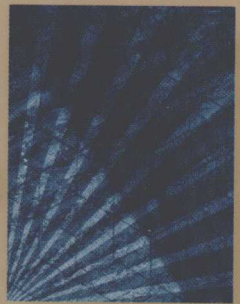
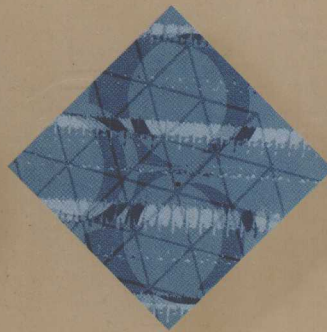


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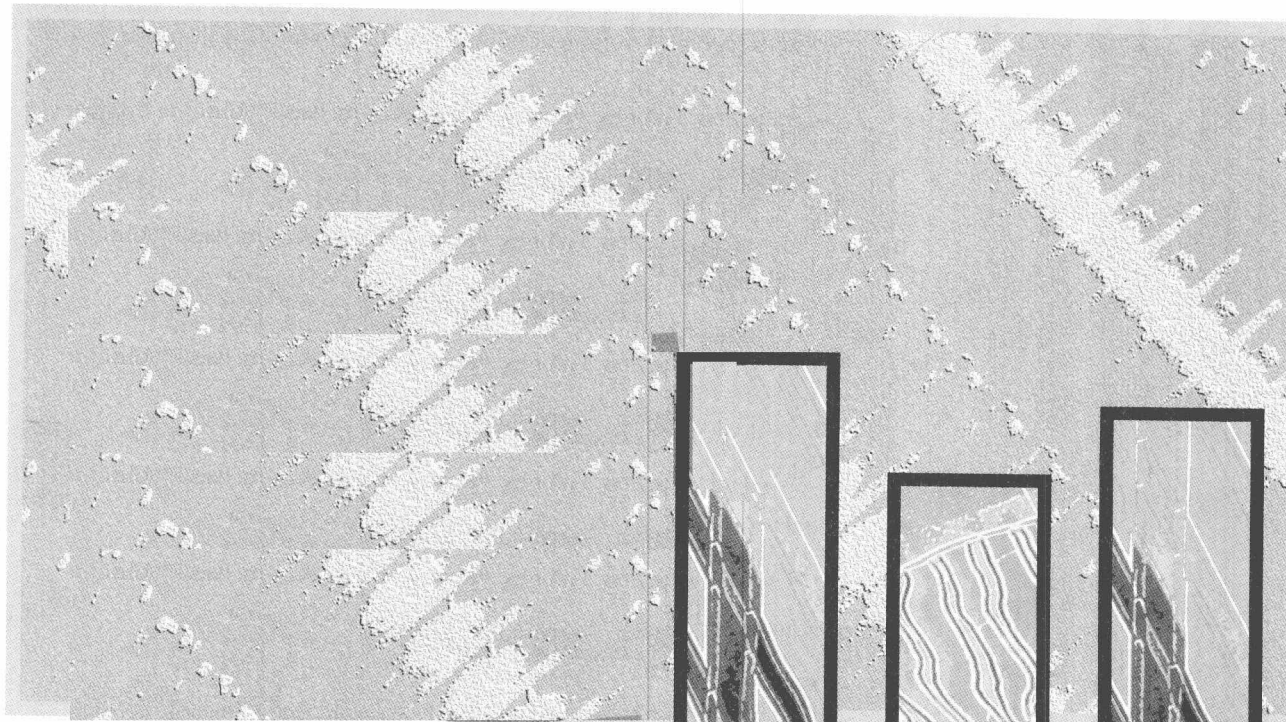
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Legal Studies in Business

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Preface



L*egal Studies in Business* is designed to help future managers think critically about how the law affects business decisions. It is for use in a survey course—whether the name of the course is legal environment of business, business law, or some combination of the two. *Legal Studies in Business* encompasses what the legal environment approach to business was meant to provide but never did because of its focus on regulatory minutia. Furthermore, like the traditional approach, rigor and depth exists in *Legal Studies in Business*, but overwhelming detail has been replaced with context and explanation of what is truly important for the future business manager.

