

**The Law
of American
Business
Organizations**

An
Environmental
Approach
WOLFE | NAFFZIGER

*The Law
of American
Business
Organizations*

The Law of American Business Organizations: An Environmental Approach

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*This book is dedicated to our children,
Wendy, Becky, and Jane Wolfe and
Susan, John, Ann, and Ellen Naffziger*

Preface

Most new textbooks are motivated by a perceived gap between the real world and the knowledge of that world provided by current instructional materials. In *The Law of American Business Organizations: An Environmental Approach*, formerly entitled *Legal Perspectives of American Business Associations*, we attempt to close that gap by proceeding in three ways, all of which help to distinguish this book from others on the same material. First, most textbooks focus primarily on the formation and control of business corporations under state law. They neglect the strong federal influence exerted on business corporations through federal regulation of the issuance and trading of securities. Over one-fifth of this text is devoted to a comprehensive treatment of federal securities regulation.

Second, the title includes the words, “An Environmental Approach.” These words reflect both substantive ideas and matters of form. Business students, undergraduates especially, have a strong urge to seek out hard-and-fast rules. This is a result of the kind of information and pedagogy that exists in almost all business-college instruction. But law, like life, *cannot and should not be reduced to a mere presentation and then memorization of rules*. Almost all rules have exceptions, rough or vague edges, and even voids. The exceptions, the vagueness, and the voids are understood only if the rules are presented in a broader context that includes at least history and present-day policy and political ideas and forces. Substantively, the material in this book in all the major areas covered includes information on the history of the rules or exceptions and the policy reasons for them.

As a matter of form, we realize that a convenient starting point for the study of law is with the rules. The critical question for authors is, which rules are important? Often students are presented with massive doses of rules and they cannot discern the important rules from the less important rules. We focus on fewer rules. What we believe to be the more important ones in the areas of law are covered and then explained, analyzed, and evaluated in a thorough manner. Also, as a matter of form, the cases are a bit longer than those found in comparable texts. This requires the student to analyze a factual pattern as he or she must do

when confronting a problem outside the classroom. The review questions following the cases focus the readers' attention on our purpose for including the case in the text. At the end of each chapter, and in the appendix, are a series of review questions, some of which are from past CPA exams. These require the student to analyze the facts, correctly recall and apply one or more legal principles, and, finally, synthesize an answer by, in some cases, considering both legal and policy issues.

Third, we demonstrate how business organizations do not operate merely within the sometimes too-narrow confines of a legal environment. There exist social, political, ethical, and international forces that affect the management of a business. An enterprise may operate legally and profitably yet encounter serious problems if society believes that its activities are harming the social fabric of the nation. Some social beliefs, such as the view that discrimination against an individual on account of race, religion, sex, or national origin is wrong, eventually are enacted into law. Others, no less real, exist in an unwritten form within the collective conscience of a country. Readers of this text are made aware that the consideration of such nonlegal factors is a significant part of the management process.

The book is intended for two types of courses: (1) the undergraduate course in business organizations, particularly that taken by accounting majors and (2) the graduate MBA course that deals with the legal environment of business.

The student in the business organization course will find not only the traditional material on agency, partnership, and corporation law, but also, the law of federal securities. Excerpts from the Model Business Corporation Act are integrated into the text. The accounting student will also find worthwhile Chapter 17, Accountants and the Securities Law, for it also contains a discussion of accountants' liability under common law. The CPA examination law questions in both the review problems at the end of most chapters and the appendix should be a major aid to those considering taking the CPA examination.

MBA students will find the text illustrating the legal environment within which the business organization operates relevant, as well as illuminating. The emphasis on the most important rules, policy questions, and issues of social responsibility that confront management provide for graduate students a thorough introduction to the law and legal environment of business organizations.

The text is divided into six parts followed by an appendix and glossary.

