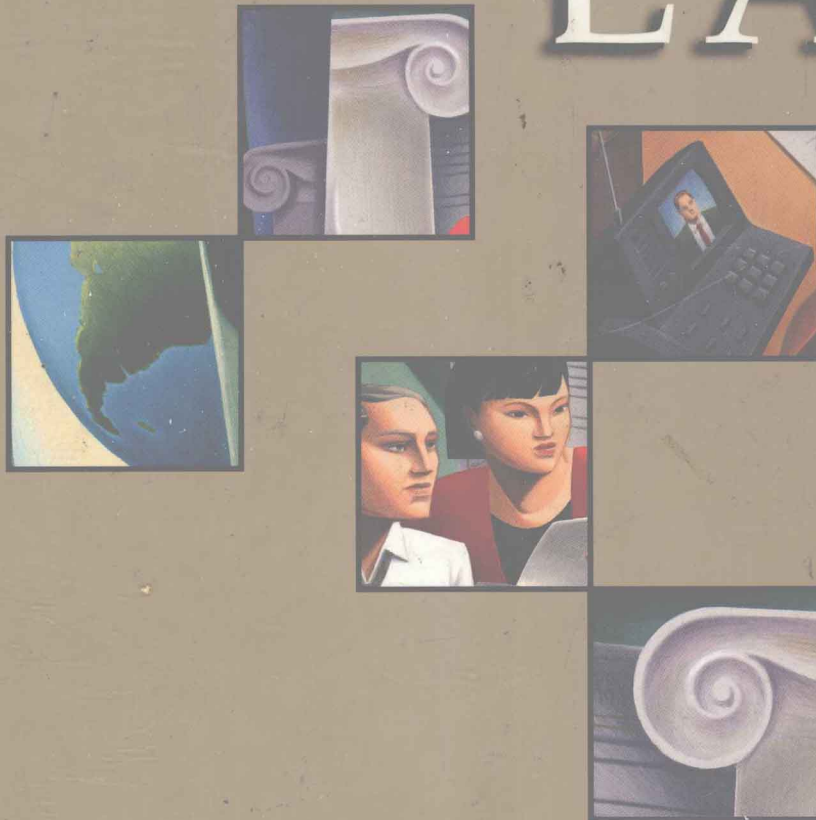


DAVIDSON,  
KNOWLES & FORSYTHE

# BUSINESS LAW



PRINCIPLES AND CASES  
IN THE LEGAL ENVIRONMENT

SIXTH EDITION

# **BUSINESS LAW**

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To Dee, Jaime, and Tara. Thanks for your help and support.

*Daniel V. Davidson*

To Paul for challenging me to be better and for sustaining me with his unfailing love and support.

*Brenda E. Knowles*

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*Lynn M. Forsythe*

## A BUSINESS-ORIENTED BUSINESS LAW TEXT

*Business Law: Principles and Cases in the Legal Environment*, Sixth Edition, offers students a business-oriented introduction to the legal and ethical topics that affect business. This may seem redundant. After all, doesn't a business law textbook by its nature adopt an orientation toward the practice of business? Textbooks that typically teach the law, often clearly and in great detail, can fail to show students how the law will affect their future careers in the business world. Our goal as business law and legal environment instructors is not to train lawyers. Rather, our goal is to train future businesspeople how to avoid legal problems or, should legal problems arise, how to recognize the nature of these problems and work with a lawyer to achieve solutions.

Our strategy in revising the sixth edition is threefold:

- To present, in an accessible style, a current and comprehensive introduction to the legal topics relevant to business
- To demonstrate how these topics apply to the practice of business
- To provide an approach to legal analysis—often termed *critical thinking*—for addressing legal problems encountered in the practice of business.

We have also tried to better support the teaching and learning process associated with using the text. Our association with West Education Publishing now allows us to offer a wide array of supplementary materials for instructors and students.