You will find fewer legal rules than you are accustomed to seeing in other textbooks. We hope that none of your favorites are missing. In our view, comprehensive coverage of legal rules should not be the aim of a business law course. Instead, the course must integrate and explain the key concepts that make up the legal world in which managers work.

To accomplish this, we wrote *Legal Studies in Business* with the following guideposts in mind:

- How can a business law book be made manageable, yet retain rigor?
- For each legal rule, we asked, “Is there a point to including it in a book that is to be used by future business managers?”
- Can the student be engaged critically to think about business decision making and law?
- What is the context (historical, ethical, social policy, international concerns) of the legal principle?
- How do managers respond to the legal environment that affects their business?

You can see how these questions were applied; for example, in Chapter 11 on the “Legal Aspects of Business Organizational Forms,” this topic is explored by using four investor interests—limited liability, profit share, management rights, and control. These interests drive the discussion of the forms and provide a means by which students choose the form that best meets their business goals. Three investors—Jones, Thomas, and Smith—are followed throughout this chapter. Then, in the next two chapters, these investors hire employees (which emphasizes the agency and fiduciary duty principles) and seek capital for their business.

Even the Table of Contents illustrates our integrative approach. In addition to listing the topics in each chapter, we show how each

chapter's coverage is geared toward the needs of the future business manager. We accomplish this in two ways. First, by highlighting the issues that capture key elements in the chapter, we draw the student's attention to important managerial concerns. For example, Chapter 16 in the Table of Contents contains the question (which is tied to a section of the chapter), "Should business managers be concerned if modifying an employee healthcare plan will affect the disabled?"

Second, we summarize why the chapter's materials are important for business. Thus, the Table of Contents connects the future business manager with the law in a compact form for each chapter in the text. Our Table of Contents is a learning tool as much as a guide to the book.

Key Features in Legal Studies in Business

INTERACTIVE MATERIAL TO ENCOURAGE CRITICAL THINKING

Legal studies should be an exciting and rewarding experience. But, this may happen only if the student is engaged by the learning process. *Legal Studies in Business* is an interactive textbook. Every chapter contains materials that require a student's participation. Thus, Thought Problems, Ethical Perspectives, International Perspectives, and Managerial Perspectives are raised throughout this textbook. The purpose of these elements is to connect the law to situations that face executives in the business world.

- *Thought Problems:* Thought Problems are critical thinking exercises. Some of them were derived from cases, others were derived from general sources. A few of the Thought Problems are hypothetical examples. All help the student connect legal principles to managerial concerns. For example, in Chapter 10 which covers torts, one Thought Problem asks the student to make suggestions to Norfolk and Western Railway Company after one of its sleep-deprived employees caused an accident while driving home after work. This question should encourage discussions of tort principles and risk, as well as ethics and the cost to a company in changing policies. Creative suggestions may be expected from a class that is energized by the Thought Problem feature of our book.
- *Ethical Perspectives:* Chapter 7 examines the relationship between ethical business conduct and legal risk, and then offers a model for making ethical decisions. In addition, to critically engage the student throughout the book, we provide Ethical Perspectives. Some of them illustrate ethical issues, while others ask students to apply the Chapter 7 model as if they were business managers. The students are then asked to assess its outcome on legal risk. The well publicized McDonald's hot coffee case is explored from an ethical perspective, which provides future managers insight into the relationship between legal risk and ethics-based decision making.
- *International Perspectives:* Chapter 19 provides an overview of the international legal environment of business. However, given the importance of encouraging global thinking, we also provide International Perspectives in each chapter. For example, in Chapter 10 which covers tort liability, one such International Perspective compares Western European approaches to compensating injured people with the tort law approach used in the United States.

