

# BUSINESS LAW

---

TEXT AND CASES

---

COLLINS  
CIHON  
DONNELLY  
HARTZLER  
KARP  
NAFFZIGER  
WOLFE

---

# **BUSINESS LAW**

---

## **TEXT AND CASES**

---

---

**John W. Collins**

Syracuse University

**Patrick J. Cihon**

Syracuse University

**Mary Ann Donnelly**

Le Moyne College

**Richard Hartzler**

Clarkson University

**James P. Karp**

Syracuse University

**Frederick J. Naffziger**

Indiana University at South Bend

**Arthur D. Wolfe**

Michigan State University

---

---

**John Wiley & So**

New York

Chichester

Brisbane

Copyright © 1986 by John Wiley & Sons, Inc.

All rights reserved. Published simultaneously in Canada.

Reproduction or translation of any part of this work beyond that permitted by Sections 107 and 108 of the 1976 United States Copyright Act without the permission of the copyright owner is unlawful. Requests for permission or further information should be addressed to the Permissions Department, John Wiley & Sons.

***Library of Congress Cataloging in Publication Data:***

Main entry under title:

Business law.

Includes index.

1. Business law—United States. 2. Trade regulation—United States. I. Collins, John W., 1938–

KF889.B86 1986 346.73'07 85-20391  
ISBN 0-471-04075-4 347.3067

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

**TO THE STUDENT** A Study Guide for the textbook is available through your college bookstore under the title Study Guide to accompany Business Law: Text and Cases by John W. Collins, Patrick J. Cihon, Mary Ann Donnelly, Richard Hartzler, James P. Karp, Frederick J. Naffziger, and Arthur D. Wolfe. The Study Guide can help you with course material by acting as a tutorial, review and study aid. If the Study Guide is not in stock, ask the bookstore manager to order a copy for you.

---

**BUSINESS LAW  
TEXTBOOKS FROM  
JOHN WILEY & SONS**

---

**Atteberry, Pearson, and Litka**  
REAL ESTATE LAW, 3RD

**Cataldo, Kempin, Stockton, and Weber**  
INTRODUCTION TO LAW AND THE LEGAL PROCESS, 3RD

**Deaver**  
THE COMPLETE LAW SCHOOL COMPANION

**Delaney and Gleim**  
CPA REVIEW: BUSINESS LAW

**Dunfee and Gibson**  
ANTITRUST AND TRADE REGULATION: CASES AND MATERIALS, 2ND

**Dunfee and Gibson**  
INTRODUCTION TO CONTRACTS, 2ND

**Dunfee and Gibson**  
LEGAL ASPECTS OF GOVERNMENT REGULATION OF BUSINESS, 3RD

**Gleim and Delaney**  
CPA EXAMINATION REVIEW: VOLUME I OUTLINES AND STUDY GUIDE

**Gleim and Delaney**  
CPA EXAMINATION REVIEW: VOLUME II PROBLEMS AND SOLUTIONS

**Griffith**  
LEGAL ENVIRONMENT OF BUSINESS

**Henszey and Friedman**  
REAL ESTATE LAW, 2ND

**Inman**  
THE REGULATORY ENVIRONMENT OF BUSINESS

**Litka and Inman**  
LEGAL ENVIRONMENT OF BUSINESS, PUBLIC AND PRIVATE LAWS, 3RD

**Litka and Jennings**  
BUSINESS LAW, 3RD

**Rothenberg and Blumenkrantz**  
PERSONAL LAW

**Whitman and Stoltenberg**  
COMMERCIAL LAW

**Wolfe and Naffziger**  
THE LAW OF AMERICAN BUSINESS ORGANIZATIONS: AN ENVIRONMENTAL APPROACH

# ABOUT THE AUTHORS

---

**JOHN W. COLLINS** received an A.B. from Hamilton College and a J.D. from Harvard Law School. His published articles include "Improving the Relationship Between Lawyers and Business Clients," "Law in the Business Curriculum," and "Creative Analysis of Judicial Decisions." He is presently a staff editor of the *American Business Law Journal* and professor of Law and Public Policy in the Syracuse University School of Management.

