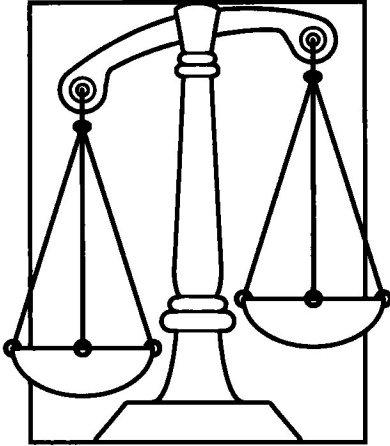


WEST'S ADVANCED TOPICS AND CONTEMPORARY ISSUES

Expanded Coverage for:

**West's Business Law
West's Legal Environment
of Business**

Frank B. Cross



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West's Legal Environment
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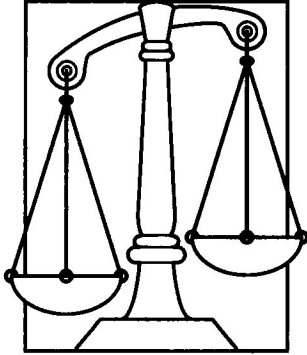
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Preface

Even a casual reader of the *Wall Street Journal*, or other business periodicals, quickly becomes aware of the importance of legal requirements in modern business. Detailed government regulations and multimillion-dollar liability actions have become an integral part of conducting businesses of all types. Consequently, a solid understanding of the law and the legal environment is critical in today's business world.

West's Advanced Topics and Contemporary Issues goes into greater detail than the typical business law or legal environment text on some of the most pressing issues confronting business today. It also addresses special legal topics that are not covered in these introductory texts.

The chapters can be used in any order. Students will gain much greater value from the book, however, by using it to build upon knowledge gained from their business law or legal environment of business text. The book can be used in tandem with an introductory text or in a follow-up course.

West's Advanced Topics and Contemporary Issues is keyed to two texts—*West's Business Law, Fifth Edition* and *West's Legal Environment of Business*. There are numerous specific references to these texts. Consequently, this text will be of particular value to students who use or have used *West's Business Law, Fifth Edition* or *West's Legal Environment of Business*.

Coverage

West's Advanced Topics and Contemporary Issues begins by introducing two topics of critical concern today: business ethics and international business law. These first two chapters provide a detailed analysis of these topics, building upon the discussion of business ethics and international business law found in business law and legal environment texts. Ethical concerns are also addressed in each succeeding chapter.

The next twelve chapters offer expanded and more detailed coverage of selected topics covered in business law and legal environment texts. The

topics selected involved legal issues which are of particular importance in management, finance, accounting, and marketing. Some of the issues covered in this section are employee rights, mergers and acquisitions, accountant liability, and advertising law.

The remaining six chapters of the text address legal topics of special concern in business. This last section deals with issues that are generally not covered in business law and legal environment texts. Some the topics involve the unique legal problems faced by particular industries, such as the health care industry and the hospitality management industry. Other topics are of general interest, such as the legal representation of business.

Special Features

In addition to the expanded coverage and special topics described above, this text also contains special features to enhance student understanding.

Ethical Perspectives After Chapter 2, each chapter concludes with an "Ethical Perspective" that relates to the subject matter of the chapter. Ethics has become a critical concern of businesspersons and is an integral part of business law and legal environment courses.

The "Ethical Perspective" for each chapter analyzes an ethical concern that is both current and controversial. Different perspectives of the ethical controversy are presented. The text then attempts to offer some resolution to these ethical dilemmas that confront business.

International Perspectives In light of the increased importance of international business and applicable legal standards, Chapters 3 through 20 conclude with an "International Perspective." As business becomes more global in scope, managers have a greater need to understand the international legal environment.

The "International Perspective" for each chapter discusses issues that are relevant to that

chapter. While it is obviously impossible to detail every international legal requirement for a given issue, the text selects highly relevant and representative international requirements. For example, the text discusses the environmental law controlling hazardous waste in Europe and the law of employer–employee relations in Japan.