- *Managerial Perspectives*: An important way that our textbook connects the future business manager to the law is through Managerial Perspectives. For example, in Chapters 8 and 9 which deal with contract law, we include contract negotiating exercises. These Managerial Perspectives not only energize the student's learning of contract principles, but they also illustrate the business manager's role in the process.

WRITTEN FOR THE FUTURE BUSINESS MANAGER

Legal Studies in Business encourages the student to approach the law as a business manager, not as an attorney. Likewise, the text has been written for this reader, not for an attorney. It is written in a clear and concise manner that is meant to provide relevant information in a challenging way, especially to the business student. In addition, we reworked the traditional cases and aimed them at the business student. Our end-of-chapter questions will also be noted and discussed later in the Preface.

- *Cases*: We use cases to *illustrate* principles that have already been discussed in the text. They are "real life" examples of previously well explained material. We do not use cases as sources from which the students must derive the principle. Nor must the students rely on the cases to have the principle explained. These are approaches that *future attorneys* should learn—not *future business managers*.

You will find cases presented in the following three ways:

1. *Edited*. In every chapter, we edited carefully chosen, factually interesting, and pertinent judicial opinions to capture some of the issues we wanted to illustrate. Discussions of legal procedures and extraneous issues were removed, because we do not see how they would enhance the education of a business manager. Nonetheless, students will read the judge's language (and sometimes a dissenting opinion, too). This is original source material that we transformed to make useful for business students.
2. *Textualized*. These cases are still set apart from the rest of the book. However, we rewrote them so that they appear as "real life" examples. The citations are provided, however, for the curious student who wants to check the original source. For example, in Chapter 12 on "*Members of Business Organizations: Regulation of Their Activities through Agency and Fiduciary Duty Principles*," we provide a synopsis of a case to illustrate vicarious liability arising from a company's picnic policies.
3. *Thought Problems*. Many of the textualized cases are also Thought Problems. As previously discussed, these items encourage critical thinking. In fact, the example provided in the earlier discussion on Thought Problems was a textualized case.

Every chapter ends with Review Questions. All of them are hypothetical examples designed to provide clear illustrations of the materials in the chapter. Our hypotheticals may be used for two purposes:

1. *Student Self-Testing*. The student alone (or, preferably in groups) may readily use the Review Questions to check their understanding of the materials in the chapter.
2. *In-Class Discussion*. The Review Questions may become starting points for in-class discussion, or they may be used as quick summaries of materials that the instructor has previously covered, but believes need more elaboration.

Supplements Supplements are also available for use with *Legal Studies in Business*:

- An **Instructor's Manual** by Gary Sibeck (Loyola Marymount University) includes an overview and teaching goals, case summaries, a chapter outline with detailed teaching suggestions and discussion points, and suggested answers to the review questions.
- A **Student Study Guide** by Susan Grady (University of Massachusetts—Amherst) is available for sale to students. It offers an excellent review of key points for each chapter, as well as self-tests with answers for students to test their understanding.
- A **Test Bank** by James Hill (Central Michigan University) offers true-false, multiple choice, and essay questions. The test bank is also available in computerized form.
- **Transparency Acetates** provide key figures from the text to display during lectures.

West Publishing Company offers supplemental classroom tools to qualified adopters for use with *Legal Studies in Business*.

- **Westest Computerized Testing.** The test bank is available on the latest version of Westest for IBM PCs and compatibles and Macintosh. It allows you to:
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- West Regional Reporter System. *The Reporter* is available free to qualified adopters for one year. It gives you and your students updated case decisions from your region throughout the year and helps students learn the reporting system for legal research.