## NEW COVERAGE IN THE SIXTH EDITION

As we mentioned, our first goal is to present, in an accessible style, a current and comprehensive introduction to the legal topics relevant to business. Toward this goal, the book is divided into ten parts based on traditional topical areas of undergraduate business law. The following content changes and updates were made to the sixth edition.

**Part 1 Foundations of Law** Part 1 presents an overview of law and the legal system. The sixth edition provides increased coverage of ethics and international law topics. In particular, Chapter 2, "Business Ethics," has an increased focus on the application of ethical theories in the practice of business.

**Part 2 The American Legal System** Part 2 examines the court system and the legal system used in the United States. New to the sixth edition is a full chapter devoted to alternative dispute resolution—Chapter 7, "Alternate Dispute Resolution."

**Part 3 Contracts** Part 3 examines the primary importance of contract law to business. The chapters contained here have been substantially updated.

**Part 4 Sales and Leases** Part 4 introduces the Uniform Commercial Code in significant detail and examines the law of sales from an international perspective. Part 4 now offers comparisons of Article 2A contracts with Article 2 contracts and the similarity in



treatment between contracts for the sale of goods and contracts for the leasing of goods. Part 4 also provides a detailed examination of the international sale of goods, including increased coverage of the UN Convention on Contracts for the International Sale of Goods (CISG), INCOTerms, and ISO 9000 and 14000.

**Part 5 Negotiables** Part 5 discusses UCC Articles 3 (Revised), 4 (Revised), 4A, and 7. It also includes a discussion of electronic fund transfers. New coverage reflects the changes in negotiable instrument law with the revision of Articles 3 and 4 of the UCC.

**Part 6 Debtor-Creditor Relations** Part 6 examines secured transactions under Article 9 of the UCC and the federal protections available under the Bankruptcy Reform Act. This part includes increased coverage of the Bankruptcy Reform Act of 1994.

**Part 7 Agency** Part 7 explains the agency relationship and its use in the conduct of a business. Special emphasis is given to the liability of both the principal and the agent for contracts entered into by the agent and to the liability of both the principal and the agent for torts and crimes committed by the agent.

**Part 8 Business Organizations** Part 8 treats the various types of business organizations in a unique manner. Rather than have separate chapters dealing with the various organizations, the text treats the organizations in a compare-and-contrast fashion within the chapters. The emphasis is no longer on *how* the various types of business organizations should be implemented; rather, the text emphasizes *why* a particular form should be chosen.

**Part 9 Government Regulation of Business** Part 9 addresses regulatory topics. Part 9 now has an entire chapter devoted to consumer law—Chapter 41, “Consumer Protection”—and to environmental law—Chapter 42, “Environmental Protection.”

**Part 10 Property Protection** Part 10 examines real and personal property law and “wealth protection.” Part 10 also offers updated coverage on intellectual property law.

## NEW AND IMPROVED APPLICATIONS

Our second goal for this revision is to demonstrate how the legal topics presented here apply to the practice of business. Toward this goal, *Business Law* offers the following features, many of which are unique to this text.

### Court Cases

Each chapter contains four to five court cases in the language of the court. Cases are briefed in the following format:

- *Facts*—the facts of the case
- *Issue(s)*—the issues, in the form of questions, on which the decision hinges
- *Holding*—a summary, in the form of answers to the preceding questions, of the court decision
- *Reasoning*—the reasoning the court used in reaching its decision

We have made an effort in the sixth edition to include more court language in our briefed cases. Our selection of cases includes both classic, landmark opinions and current, cutting-edge cases. In addition, all of our court cases end with a Business Considerations and an Ethical Considerations section.

## Call-Image Technology (CIT) Business Application Thread Case

An integrated, continuous business “thread” case, or scenario, profiles the experiences of a hypothetical videophone business, Call-Image Technology (CIT). Chapters begin with an Agenda that highlights the major legal issues relevant to CIT. Within chapters, Application Boxes address particular legal issues and call for students to offer the firm guidance. Each application box is categorized by the functional area of business—management, manufacturing, finance and accounting, sales, marketing, and international business—to which the scenario is most relevant. Finally, application boxes include Business Considerations and Ethical Considerations questions, asking the students to go beyond CIT’s problem to decide how the type of problem faced might affect other business concerns. See pages 27–28 for an introduction to the CIT business application thread case.