**PATRICK J. CIHON** received a B.A. in political science from Pennsylvania State University, an LL.B. from Osgoode Hall Law School of York University, and an LL.M. from Yale Law School. His areas of interest are labor relations and government regulation of business. He is currently an assistant professor of law and public policy at the Syracuse University School of Management.

**MARY ANN DONNELLY** received a B.A. in English from Le Moyne College in Syracuse, New York, and a J.D. from Harvard Law School. She is a coauthor of *Bankruptcy, Arrangements and Reorganizations*. For the past 14 years she has coauthored "Commercial Law" in the *Annual Survey of New York Law* published by the Syracuse Law Review. She is a member of the New York State Bar and is currently an associate professor in the Business Administration Department at Le Moyne College.

**H. RICHARD HARTZLER** received an A.B. degree in government and a J.D. from Indiana University. He has specialized in Uniform Commercial Code and small business management subjects as well as in legal history, philosophy, and justice. He has served many years as an administrator in Schools of Management and was most recently Dean of the School of Management and Public Affairs at the University of Alaska, Anchorage, before returning to full-time teaching and research. Presently, Hartzler is editor of the *North Country Business and Economic Report for Entrepreneurs* published by the

School of Management, Clarkson University, Potsdam, New York, where he holds the rank of professor.

**JAMES P. KARP** received a B.S. from Pennsylvania State University and a J.D. from Villanova University. He has written numerous articles on environmental law and land use law. He has been an advisor to several government agencies and private corporations on environmental and land use matters. He is coauthor of a text on real estate law. He has served as a staff editor for the *American Business Law Journal*. Currently, James P. Karp is a professor of law and public policy at Syracuse University.

**FRED J. NAFFZIGER** received both his B.A. and J.D. from the University of Illinois. He is a coauthor of *A Basic Guide to Federal Labor Law* and *The Law of American Business Organizations*. He has served as a staff editor of the *American Business Law Journal* and is a past president of the Tri-State Business Law Association. He has been a U.S. Department of State Scholar-Diplomat and has also taught in Saudi Arabia. He is a member of the Illinois, District of Columbia, and Texas Bars and currently is a professor of business law at Indiana University, South Bend.

**ARTHUR D. WOLFE** received a B.A. in history and a J.D. from Ohio State University and an M.A. in economics from the University of Illinois. He has written numerous articles, including "Undergraduate Legal Instruction and the Development of Cognitive Behaviors" and "A Legal and Ethical Critique of the Use of Cost Benefit Analysis in the Public Law System," and he is the coauthor of four books on business law and the legal environment of business. He has served on the editorial board of the *American Business Law Journal* for 10 years and was editor-in-chief in 1984–1985. He is a member of the Indiana, Ohio, and U.S. Virgin Islands Bars and is professor of business law at Michigan State University.

# *PREFACE*

---

This book is about law. Our intention, however, is not that it be used by lawyers. Instead, this book has been written for people who are not lawyers but who nevertheless recognize that a basic understanding of the law and the legal system is indispensable in contemporary society. We expect that most, although not all, of our readers will be instructors and students in universities and colleges throughout the United States. We hope that they and others who use this book will find it enjoyable and useful.

## THE PURPOSE OF THIS BOOK

The purpose of this book is to help the reader to learn about business law and the legal environment of business. The book has been designed to be a teaching tool that will help instructors to convey their knowledge of law to their students, and it has been written with an eye to avoiding the pitfalls common to many business law books. Thus, students who use this book should develop a thorough knowledge of law and a firm understanding of its effects on business and society.

The book's accurate and comprehensive coverage — 56 chapters, 7 appendices, and a glossary — means that it can be used in both business law and legal environment of business courses. The text and cases throughout the book have been written and edited by business law instructors who are recognized experts in their respective fields.