We would like to thank all of the people who contributed so much to *Legal Studies in Business*. Elizabeth A. Miller did outstanding research work for portions of this textbook. Joan M. Gergacz provided exceptional editorial criticism and rewrites of parts of the book. In addition, we owe a heavy debt of gratitude to the many reviewers of *Legal Studies in Business*. The reviewers critiqued the manuscript throughout its development, and their insight inspired us to make innumerable changes that improved the book greatly. The reviewers include:

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Prologue

The Importance of Knowing the Law

During the Industrial Revolution in the nineteenth century, most of the rules governing business arose from private agreements. Federal, state, and local governments tended to regulate businesses only to a minimal extent. This worked to the advantage of the nation, as it permitted the rapid industrialization of America. At the conclusion of the nineteenth century many American businesses such as Standard Oil spanned the globe.

As we no longer needed to concern ourselves with developing our industrial base, the concerns of people in America by the end of the nineteenth century began to turn to the distribution of wealth brought about by such multinational enterprises as the Standard Oil Trust and the Carnegie Steel Corporation. The perception of many people during that era was that private agreements could not bring about the social changes that many people desired in American society. For this reason, people turned to government in an attempt to change the relationship between business and society.

As the decades unfolded in the twentieth century, we began to see more and more laws created at all levels of American government. We entered a new era of supervision of business by government. Today's business manager not only needs to know the fundamentals of business—finance, marketing, and accounting—but he or she must also keep abreast of the law. In many ways the law controls what can and cannot be done in business, and how various managerial functions must be performed. Something that may seem to make sense in terms of finance or marketing may nonetheless not be possible because of the law. For this reason, before embarking on a given course of action, a wise manager needs to consider the legal environment of business.

The law is dynamic and ever changing. It responds to social forces such as public opinion. What may have been permissible in one year may no longer be legal behavior. A manager needs to consult with lawyers. This book will greatly assist you in your dealings with the legal profession and with your own attempts to stay current in the areas of law that affect your particular business position. The chapters in this book will, first of all, give you a broad overview of the legal system itself. This will assist you in understanding how laws are created, how they are enforced, and how they are interpreted. At the same time, one needs to bear in mind that even if a given course of action is lawful, it may nonetheless be unethical. To give you some insight with respect to appraising business behavior, we devote a specific chapter to business ethics.

The balance of the text is broken down into chapters that discuss various bodies of law that govern certain types of behavior or transactions. Once you have completed this material, it will be much easier to communicate meaningfully with your attorneys, and to understand articles that appear in such publications as *The Wall Street Journal*, *Business Week*, or *Money Magazine*. When you take other courses in business school such as marketing or accounting, this material will give you a better understanding of any references to the law.

Civil and Criminal Law

CRIMINAL AS OPPOSED TO CIVIL LITIGATION

The American legal system handles cases in two separate ways—*civil litigation* and *criminal litigation*. The same action may result in both a civil case and a criminal case, but usually a set of facts gives rise to either one or the other.

■ **Civil Cases**

In a **civil case**, the plaintiff institutes suit against the defendant for some civil wrong allegedly committed by the defendant. Civil suits may be instituted by private citizens, businesses, or the government. The law creates the rights and duties of people. The term *civil law* refers to suits dealing with the rights and duties of people other than those created in the criminal law. The plaintiff often seeks monetary damages in these cases. The goal of the civil system, in general, is to restore the injured party to the position he or she occupied prior to the defendant's wrongful actions. For example, if a person drives a vehicle at an excessive speed and as a result, an accident occurs, that individual probably has committed a civil wrong—a tort. If the injured party broke a leg, the courts would require the defendant to compensate the plaintiff for the damages caused to the plaintiff. By the payment of a certain sum of money, the plaintiff in theory is restored to his or her position before the accident.

■ **Criminal Cases**

In a **criminal case**, a prosecutor representing either the state or the federal government brings suit against the defendant for an alleged violation of the state or federal criminal laws. The prosecutor, in effect, represents the public at large. The law penalizes a violation of the criminal law with a fine or imprisonment. The victim is not, as a general rule, compensated for the damages done.

