. Professor Corley is past president of the American Business Law Association and a past member of the editorial board of the *American Business Law Journal*. Winner of numerous teaching awards at both the undergraduate and graduate levels, he also teaches in three national executive development programs. Since 1964 he has been senior author of *The Legal Environment of Business*. In important respects his contributions have shaped the content of the entire legal environment of business field.



**O. Lee Reed** holds a J.D. degree from the University of Chicago and a B.A. degree from Birmingham-Southern College. Presently, he is Professor of Legal Studies at the University of Georgia. The author of many scholarly articles, he is former editor-in-chief of the *American Business Law Journal*. He also has served as president of the Southeastern Regional Business Law Association. Professor Reed has received teacher-of-the-year awards from both undergraduate and graduate student organizations. He has been co-author of the *Legal Environment of Business* since 1977.

---

# PREFACE

One oil company has recently been ordered to pay nearly \$2 billion under federal environmental clean-up law. A jury has returned a verdict of \$10.5 billion against another oil company for interfering with a merger. In March 1986 over a thousand manufacturers traveled to Washington and lobbied Congress to federalize product liability law. Now more than ever, students preparing for careers in the business community need to grasp the significance of law and its potential impact on their lives.

Beginning around 1960, the impact of law on the business community grew significantly. Important changes in the law brought new rights to employees, investors, consumers, and others that were often enforced by regulatory action. In 1963 we wrote *The Legal Environment of Business*, the first textbook responding to the great changes taking place in the law. In it we developed an approach to law that focuses on public law, the regulation of business, and legal trends rather than on detailed private law rules. We are gratified that this approach has come to define the *legal environment of business*, the required law course of the American Assembly of Collegiate Schools of Business. The majority of new collegiate law textbooks being published have adopted this approach. With the seventh edition of *The Legal Environment of Business*, we now continue our leadership in the teaching of law that was begun more than two decades ago.

## GUIDING PRINCIPLE

---

In preparing these materials for an environmental course in law, a basic principle has guided us: the materials should actively prepare students for decision making in business rather than merely summarize for them the course content of various law school subjects. This is the heart of our instructional approach, and it ensures that we have treated law as an important institution of society and as a tool for generating policy. Only students who appreciate these dynamics of law will be able to go beyond the commonly held

lay concept of law as a series of rules and to understand it most effectively for business decision making. At the same time we have not neglected important substantive legal rules.

## CASE TREATMENT

---

The materials in this book include text discussions, summaries of important legislation, articles, and decided cases. We have deleted most of the procedural issues from the cases and have omitted case references and footnotes. Since we believe that students should be required to study judicial language and reasoning on substantive issues, we include those portions of each case that show the arguments of the parties and the court's resolution of the issues raised. We have shortened long cases without deleting the heart of the opinions.

## NEW FEATURES

---

The seventh edition of the *Legal Environment of Business* contains several new features. Among the most important are:

- 1 The chapter arrangement has been completely reorganized. We have grouped twenty-two chapters into seven basic categories: (1) Introduction (the working of the legal system), (2) Private Law principles, (3) Public Law and Business, (4) Conducting Business, (5) Protecting the Individual, (6) Protecting Groups, and (7) Protecting Society.
- 2 Since contracts form the basis for economic exchanges, and since much government regulation affects contracts, a new chapter covers principles of contract law. This chapter also introduces contracts to students who will not take additional, specialized courses in private law subjects.
- 3 To emphasize the importance of international law, we have added an entire chapter on that topic. The chapter was prepared by Russell Welch of North Texas State University. We are delighted to bring to students Professor Welch's special expertise in international law since exporting and importing by multinational corporations are of steadily growing significance to American economic life.
- 4 An explanation of limitations on the employment-at-will doctrine forms part of a new chapter on worker protection. Other subjects include unemployment compensation, the Fair Labor Standards Act, workers' compensa-



tion, and pension plans. Understanding worker protection law is vital in a system where a great majority of the labor force is employed by corporations.

5 A full 60 percent of the cases in the seventh edition are new. Over 70 percent were decided since 1980. These figures reflect our conviction that judicial interpretation of the law is best impressed upon students as a currently relevant, ever-evolving process. Of course, a certain number of landmark decisions are also covered.