Part One of the book is written with the assumption that the student has never taken a law course. We realize this assumption may not be accurate, but we believe it is better to be thorough than incomplete. Students who have had a previous business law course may wish to skip Chapter 1, which presents the process of rule creation by legislatures, individuals, and judges. This chapter gives special emphasis to the studying and

briefing of appellate cases. In Chapter 2 we present an overview of the most prominent forms of American business organizations, as well as “S” (formerly subchapter S) corporations and franchises.

Part Two discusses the law of agency. These chapters, and the ones that follow, are not burdened with the terse statements of all the possible rules on agency law. Rather, the textual material emphasizes the fundamental rules of agency: the nature of the fiduciary relationship, the concepts of contractual authority and vicarious liability, and the growing uses of apparent authority.

Part Three combines text and appellate cases, together with sections of the Uniform Partnership Act, in order to analyze and evaluate partnership law. The presentation uses a typical partnership agreement as an organizational guide. Topics included are partnership formation, the duties owed by partners to each other and the partnership, partnership property, the contractual and tort liabilities of the partners and the partnership, and the liability of incoming partners and other issues created by partnership dissolution.

Part Four focuses on corporation law. Corporate documents, the MBCA and statutes from various states, as well as text and appellate cases are used in these chapters to illustrate the circumstances in which courts apply corporate law. The chapters cover the formation and personality of corporations; the relationship of the shareholder to both the large and closely held corporation; the role of the directors and officers in managing the corporation and their liability for crimes, torts, and the breach of their fiduciary duties; and the alteration or dissolution of the corporate structure.

Part Five presents federal securities law. The increasing importance of this area of law for business persons is manifested not only by the increasing number of major CPA examination questions on the topic, but also by the increased litigation spawned under these federal statutes. The analysis of this area begins with a chapter that provides an overview of securities regulation and is followed by one devoted to the issues raised by the insider trading laws. Next we discuss the liability of directors and attorneys involved in securities transactions. The explosive growth of litigation against accountants under these statutes has resulted in a longer chapter on accountants’ liability, including an explanation of the Foreign Corrupt Practices Act. Coverage of the proxy and tender offer process ends this portion of the book.

Part Six explores the business organization’s duties to employees and the public. The discussion of such legal issues also involves issues of a social and ethical nature. The relationship of the employer to the employees is examined not only in the traditional labor law context, but also within the milieu of the laws against discrimination in employment. The social responsibilities of business are examined within the context of products liability and environmental protection laws. Finally, the role of the

corporation in the political process is explored and its role in the international business environment is considered.

We wish to note the extensive contributions of the judges who authored the opinions reproduced herein. Without their careful analysis and lucid prose this work would suffer significantly. Also we gratefully acknowledge the kind contributions of Thomas H. Corson, Chairman of Coachmen Industries, Inc., for the use of a Coachmen stock certificate; the American Institute of Certified Public Accountants for the use of CPA examination questions; Professor Keith Knauss for permission to reprint portions of a chapter from a book that he coauthored; and Matthew Bender and Company, Inc., for the use of a partnership agreement.

Appreciation also goes to professors James R. Bliss of Western Michigan University, Donald L. Boren of Bowling Green State University, Michael D. Engber of Ball State University, Richard A. Mann of the University of North Carolina, and David Reitzel of California State University, Fresno, for the many helpful suggestions they provided in the review process. Legal discussions with Robert Schlifke, attorney-at-law of South Bend, Indiana, have also been productive. We note also the special contribution of Professor Thomas Dunfee of the Wharton School, University of Pennsylvania, to the previous edition of this book. Finally, we express our gratitude to Lucille H. Sutton, business law editor at John Wiley & Sons. Her encouragement, patience, and suggestions aided us immensely. Authors cannot have a better editor than Lucille.

As authors the final responsibility for the book rests with us. We are responsible for the views presented and the accuracy of the information. Professor Wolfe is primarily responsible for the material in chapters 1–8 and 21. Professor Naffziger is primarily responsible for the material in chapters 14–20 and 22. Chapters 9–13 reflect a blending of efforts.

We welcome suggestions and comments from those who use the text.

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Frederick J. Naffziger

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