Cases In order to illustrate and amplify important legal principles discussed in the text, excerpted cases are interspersed throughout each chapter. Most of the cases have been decided recently, but some classic cases are included when they stand as landmarks in the law.

Each case presented in *West's Advanced Topics and Contemporary Issues* follows a special format: case title and full case citation, background and facts, case excerpt, and discussion and remedy.

Exhibits When appropriate, the text contains exhibits to illustrate important legal principles or rules. These exhibits are designed to enhance the material and aid the reader's understanding of the legal concepts discussed.

Questions and Case Problems Each chapter ends with questions and case problems. Some questions are hypothetical and are intended to

help review the understanding of key legal issues in the chapter. Others are actual cases that exemplify the issues discussed in the chapter. The answers to the questions and case problems are available free to professors and can be placed on reserve in the library for students.

Acknowledgments

Many individuals have contributed to this inaugural edition. I wish to thank my editor, Clyde Perlee, Jr., who provided the basic ideas for this text and provided considerable assistance in designing its framework. Jan Lamar, Bette Darwin, and Bridget Neumayr of West also provided substantial assistance. Roger LeRoy Miller performed helpful service in reviewing the chapters for this text and in providing many useful suggestions and comments. Morli Fidler and Bill Stapleton assisted me greatly in researching the issues addressed in this text.

Of course, any errors that may remain are my own responsibility. Please write to me with any ideas about how to improve the usefulness of this work. This is a first edition that doubtless can benefit greatly from the ideas and suggestions of adopters. I welcome your ideas, so that I can incorporate them in subsequent editions.

This is dedicated to Pam.

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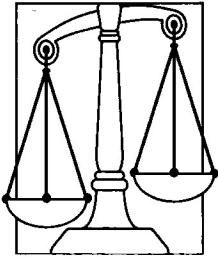
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CHAPTER ONE

Business Ethics

KEY BACKGROUND



Business ethics seems to some a contradiction in terms. The concept of ethical business took a black eye in the 1980s, with misconduct in the savings and loan industry, insider trading, "junk bonds," Department of Defense supplier overcharges and other

scandals. Yet most Americans believe that business should behave ethically. The exact nature of the ethical obligations of business is not so clear. This chapter will set forth the sources of business ethics, the scope of ethical duties, and the interface of ethics and the law.

The nature of ethical behavior has long been debated by philosophers, some of whom argue for universal rules of behavior, while others argue for a utilitarian maximization of human welfare, and still others employ other approaches. The scope of this debate is well beyond our chapter. Rather, the chapter will focus on how the business context influences ethical duties of individuals.

The specific focus of this chapter will be on the ethical duties of the officer or employee of the corporation. The corporate context is not the only scenario for business ethics. For example, the sole proprietor of a business has ethical duties. The problem of business ethics for the corporate officer, though, is the most common situation and also the most difficult to resolve.

Profit Maximization as Ethical Duty?

Cynics about business ethics argue that business is only interested in making a profit. Some authors on business ethics contend, however, that making a profit is *the* ethical requirement for business managers. It is a useful starting point to consider this position, which contends that the only ethical duty of corporate employees is to maximize corporate profits. This position seems contrary to what most persons consider business ethics. A duty to maximize profits could possibly necessitate breaking the law, polluting of water supplies, cheating on contracts, and other acts that seem questionable.

Yet a case can be made for profit maximization as an ethical duty. Milton Friedman, the conservative economist and Nobel prize winner, has declared: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."¹

The corporate employee, even a chief executive officer is, after all, managing someone else's money—that of the shareholders. This surely gives the employee some duty to the shareholders. By what authority do such employees have a right to spend their shareholders' money for whatever purpose the employee deems

¹"The Social Responsibility of Business Is To Increase Its Profits," printed in *Ethical Issues in Business* (T. Donaldson and P. Werhane, eds. 1983), p.239.

“ethical”? What makes such employees ethical experts, anyway?

Suppose that Barbara Bookman is a majority shareholder in Tiller, Inc. William Puckett is Tiller's president and chief executive officer. Puckett decides that it would be ethical to make a large contribution to Planned Parenthood for use in promoting birth control. Barbara, however, for religious reasons believes that use of birth control is immoral. Regardless of whether birth control is ethical or not, why should William decide how to spend Barbara's money for what he personally considers ethical?