6 Where appropriate, we have added material treating the ethical issues of public and social policy that underlie legal rules. This material meets AACSB standards for coverage of business ethics.

## STUDENT AIDS

---

The text continues to include a glossary that defines legal terms used throughout the text so that students will not require access to a legal dictionary while reading. The appendixes include the United States Constitution and excerpts from the antitrust laws and labor laws for student reference. We feel that students often benefit from reading the exact language of the Constitution and of some of the major statutes that furnish the basic legal principles for substantial portions of the text.

Following this preface, there is a special section addressed to students. In this section we provide step-by-step instructions on how to study this textbook. We include as a part of the instructions a written example of the case briefing system so that students will know how to brief a case if the instructor asks them to do so.

For the first time the text now places important terms in bold type. This innovation should also aid students in their study.

## SUPPLEMENTARY MATERIALS

---

To supplement the text's coverage, a comprehensive instructor's manual and test bank are available to adopters. The test bank was prepared by Robert J. Aalberts, Louisiana State University.

For students there is a study guide prepared by Professor O. Lee Reed. As one of the co-authors of the text, his special insight has enabled him to prepare a study guide that complements the text. As a teaching tool, it should aid in understanding the more difficult subjects of the text. If the study guide is not available to students, it may be ordered for them by their bookstores on a rush basis directly from the publisher.

## ACKNOWLEDGMENTS

---

The authors express their gratitude to the Yale University press for permission to reprint excerpts from Cardozo, *The Nature of the Judicial Process*; and the *Harvard Business Review* for permission to reprint two articles. We are also grateful to the Caterpillar Tractor Company of Peoria, Illinois, for permission to quote extensively throughout the text from its Code of Worldwide Business Conduct and Operating Principles.

The authors also acknowledge the assistance of the following professors who reviewed the manuscript and provided many helpful suggestions: Jack Manders, Drake University; and John Norwood, University of Arkansas.

Finally, we thank Sue Hoy of the University of Georgia for her many contributions to the manuscript.

**Robert N. Corley**  
**O. Lee Reed**

---

# TO THE STUDENT

## How to Study *The Legal Environment of Business*

---

To gain the most from this textbook, you should learn how to study written material effectively. You can achieve effective study through use of the SQ3R method, a method widely taught by study-skills psychologists for learning textual material.

SQ3R stands for **survey, question, read, recite, and review**. As a study method, it has dramatically improved the grade-point averages of most students who have practiced it. It is based upon the concept that active study of written material improves memory and comprehension of information far better than passive reading. Unfortunately, many students have not recognized the difference between active study and mere passive reading.

Students often read a textbook chapter exactly as they would read a novel or a magazine article. They begin with the first sentence of the chapter and read straight through the material, pausing only to underline occasionally. This way of reading may be suitable for a novel, but it is quite inappropriate for a textbook. Psychologists insist that an active study method must begin with a **survey** of the material to be read. If you plan to spend two hours studying a thirty-page chapter, take three-to-five minutes in the beginning and survey the chapter. First, read the boldtype section headings; (each chapter of this book is divided into numbered sections). Second, read a sentence or two from the text of each section. The purpose of this survey is to familiarize you with the topics covered in the chapter. Fight the tendency to stop your surveying process in order to comprehend all of the concepts you are surveying. Comprehension is not the goal of surveying.

Following the survey of all the sections, go back to the beginning of the chapter. Ask yourself a **question** before reading each section. Ask it aloud, if possible, but silently if circumstances demand. The important thing is actually to “talk to yourself.” Normally, each section heading can easily be turned into a question. If the section heading reads **Stare Decisis**, ask yourself the question, “What does stare decisis mean?”

Only after asking a question are you finally ready to **read** a chapter

section. In reading keep your question in mind. By so doing you will be reading for a purpose: to discover the answer to your question.

Upon finishing each section, stop and **recite** the answer to your question. As an example, at the end of the section on stare decisis say to yourself, "Stare decisis refers to the legal tradition that a judge in a given case will follow the precedent established in similar cases decided by courts in that jurisdiction." According to psychologists, to recite this way greatly aids memory. Recitation also lets you know whether or not you have understood the material just read.