### Clear Presentation

Throughout the book, the text, the cases, and the problems have been written and edited to make the law clear to students. All technical words are explained in the text and are included in the glossary. Legal concepts are developed logically, and the use of four levels of headings will help students to understand the concepts as they are developed. Examples are used frequently to explain



legal concepts. Actual court decisions have been very carefully edited so that they too are comprehensible to students and clarify the text rather than cause confusion. Most of the court decisions begin with an edited summary of the facts and procedure of the case.

### Total Integration

Perhaps the characteristic that contributes the most to the high quality of this book is the total integration of its materials. In each chapter, the text that explains legal concepts flows naturally into the cases that illustrate those concepts. The lead-in to each case explains the relationship between the case and the preceding text material. Furthermore, each case is followed by case review questions that require the student to relate the text material to the case, thereby highlighting the important points that the student should learn from reading and analyzing the case. Finally, each chapter concludes with review questions and case problems. A student who can answer all of the review questions for a chapter will have gained a basic understanding of the most important points of the chapter. The case problems, which have been carefully developed so that they can be fully answered on the basis of the material presented in the chapter, require the students to apply the law that they have learned rather than just to memorize it.

The 7 appendices consist of the Constitution of the United States, the Uniform Commercial Code, the Uniform Partnership Act, the Uniform Limited Partnership Act, the Revised Uniform Limited Partnership Act, the Model Business Corporation Act, and selected antitrust statutes. The appendices have been placed in a separate volume in order to facilitate their use. When studying topics that require reference to material in an appendix, the student can look at the text and the appendix at the same time. We have found this to be much more convenient than having to refer to appendices that are located in the back of the book.

## THE ORGANIZATION OF THE BOOK

The organization of this book has been developed to present information in an order that will help the reader to learn about and to understand law. The book is divided into 10 parts.

### Part I: The Legal Environment of Business

Part I consists of 7 chapters that introduce the student to the study of law and to the legal environment in which business functions. Chapter 1 presents an approach to the study of law that will help the student not only to memorize legal rules but also to understand how those rules operate in the business world. The analytical framework that is presented to the student explains in simple terms the sources of laws, the effects of laws, and the possible goals of law.

Chapter 1 also carefully explains how court decisions are used in the study of law, instructs the student on how to brief a case, and presents a practice court

decision for the student to read and analyze in the manner recommended in the chapter. Although all of the introductory topics usually found in the first chapter of business law books are included in Chapter 1, the chapter has been organized in a way that permits the students to understand the significance of each of the topics as well as their relationships to one another and to topics presented later in the book.

In Chapters 2 through 4, students learn about the structure and process of the legal system—including the process of legal reasoning that contributes to the environment in which business operates. In Chapters 5 and 7, two areas of the law—tort law and criminal law—that are not related exclusively to business, but which are such pervasive legal topics that they are important aspects of the legal environment of business, are explained and discussed.

Also included in Part I is coverage of product liability in Chapter 6. This chapter has been placed after the chapter on tort law in order to illustrate how the courts have applied tort law to the issue of product liability. Chapter 6 is also included in Part I to show students one of the areas in which business has an impact on society and how society has responded to that impact.

## Parts II through IX

The next 8 parts of the book—Parts II through IX—provide accurate and comprehensive coverage of those areas of law that directly affect business:

- Part II: Contract Law (11 chapters)
- Part III: Sales Law (6 chapters)
- Part IV: Negotiable Instruments Law (4 chapters)
- Part V: Debtor–Creditor Law (2 chapters)
- Part VI: Agency Law (4 chapters)
- Part VII: Partnership Law (3 chapters)
- Part VIII: Corporation Law (4 chapters)
- Part IX: Property Law (3 chapters)

## Part X: The Regulatory Environment of Business

Part X contains 12 chapters. It begins with 2 chapters that carefully explain the structure and process of government regulations of business. The remaining 10 chapters deal with various areas of business activity that are regulated by the government through antitrust law, consumer protection regulation, insurance law, securities regulation, labor law, employment discrimination law, environmental law, and land-use regulation.

## SUPPLEMENTS TO THIS BOOK

Four supplements are available to users of this book. The purpose of each of the supplements is to enhance the effectiveness of the book as a tool for teaching and learning about business law and the legal environment of business.