It seems clear that corporate officers such as William have some ethical duty to shareholders such as Barbara. It is troublesome to have such officers using “others' money” to advance their own ethical agenda. It does not follow, however, that William's only ethical duty is to maximize Barbara's profits.

Consider the implications of an ethical duty only to maximize profits. Under the most extreme form of this theory, the officer should violate the law, even market illegal drugs, at least if the corporation would not be caught and punished. Indeed, the most extreme form of this theory dictates that the employee should lie, cheat and steal whenever such actions would actually increase corporate profits. Something is wrong with such a theory of business ethics. Even Milton Friedman does not adopt this extreme view of profit maximization. He says that corporations have an ethical duty to obey the law as well as to maximize profits. This leads to a second theory of business ethics.

▬ Obeying the Law as Business Ethics?

A more widely held vision of business ethics contends that business should maximize profits within the bounds of legal behavior. The corporate officer acting within the context of this theory would rely on the government to set the bounds of ethical behavior. If an action is illegal, businesspersons should avoid it. If, however, the law permits a certain business action, and if that action is profitable, a company has an ethical right to take the action.

This theory has appeal, for it reflects some duty to shareholders and recognizes the limitations of corporate employees. After all, what qual-

ifies officers to determine ethical behavior? Corporate managers are hired for their ability to make business decisions, not ethical ones. The laws reflect the ethical decisions of society as a whole and perhaps offer a better ethical guide than the instincts of corporate officers.

This theory is frequently invoked by business. For example, the government recently brought an action against Neil Bush, the son of President Bush and a savings and loan official, regarding allegedly unethical loans that he made. The government argued that Bush had a conflict of interest, when he made loans in order to advance his own businesses. An expert witness law professor contended at a hearing that Mr. Bush had not behaved unethically. The witness emphasized that ethical standards varied from state to state and that Mr. Bush should be judged by the laws of Colorado, where the savings and loan institution was located. Because Bush apparently violated no Colorado statute, the expert argued that his behavior was ethical.²

This reliance on the law as the only ethical standard, however, is a misuse and misunderstanding of both the law and ethics. The law was never meant to define the full scope of ethical duties. Earl Warren, former Chief Justice of the Supreme Court, wrote that “Society would come to grief without Ethics, which is unenforceable in the Courts and cannot be made part of Law.”³

There are two reasons why the law cannot define all ethical duties. First, our lawmakers have limited time and cannot write laws to cover every possible ethical problem. Congress is busy with foreign policy, the national budget, and innumerable other issues. Lawmakers cannot consider all of their own ethical problems, let alone every ethical issue in business. Second, Congress cannot deal well with all types of ethical problems. For example, no law could prevent a person from lying to friends or parents. Yet such action would often be unethical. Ethics must go beyond the law.

Indeed, it could be harmful for the law to attempt to enforce business ethics fully. The following opinion emphasizes the difference between law and ethics and contends that the law already has gone too far in attempting to enforce business ethics.

²*New York Times*, September 27, 1990, p.C2 (National edition).

³Speech quoted in *Trends in Business Ethics* (C. van Dam and L. Stallaert, eds. 1978), p.9.

Case 1.1
Oki America, Inc. v.
Microtech International, Inc.

United States Court of Appeals,
 Ninth Circuit, 1989
 872 F.2d 312

Background and Facts *Oki America, Inc., and Microtech International, Inc. were involved in a contract dispute. In connection with this dispute, Oki argued that the parties had no contract. Microtech then brought suit for the tort of "malicious denial of the existence of a contract." The district court granted summary judgment for Oki and Microtech appealed. The appellate court affirmed on the grounds that Microtech had failed to meet its burden of proof. Judge Kozinski wrote an interesting concurring opinion, in which he challenged the basis for such a tort as malicious denial of a contract.*

KOZINSKI, Circuit Judge, concurring:

* * * *

Nowhere but in the Cloud Cuckooland of modern tort theory could a case like this have been concocted. One large corporation is complaining that another obstinately refused to acknowledge they had a contract. For this shocking misconduct it is demanding millions of dollars in punitive damages. I suppose we will next be seeing lawsuits seeking punitive damages for maliciously refusing to return telephone calls or adopting a condescending tone in interoffice memos. Not every slight, nor even every wrong, ought to have a tort remedy. The intrusion of courts into every aspect of life, and particularly into every type of business relationship, generates serious costs and uncertainties, trivializes the law, and denies individuals and businesses the autonomy of adjusting mutual rights and responsibilities through voluntary contractual agreement.