The Common Law A great deal of the law in America today appears in statutes—laws passed by a legislative branch of government such as Congress or a state legislature. Some areas of law, however, are not governed by statute. This law may be found in the decisions of judges in the course of resolving disputes between people—referred

to in this text as the common law. When we speak of the common law, we are referring to the entire body of law created by judges when they decide cases. In Chapters 8–10 we discuss two very important areas of common law—contracts and torts.

Some areas, such as the law of contracts, for the most part come entirely from the decisions of judges. Judges also create law, however, by interpreting statutes and other sources of law discussed in this book. For this reason, cases are very important and a considerable portion of this text is devoted to the presentation of decisions of judges.

Analyzing Cases

Because cases are a very important source of the law, you should have some systematic method of analyzing them.

It may be useful to you to “brief” the cases in this text. Briefing the cases will assist you in understanding the material dealt with in each case. You should ask yourself the following questions about a case:

1. Who is the party bringing the suit, and who is the party being sued?
2. What are the facts of the case?
3. What issue of law was involved in the case?
4. Which party won the case?
5. Why did the judge rule in the manner he or she did?

Most of the cases in this text include an initial statement concerning the facts of the case. The authors of this text wrote this material. This initial statement generally indicates who brought the suit and which party won the case. The material after the judge’s name is the actual language of the judge’s report in the real case. This generally deals with the legal issue involved in the case, and it explains the basis of the judge’s ruling. You should carefully consider this material in order to develop an understanding of the judge’s rationale for his or her decision.

Many cases involve technical issues beyond the scope of this text; therefore, we have edited the cases in this book. We present only the portions of the case that are relevant to the point we are trying to illustrate with the case. The *State Farm Mutual Automobile Insurance Company v. Davis* case is a typical example.

(1) State Farm Mutual Automobile Insurance Company v. Davis

(2) United States Court of Appeals,
Ninth Circuit (3) 937 F.2d 1415 (1991)

(4) Walter Davis, a United States Marine, purchased a 1984 GMC van. State Farm issued Davis (the insured) a policy of automobile insurance covering the vehicle. On November 23, Davis and two other Marines, Brian Painter and David Roberts, were in the GMC van. Painter was driving the van. Davis was riding in the front passenger seat. Roberts occupied the rear seat. While driving on Interstate Highway 5 a Corvette passed them. Davis told Painter to overtake and pass the Corvette. As the van approached the rear of the Corvette, Davis fired his .44 caliber revolver at the Corvette. A bullet struck the driver, Charles Keukelaar, in the back of the head.

In this case, Shellie, a passenger in the Corvette, and Charles Keukelaar sued Davis. Davis's insurer, State Farm, asked the Court for a ruling that it was not obligated to provide coverage for this incident because the shooting did not result from Davis's use of the vehicle. The trial court ruled for State Farm. The Court of Appeals ruled that this shooting did result from the use of the vehicle. It remanded (sent the case back) to the trial court for further consideration of the question of State Farm's obligation to provide insurance coverage to Davis.*

(5) Singleton, Judge

(6) State Farm argued that it should not have to provide coverage to Davis because the injuries were not caused by an accident resulting from the ownership, maintenance, or use of Davis's car.

The policy which State Farm issued to Davis contains the following relevant language: "We will: 1. pay damages which an insured becomes legally liable to pay because of: bodily injury to others caused by accident *resulting from* the ownership, maintenance, or *use of* your car."

In *State Farm Mutual Automobile Insurance Company v. Partridge*, the Supreme Court of California addressed similar language in an automobile insurance policy. The court found coverage where a gun discharged injuring a passenger while the vehicle was being driven off-road in pursuit of rabbits. The court noted that a "use" of a vehicle need not be the proximate cause of an injury in order to require coverage. It was sufficient if some minimal causal connection existed between the vehicle and an injury.