The last step of the SQ3R method is **review**. When devoting two hours to the study of a chapter, take the final fifteen minutes of that time to review the material. Review the questions taken from the headings of each chapter section and recite the answers to them, rereading material if necessary to answer accurately.

While the SQ3R method may be used effectively to study any subject, the **case briefing system** is uniquely designed to aid in the study of court decisions. In studying law, students frequently write up case briefs of each decision they read. Whether you are required to write up every decision is up to your individual instructor. However, the case briefing system provides an excellent framework for comprehending complicated judicial reasoning processes, and you should brief cases whether required to do so or not.

To avoid getting lost in a maze of judicial terminology, you should ask yourself a standard set of questions about each case decision and read to discover the answers to these questions. These standard questions lie at the heart of the case briefing system. They are:

- 1 Who is the plaintiff and who is the defendant?
- 2 What are the facts of the case? (Who did what to whom? What is the behavior complained of?)
- 3 Did the plaintiff or the defendant win in the lower court(s), and which party is appealing? (All decisions in this textbook come from appellate courts.)
- 4 What was the legal issue or issues appealed?
- 5 Does the plaintiff or the defendant win on the appeal?
- 6 What rules of law and reasoning does the appellate court use in deciding the issue?

Here is an illustration of a written case brief. It is a brief on the first case in the book, which is found on page 51. Before looking at the brief you should now read that case. To understand the case you need to know that the term "diversity jurisdiction" refers to the power of the federal courts to try cases on subjects of state law. Such jurisdiction is appropriate only when there is complete "diversity of citizenship," i.e., when every plaintiff is from a different state than every defendant.

**Case Brief**

NAVARRO SAV. ASS'N v LEE, 100 S.Ct. 1779 (1980) [The notation following the name of the case indicates that the case may be found in volume 100 of the Supreme Court Reporter, starting at page 1779. The case was decided in 1980.]

**Plaintiff and Defendant**

The plaintiffs are eight individual trustees of Fidelity Mortgage Investors. The defendant is the Navarro Savings and Loan Association.

**Facts**

In 1971, the trustees who controlled Fidelity Mortgage Investors, a real estate investment trust organized under Massachusetts law, loaned \$850,000 to a Texas firm in return for a promissory note. The note was secured in part by the commitment letter of Navarro Savings and Loan Association to loan the Texas firm the money necessary to repay the note. In 1973, the trustees demanded that Navarro honor its commitment, but Navarro refused. The trustees (none of whom were from Texas) sued Navarro (a Texas S & L) in federal district court, alleging that the court had diversity jurisdiction.

**Lower Courts**

The district court dismissed the case for lack of proper jurisdiction. When the U.S. court of appeals reversed the district court's decision, Navarro (called the *petitioner*) petitioned the Supreme Court to decide the issue. (The trustees are called the *respondents* because they respond to the petition.) The Supreme Court agreed to hear the case (the proper phrase is *granted certiorari*).

**Issue Appealed**

In a case involving a business trust is diversity of citizenship determined by the states of citizenship of the trustees or by those of the trust's beneficiaries?

**Who Wins**

The plaintiff.

**Reasoning**

Prior Supreme Court cases establish that the trustees of business trusts may bring diversity of citizenship cases based on their own states of citizenship. In the present case this applies even though some beneficiaries of the trust are citizens of Texas, as is the defendant Navarro. The trustees have complete legal power over the investment monies they control, and the trust beneficiaries have no say-so over investment decisions. [*The judgment of the court of appeals is affirmed.*]

As with the SQ3R method, the case briefing system assists you best when you pause after reading each case to recite answers to the questions raised by

the system. These questions should either be memorized or written down for easy reference while reading case material.

Regular use of the SQ3R method and the case briefing system will substantially raise the grades of most students. The secret to your own success, however, is for you to continue to practice these methods despite an initial awkwardness in their use. The temptation to slide back into a passive reading of the material must be overcome.