* * * *

It is impossible to draw a principled distinction between a tortious denial of a contract's existence and a permissible denial of liability under the terms of the contract. The test—if one can call it such—seems to be whether the conduct "offends accepted notions of business ethics." *Seaman's*, 36 Cal.3d at 770, 206 Cal.Rptr. 354, 686 P.2d 1158. This gives judges license to rely on their gut feelings in distinguishing between a squabble and a tort. As a result, both the commercial world and the courts are needlessly burdened: The parties are hamstrung in developing binding agreements by the absence of clear legal principles; overburdened courts must adjudicate disputes that are incapable of settlement because no one can predict how—or even by what standard—they will be decided.

* * * *

The eagerness of judges to expand the horizons of tort liability is symptomatic of a more insidious disease: the novel belief that any problem can be ameliorated if only a court gets involved. Not so. Courts are slow, clumsy, heavy-handed institutions, ill-suited to oversee the negotiations between corporations, to determine what compromises a manufacturer and a retailer should make in closing a mutually profitable deal, or to evaluate whether an export-import consortium is developing new markets in accordance with the standards of the business community.

* * * *

Perhaps most troubling, the willingness of courts to subordinate voluntary contractual arrangements to their own sense of public

policy and proper business decorum deprives individuals of an important measure of freedom. The right to enter into contracts—to adjust one's legal relationships by mutual agreement with other free individuals—was unknown through much of history and is unknown even today in many parts of the world. Like other aspects of personal autonomy, it is too easily smothered by government officials eager to tell us what's best for us. The recent tendency of judges to insinuate tort causes of action into relationships traditionally governed by contract is just such over-reaching. It must be viewed with no less suspicion because the government officials in question happen to wear robes.

Decision and Remedy *The court affirmed the dismissal of plaintiff's claim.*

As Judge Kozinski indicated, it can be inefficient to "judicialize" all ethical precepts. This fact makes voluntary private recognition of business ethics all the more important. Indeed, failures of business ethics explain a great deal of government and judicial regulation of business practices.

The law is an important part of ethics, however. The law does reflect societal standards of

ethics and provides the context in which business operates. There is considerable overlap between legal and ethical requirements. Legal principles will be used to illustrate ethical duties throughout the remainder of this chapter. Prevailing approaches to business ethics inevitably influence the law as well. The following case indicates how business ethics helps define the law of fraud.

Case 1.2
First Federal Savings and
Loan Association v.
Twin City Savings Bank, FSB

United States Court of Appeals,
Fifth Circuit, 1989
868 F.2d 725

Background and Facts *Twin City Savings Bank sold to the First Federal Savings and Loan Association participation in a multi-million dollar loan to Sea Oats of Juno Beach, Inc., a condominium developer. In negotiating the sale of loan participation, Twin City concealed facts regarding Sea Oats' credit worthiness. Sea Oats ultimately was unable to pay off the loan. First Federal sued Twin City for fraudulent concealment. The district court found that Twin City had indeed fraudulently concealed facts but held for Twin City, because First Federal was negligent in investigating the facts and in failing to detect Twin City's concealment. For example, First Federal had access to Twin City's files on the loan, which revealed that Sea Oats was behind in construction. First Federal appealed the judgment.*

RUBIN, Circuit Judge.

* * * *

To permit the perpetrator of a fraud to escape liability because of the failure of his victim to take precautions to prevent deception imposes on an innocent party a duty of care to avoid the culpable conduct of a miscreant.

* * * *

Prosser and Keeton state in their standard work on Torts:

The last half-century has seen a marked change in the attitude of the courts toward the question of justifiable reliance. Earlier