## Study Guide

A study guide that helps the students to derive the most benefit from using this book has been prepared by Professor Janine Hiller of Virginia Polytechnic Institute and State University. In the study guide, each chapter of the book has been outlined. Included in the outline are references to the cases in the chapter, the case review questions, the review questions, and the case problems. A list of key words and objective study questions are also included for each chapter.

## Instructor's Manual

A comprehensive instructor's manual prepared by the authors is available to instructors who adopt this book. The manual contains the same chapter outline with references that is found in the Study Guide. In addition, the instructor's manual includes case summaries and answers to the case review questions, the review questions, and the case problems.

## Test Bank

An extensive test bank of effective true-false, multiple-choice, and essay questions prepared by William Burke of the University of Lowell is available to instructors who adopt this book. This test book is available on software disks for Apple, TRS-80, and IBM-PC compatible computers.

## Transparencies

A set of acetate teaching transparencies is also available free to adopters.

In summary, we hope our book provides both instructors and students with an effective tool for the study of business law. We are anxious to receive feedback from you letting us know in what ways we have succeeded and in what ways we might improve our efforts. Please feel free to write us to give us your views. In the meantime, we hope you enjoy and benefit from using this book.

**John W. Collins**  
**Patrick J. Cihon**  
**Mary Ann Donnelly**  
**Richard Hartzler**  
**James P. Karp**  
**Frederick J. Naffziger**  
**Arthur D. Wolfe**

# ACKNOWLEDGMENTS

---

The authors wish to acknowledge the many people who have made significant contributions to the completion of this book.

Professor Sandra N. Hurd of Syracuse University wrote Chapter 5, *Tort Law*, and Chapter 7, *Criminal Law*. Professor Edward Graves of the American College wrote the original draft of Chapter 50, *Insurance Law*. Chapter 53, *Employment Discrimination*, is adapted from *A Basic Guide to Federal Labor Law: The Private Sector*, second edition, pp. 155–173, © 1975, 1981, by Fred J. Naffzinger and Keith Knauss.

We have benefitted from the thoughtful manuscript reviews of Jenny Bennett, Sandra Hurd (Syracuse University), Jack Karns (University of North Dakota), Charles Patten (University of Wisconsin-Oshkosh), Eric Richards (Indiana University), Michael Schuster (Syracuse University), George Spiro (University of Massachusetts, Amherst), and Frances Zollers (Syracuse University).

For help in the production of the manuscript we thank Gloria Burhyte, Roberta Chamberlin, Sheila Forsyth, Jill Cooper, Colleen Woodward, Mary Ann De Michele, Joseph Callahan, Jon Canis, Matthew McCabe, William Kiessling, Patti Vassalo Hoversten, and Denise Androvette.

The following permissions to reprint materials are acknowledged: Drawing by Robt. Day, © 1950, 1978 The New Yorker Magazine; partnership agreement by Matthew Bender and Company, Inc.; excerpts from the Restatement (Second) of Agency, © 1958, the Restatement (Second) of Contracts, © 1981, and the Restatement (Second) of Torts, © 1965, all copyrighted by the American Law Institute; Uniform Commercial Code, © 1978, The American Law Institute and the National Conference of Commissioners on Uniform State Laws; adaptations of CPA examination questions, all copyrighted by the American Institute of Certified Public Accountants; stock certificate provided by Maura Rodgers; specimens of bank documents provided by Key Bank of Central New York through Mr. Richard Liddle.

We are greatly indebted to the talented, understanding, and patient people at

John Wiley & Sons who have contributed so much to our efforts: Barbara Heaney, Rafael Hernandez, Jan Lavin, Elizabeth Meder, Kevin Murphy, Chris Ross, Alida Setford, Susan Winick, and especially our editor, Lucille Sutton. Thanks also to Steve Perine, whose tough blue pencil has become so familiar to us.

Finally, we wish to thank our families, friends, and students, whose support and patience have been indispensable.