**Robert N. Corley**  
**O. Lee Reed**

---

# CONTENTS

List of Cases	xxi
Preface	xxv
To the Student: <i>How to Study The Legal Environment of Business</i>	xxix

## PART ONE INTRODUCTION

<b>Chapter 1</b>	<b>THE LAW AND LAWYERS</b>	<b>2</b>
	1 The Law and Business	2
	2 Definitions of Law	3
	3 The Rule of Law	5
	4 General Classifications of Legal Subjects	6
	5 The Criminal Law	7
	6 The Law of Contracts	10
	7 The Law of Torts	11
	8 The Law of Property	11
	9 Sources of Law	13
	10 Lawyers	15
	11 Other Influences on Behavior	16
	12 Law and Ethics	17
<b>Chapter 2</b>	<b>THE POWERS AND FUNCTIONS OF COURTS</b>	<b>22</b>
	1 Introduction	22
	2 Judges and Justices	23
	3 The Jury	24
	4 Judicial Review	26
	5 Attitudes toward Judicial Review	28
	6 The Interpretation of Legislation	31
	7 Uniform Statutes	33

<b>Case Law</b>	<b>34</b>
8 Inherent Problems	34
9 The Weight to Be Given Precedent	35
10 Selecting the Applicable Case Law	37
11 The Judicial Process	38

---

<b>Chapter 3</b>	<b>THE COURT SYSTEM</b>	<b>44</b>
------------------	-------------------------	-----------

---

1 Introduction	44
2 The State Court System	46
3 Small-Claims Courts	48
4 The Federal Court System	49
5 Diversity of Citizenship Cases	51
6 Federal Reviewing Courts	54
7 Transfer from the States to the Federal System	55
8 The Law in the Federal Courts	55
9 Law and Equity	59
10 Equitable Procedures	61
11 Contemporary Problems	63
12 Delay: Some Solutions	64
13 High Cost: Some Solutions	65
14 The Competency of Lawyers	66
15 Advertising and Competition	67
16 Other Policy Trends and Ethical Considerations	68

---

<b>Chapter 4</b>	<b>LITIGATION AND OTHER METHODS FOR RESOLVING DISPUTES</b>	<b>72</b>
------------------	--	-----------

---

1 Introduction	72
2 Parties to Litigation	73
3 Standing to Sue	74
4 Class-Action Suits	77
5 Jurisdiction of Courts	80
6 Venue	84
7 Pleadings	85
8 Motions	86
9 Discovery Procedures	88
10 Conduct of a Trial	89
11 The Burden of Proof	91
12 Rules of Evidence	92
13 Appellate Procedure	94
14 Enforcement of Judgments and Decrees	98
15 Res Judicata	99
16 Mediation and Arbitration	100



17	Arbitration Proceedings	101
18	Policy Trends and Ethical Considerations	103

## **PART TWO**

### **PRIVATE LAW PRINCIPLES**

---

<b>Chapter 5</b>	<b>CONTRACT LAW AND PRIVATE ENTERPRISE</b>	<b>110</b>
------------------	--	------------

---

1	Introduction	110
2	Classification of Contracts	111
3	Remedies for Breach of Contract	112
4	Offer to Contract	114
5	Acceptance of Offer	116
6	Voluntary Consent to Contracts	117
7	Consideration in the Contract	118
8	Capacity of Parties to Contract	120
9	Illegal Contracts	121
10	When Contracts Should Be in Writing	123
11	The Parol Evidence Rule	126
12	Interpretation of Contracts	126
13	Assignment of Contracts	128
14	Contracts Benefiting a Third Party	129
15	Performance of Contracts	131
16	Discharge of Contracts	132
17	Trends in Contract Law	133

---

<b>Chapter 6</b>	<b>TORTS IN THE BUSINESS ENVIRONMENT</b>	<b>136</b>
------------------	--	------------

---

1	Introduction	136
2	The Development of Tort Law	138
<b>Intentional Torts</b>		<b>140</b>
3	Assault and Battery	140
4	Intentional Infliction of Mental Distress	140
5	Invasion of Privacy	141
6	False Imprisonment and Malicious Prosecution	142
7	Trespass	142
8	Conversion	142
9	Defamation	143
10	Business Torts	146
11	Trademarks and False Advertising: The Lanham Act	148
12	Patents and Copyrights	150
13	Constitutional Torts	154