Davis's shooting of Keukelaar was not merely incidental to his use as a passenger of the GMC van. At the time of the shooting, Keukelaar was proceeding rapidly down the highway in his Corvette. Had Painter not heeded Davis's request to overtake and pass the Corvette, Davis would not have been in a position to shoot at Keukelaar. Further, it is not unreasonable to assume that Davis counted on the speed of the van to escape after the shooting. Under the facts of this case, the van was more than minimally connected with the injuries Keukelaar suffered.

Painter had to chase Keukelaar so that Davis could shoot at him. Davis did not leave the vehicle, but shot Keukelaar while both were traveling down the highway. Finally, Painter had to drive the van into position next to the Corvette, giving Davis the opportunity to fire his gun. The presence of these factors supports our conclusion that the vehicle was more than incidental to this shooting.

In conclusion, we are satisfied that Painter's and Davis's use of the GMC van insured by State Farm had more than a minimal causal connection with the incident leading to Keukelaar's injuries.

(7) We therefore reverse the decision of the District Court and remand this case in order for that court to consider State Farm's other defenses.

*The parties asked the appeals court *not* to consider the question of whether Davis's shooting of Keukelaar was or was not an accident. California law prohibits insurance coverage for losses caused by the willful act of the insured. The question of whether the shooting was or was not intentional had not been resolved at the time of this appeal.

Note the following information about the Davis case.

Section 1 is the name of the case—*State Farm Mutual Automobile Insurance Company v. Davis*. In this particular case State Farm instituted the suit to obtain a determination from the court whether it was obligated to provide insurance coverage in the suit between Keukelaar and Davis. Generally, at the trial court level the plaintiff's name (the party that institutes a suit) is listed first and the defendant's name

(the party who is being sued) is listed second. On appeal, the name of the party who filed the appeal is generally listed first. Virtually all of the cases in this text are appellate court decisions.

Section 2 states the name of the court which decided the case. In this case, the United States Court of Appeals for the Ninth Circuit decided the case.

Section 3 contains what attorneys refer to as the case citation. We give a case a citation to enable people to locate the case. The citation system creates an orderly system for categorizing cases. The citation in this case is "937 F.2d 1415 (1991)." The first number refers to the volume of the Federal Reporter in which this case appears. The Davis case may be found in volume 937 of the Federal Reporter. "F.2d" refers to the second set of the Federal Reporter. "1415" refers to the first page on which this case appears in volume 937. "1991" refers to the date this case was decided by the court of appeals.

Section 4 of this case generally includes the names of the parties, the facts of the case, frequently the issue dealt with in the case, and a statement as to who won the case. We see this case involved State Farm, the plaintiff, which filed suit against Walter Davis, the defendant. This case arose out of a shooting incident. Davis shot a bullet into Keukelaar's vehicle. The issue on appeal is whether or not Keukelaar's injuries *resulted from* Davis's use of the car.

Section 5 states the name of the judge who wrote the opinion—in this case, Judge Singleton. Several judges hear each appellate case; the number of judges who participate in any given case varies from court to court. Judge Singleton wrote this particular opinion. Other judges agreed with his reasoning and joined in this opinion; however, we use only the name of the judge who wrote the opinion in this section.

It should be noted that all of the judges on a court may not agree with the thinking of the majority of the judges on the court. In such a case, the judges who disagree with the decision in a case will render a dissenting opinion. In this text, we have included a number of dissenting opinions. Judges also may agree with the decision in the case, but disagree with the reasoning of the majority opinion. Such a judge may write a concurring opinion.

Section 6 states the rationale for the judge's decision. This section, for the most part, is in the judge's own words. This decision represents the thinking of the majority of the judges hearing this case. In this case Judge Singleton states that the accident could not have happened had Davis not been using his vehicle; therefore, the incident arose out of the use of Davis's vehicle.

One may also note that Judge Singleton referred to another, similar case in his opinion—the Partridge case. Judges quite frequently examine other, similar cases in order to determine what should be the proper outcome in a particular case. Judges find it useful to consider the reasoning of other judges. In other cases, judges will look at a variety of other factors in arriving at a decision.