**J.W.C.**

**P.J.C.**

**M.A.D.**

**R.H.**

**J.P.K.**

**F.J.N.**

**A.D.W.**

# TABLE OF CONTENTS

## PART I

### THE LEGAL ENVIRONMENT OF BUSINESS

<b>1</b>			
INTRODUCTION TO LAW AND THE LEGAL SYSTEM		Decision Making 58 Judicial Philosophies 63	
	3		
Where the Law is Found 3 The Effects of Law 6 The Goal of Law 8 An Analytical Framework 9 A Practice Case 10			
<b>2</b>		<b>5</b>	
BEGINNING A LAWSUIT	17	TORT LAW	71
Jurisdiction 18 Original Jurisdiction and Venue 25 Pleadings 26		Purposes of Tort Law 71 Causation 72 Damages 73 Types of Torts 75 Business Torts 95	
<b>3</b>		<b>6</b>	
TRIAL AND APPEAL	35	PRODUCT LIABILITY	105
Pretrial Proceedings 35 The Trial 39 Appeal 47 The Effects of Final Judgment 50		Tort Law and Products 105 Warranties and Products 115 Strict Liability in Tort 125	
<b>4</b>		<b>7</b>	
LEGAL REASONING	53	CRIMINAL LAW	133
The Decision Setting 53		The Purpose of the Criminal Law 134 Substantive Criminal Law 134 Constitutional Protections 142 Corporate and Executive Criminal Responsi- bility 149	

## PART II

### CONTRACT LAW

<b>8</b>	<b>INTRODUCTION TO CONTRACT LAW</b>	<b>161</b>	<b>Exceptions to the Doctrine of Consideration</b>	<b>229</b>
	Promises, Promises	161		
	An Overview of Contract Law	163		
	Sources of Contract Law	164		
	Analyzing Contract Cases and Problems	166		
<b>9</b>	<b>THE BARGAINING PROCESS: OFFER</b>	<b>169</b>	<b>13</b>	<b>CONTRACTS IN WRITING</b>
	Was a Promise Made?	170		237
	Intent to Be Legally Bound	173		Statute of Frauds
	Definiteness and Certainty	176		Parol Evidence Rule
				Interpretation of Contracts
				Plain Language
<b>10</b>	<b>THE BARGAINING PROCESS: ACCEPTANCE</b>	<b>183</b>	<b>14</b>	<b>CAPACITY TO CONTRACT</b>
	Was the Offeror's Demand Met?	183		257
	Did the Offeree Intend to Accept?	187		Capacity of Minors
	Did the Offeree Accept by a Proper Means?	188		Capacity of the Mentally Infirm
	Was the Offer Still in Existence When Accepted?	192		266
<b>11</b>	<b>FAIRNESS IN THE BARGAINING PROCESS</b>	<b>199</b>	<b>15</b>	<b>ILLEGALITY</b>
	Misrepresentation	199		271
	Fraud	201		When Is an Agreement Illegal?
	Duress and Undue Influence	205		Effect of Illegality
	Unconscionability	207		278
	Mistake	212	<b>16</b>	<b>RIGHTS OF THIRD PARTIES</b>
				287
<b>12</b>	<b>CONSIDERATION</b>	<b>221</b>		Assignment of Rights
	What Is Consideration?	222		Delegation of Duties
	Application of the Doctrine of Consideration	222		Third-Party Beneficiaries
			<b>17</b>	<b>DISCHARGE OF CONTRACT DUTIES</b>
				299
				Discharge by Performance
				Excuses for Nonperformance
			<b>18</b>	<b>REMEDIES</b>
				313
				Money Damages
				Specific Performance
				Restitution