## Resources for Business Law Students

Resources for Business Law Students, included in every chapter, highlight World Wide Web sites of particular relevance to the study of business law and legal environment. For convenience, Web sites are listed by their name, the resources of particular interest, and the address:

<http://>

RESOURCES FOR BUSINESS LAW STUDENTS

NAME	RESOURCES	WEB ADDRESS
<b>Business Law Web Site by West Publishing</b>	The Business Law Web Site by West Publishing contains teaching and learning materials, case and current event updates, and resources from West Publishing. As well, you can communicate with the authors and the editors of <i>Business Law: Principles and Cases in the Legal Environment</i> .	<a href="http://www.westbuslaw.com/">http://www.westbuslaw.com/</a>

## Memos from Amy Chen

Memos from Amy Chen, included in most chapters, offer practical legal suggestions for business managers. Amy Chen, the hypothetical lawyer introduced in the Call-Image Technology (CIT) business application thread case, offers pragmatic comments on the topics discussed in the chapter.

## You Be the Judge Boxes

You Be the Judge boxes, included in every chapter, highlight scenarios from the news in which legal or ethical problems are at play. Students, using the material in the chapter, are asked to decide the outcome of the scenario. Students have the opportunity to think critically and to discuss these problems in class; also, the problems provide potential writing assignments or team projects for students. Finally, You Be the Judge boxes include Business Considerations and Ethical Considerations questions, asking the students to go beyond the given scenario and decide how the type of problem faced might affect other business concerns.

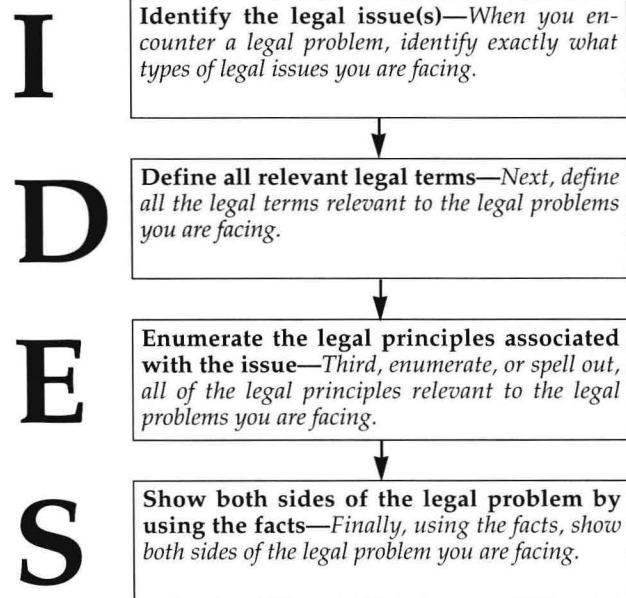
## Discussion Questions, Case Problems and Writing Assignments

Each chapter concludes with ten discussion questions, five legal case problems, one business applications case, one ethics applications case problem, and one IDES case problem based on the IDES approach to legal reasoning (discussed below). The legal case problems ask students to test their understanding of principles and terms covered in the chapter, and the business and ethics application problems and the IDES problem ask students to apply these concepts to business situations. All of the end-of-chapter materials can be used as study tools in reviewing the material, as class or small-group discussion material, or for writing assignments.



## The IDES Approach to Legal Analysis

A new feature, and one that is exciting to us, is the inclusion of the IDES approach to legal analysis. IDES is an acronym for the following:



Each part of the text contains a comprehensive business problem requiring the use of the IDES approach. Each chapter also contains a specific problem requiring the use of the IDES approach. By using IDES, students learn to analyze legal problems in an orderly and logical manner. As well, students engage in critical thinking and learn to see problems from the perspectives of all sides in a dispute.