Section 7 indicates that the appeals court overturned the decision of the trial court and sent the case back to the trial court for consideration of other issues that were not considered by the appellate court in this appeal.

An appeals court has a number of options in any case. The appeals court may affirm—that is, uphold—the decision of the trial court. It may instead reverse—that is, overturn—the decision of the trial court. It could also reverse part of the trial court’s decision and affirm part of the trial court’s decision. Finally, it may do what the appeals court did in this case—reverse and remand. This means that the appeals court is overturning the decision of the trial court and is sending the case back to the trial court for further proceedings not inconsistent with the appeals court’s decision.

Case Brief

The clarity of judges’ opinions varies. When you begin studying law for the first time, the points judges want to make in their written opinions do not always “jump right out at you.” It takes some time to become comfortable reading judicial opinions. For this reason, case briefs may assist you in developing a clearer understanding of the cases.

Briefing a case involves several steps. The first portion of a brief discusses the important facts in the case. Step two requires the student to identify the issue dealt with in the case. The next portion of the brief generally indicates who won the case. Finally, the brief notes the reasons for the judge’s decision.

A sample case brief of the Davis case is provided in Figure 1.

State Farm Mutual Automobile Insurance Company v. Davis

United States Court of Appeals, Ninth Circuit
937 F.2d 1415 (1991)

FACTS: State Farm issued an automobile insurance policy covering Walter Davis’s 1984 GMC van. While Brian Painter was driving this van, Davis was riding as a passenger. When a Corvette passed them, Davis told Painter to overtake and pass the Corvette. When Painter reached the Corvette, Davis fired a shot into the Corvette, injuring the driver, Charles Keukelaar. The trial court found that State Farm was not obligated to provide insurance coverage for this incident.

ISSUE: Did Charles Keukelaar’s injuries in this case result from Davis’s use of Davis’s GMC van?

DECISION Yes.

RATIONALE: The court found that it would not have been possible for Davis to have shot Keukelaar had Davis not been using the van. Therefore, Davis’s use of the GMC van had more than minimal causal connection with the incident that led to Keukelaar’s injuries. Keukelaar’s injuries consequently resulted from Davis’s use of Davis’s GMC van. As the trial court decided this question incorrectly, the appellate court reversed the decision of the trial court and returned the case to the trial court for further consideration of other issues involved in this case.

■ **FIGURE 1** Sample Case Brief

Your instructor may require you to brief cases. Even if he or she does not make this a requirement in your class, you will find it useful to brief the cases in this text.

When attorneys prepare a brief for an appellate court, the brief often follows a very similar form—a statement of the facts of the case, a statement of the questions presented by the case, followed by an argument in support of a particular position. Not surprisingly, judges tend to follow a similar approach in writing their opinions in cases.

Where to Find the Law If you want to locate the original source of some of the material in this text, or to find material in addition to that in this text, consult Appendix A, “Where to Find the Law.”

We hope this information will be useful to you in your study of the law.

In this case, some issues still exist that need to be resolved by the trial court before a decision may be made that State Farm must provide Davis coverage under this automobile insurance policy.

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CHAPTER 1 *Introduction to Law and the Legal Studies of Business* 2

Even though business managers are not experts in law, every decision they make has a legal component. A precise analysis of that component is best left to legal counsel, but business executives must understand the thematic features of the law. Doing so will enable them to appreciate the legal complexities they face.

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Key Features

Why was it important for business investors in reunited Germany to be certain about the ownership of the property they bought? see German Reunification and Property Ownership, page 5.

Should business managers be concerned about adverse legal consequences arising from their workplace policies even if the managers have not acted illegally? see Borse v. Piece Goods Shop, Inc., page 13.

Can business managers face a legal risk from taking steps to protect their property? see What Can Be Done to Safeguard Property?, page 17.