PART III**SALES LAW**

<b>19</b>	<b>INTRODUCTION TO SALES LAW</b>	<b>333</b>	<b>22</b>	<b>LIABILITY OF SELLERS</b>	<b>405</b>
	Uniform Law for Sales	333		Sales Warranties	405
	Sales (Article 2)	336		Breach of Warranty	406
<b>20</b>	<b>SALES CONTRACTS</b>	<b>361</b>		Code Warranties	410
	Offer and Acceptance	361		Exclusion or Modification of Warranties	419
	Fairness in the Bargaining Process	375		Warranty Coverage	424
	Exclusive Dealing Arrangements	376		Magnuson-Moss Warranty Act	424
<b>21</b>	<b>LOSS AND OWNERSHIP</b>	<b>383</b>	<b>23</b>	<b>PERFORMANCE</b>	<b>429</b>
	Identification of Goods to the Contract	383		Payment by the Buyer	429
	Risk of Loss	385		Delivery by the Seller	434
	Transfer of Title	395	<b>24</b>	<b>SALES REMEDIES</b>	<b>455</b>
	Documents of Title	400		Buyer's Breach: Seller's Remedies	455
				Seller's Breach: Buyer's Remedies	466
				Limitation of Remedies	474

PART IV**NEGOTIABLE INSTRUMENTS LAW**

<b>25</b>	<b>NEGOTIABLE INSTRUMENTS</b>	<b>483</b>	<b>27</b>	<b>LIABILITY AND DISCHARGE</b>	<b>529</b>
	Negotiability	484		Signatures	529
	Types of Negotiable Instruments	485		Fictitious Payees, Imposters, and Material Alterations	533
	The Form of a Negotiable Instrument	489		Liability of the Parties	537
	Incomplete Instruments	498		Discharge	546
				Warranties	550
<b>26</b>	<b>NEGOTIATION AND THE HOLDER IN DUE COURSE</b>	<b>501</b>	<b>28</b>	<b>BANK DEPOSITS AND COLLECTIONS</b>	<b>559</b>
	Negotiation	501		The Bank Collection Process	559
	The Holder in Due Course	511		A Payor Bank and Its Customer	567
	Abuse of Holder in Due Course Status	523		A Bank's Warranty Rights	574



PART V**DEBTOR-CREDITOR LAW**

<b>29</b>	<b>SECURED TRANSACTIONS</b>	<b>581</b>	<b>30</b>	<b>BANKRUPTCY</b>	<b>611</b>
	The Function of Security	581		State Remedies	612
	Creating a Security Interest	583		Federal Bankruptcy Law	613
	Priorities	593		Liquidation—Chapter Seven	614
	Proceeds	600		Adjustment of Debts of an Individual with	
	Termination	603		Regular Income—Chapter 13	641
	Debtors' and Creditors' Rights on De-			Reorganization—Chapter 11	643
	fault	604			

PART VI**AGENCY LAW**

<b>31</b>	<b>THE AGENCY</b>		<b>33</b>	<b>TORT LIABILITY</b>	
	<b>RELATIONSHIP</b>	<b>653</b>		<b>TO THIRD PARTIES</b>	<b>691</b>
	Creation of the Agency Relationship	654		Tort Liability	691
	Duties of the Agent to the Principal	655		Tort Liability of Principals to Third Par-	
	Duties of the Principal to the Agent	663		ties	693
<b>32</b>	<b>CONTRACT LIABILITY</b>			Tort Liability of Agents to Third Par-	
	<b>TO THIRD PARTIES</b>	<b>673</b>		ties	710
	Contract Liability of Principals to Third Par-		<b>34</b>	<b>AGENCY OPERATION</b>	
	ties	674		<b>AND TERMINATION</b>	<b>713</b>
	Contract Liability of the Agent to Third Par-			Agency Operation	713
	ties	685		Termination of Authority	721

PART VII**PARTNERSHIP LAW**

<b>35</b>	<b>PARTNERSHIP CREATION</b>	<b>733</b>		<b>Partnership Operation: Tort Liability</b>	<b>755</b>
	Partnership Creation	733		<b>Partnership Dissolution</b>	<b>764</b>
	Rights and Duties of Partners	739	<b>37</b>	<b>OTHER FORMS</b>	
<b>36</b>	<b>PARTNERSHIP OPERATION</b>			<b>OF PARTNERSHIP</b>	<b>781</b>
	<b>AND DISSOLUTION</b>	<b>751</b>		Partnership by Estoppel	781
	Partnership Operation: Contract Liabil-			Joint Venture	782
	ity	751		Mining Partnership	782
				Limited Partnership	783