IDES, as an approach to legal analysis, should not be confused with a method for briefing a case. While briefing a case allows one to comprehend the significance of a particular judicial decision, the IDES approach to legal analysis provides a framework within which to address larger legal problems.

## SUPPLEMENTAL RESOURCES

**NEW!** The sixth edition of *Business Law*, as part of the Business Law Web Site from West Educational Publishing (<http://www.westbuslaw.com/>), now has a site on the



World Wide Web devoted to teaching and learning support for the text (<http://davidson.westbuslaw.com>). Come visit to see for yourself.

The following supplemental resources are available with the sixth edition:

- *Study Guide to Accompany Business Law: Principles and Cases in the Legal Environment* (0-538-86857-0).
- *Telecourse Study Guide* (0-538-86858-9)
- *Instructor's Manual* (0-538-86031-6)
- *Test Bank*—Thoroughly revised by Wayne Wells and Janell Kurtz, Saint Cloud State University (0-538-86863-5)
- WESTEST testing software (0-538-86861-9)
- PowerPoint Transparency Masters (0-538-86864-3)
- Telecourse Videos—30 half-hour telecourse videos, developed by Intellectcom in conjunction with the third edition of *Business Law*, provide coverage for key topics in business law. (Contact your ITP/West sales representative for more details.)
- South-Western's Business Law Video Series
- Legal Tutor Software on Contracts and on Sales
- CNN Legal Issues Video Update—Update your coverage of legal issues by using the *CNN Legal Issues Update*. This video update is produced by Turner Learning, Inc., using the resources of CNN, the world's first 24-hour, all-news network. (0-538-86862-7)

The following supplements from West Educational Publishing are available to qualified adopters of *Business Law*. Contact your ITP/West sales representative for more details.

- Ten Free Hours of WestLaw
- Business Law and Legal Environment Video Library
- Business Law Videodisc
- U.S. Supreme Court Audiocassette Library
- West's Regional Reporters
- Contracts and UCC Article 2, Sales, Software
- You Be the Judge Software
- CD-ROM Resources for Business Law and Legal Environment

## A NOTE ON AACSB CURRICULAR STANDARDS

The AACSB curricular standards relevant to business law and the legal environment of business state that curricula should include ethical and global issues; the influence of political, social, legal and regulatory, environmental, and technology issues; and the impact of demographic diversity on organizations. We believe *Business Law: Principles and Cases in the Legal Environment* uniquely satisfies these standards.

First, global issues are treated in-depth in *two* chapters, Chapter 3, "International Law," and Chapter 20, "International Sales of Goods: CISG," (more than any other current business law text). Also, we have revised Chapter 2, "Business Ethics," to reflect more of the application of ethical theories than the theories themselves. Ethics questions also appear following court cases, You Be the Judge boxes, CIT business application boxes, and at the end of chapters.

Second, we have revised the text with the intent of creating a book that is intuitive, engaging, and oriented toward providing the legal skills students will need in

the business world. Hence, the contents of the book stretch beyond the mere presentation of “legal topics” to encompass the spectrum of “political, social, legal, regulatory, environmental, and technological issues.” The pedagogical features are designed to augment this content.

Finally, the attention to applications, evidenced in the CIT business application thread and the IDES approach to legal reasoning, uniquely satisfies the need to show how demographic diversity affects organizations. In the CIT case, the Kochanowskis—founders of a family business—must understand the cultural and political challenges that a larger domestic and international market (and work force) pose for them. By following the case, students are immersed in these problems and are asked to offer advice as questions arise. The IDES approach to legal reasoning mandates that the students examine each problem from *both* sides, or from the perspective of all of the parties involved. This encourages sensitivity and an understanding of other points of view.

On another level, the Kochanowskis (and, vicariously, the students) learn that successful businesses today are often cross functional. In this case, the Kochanowskis need to recognize how the law applies to marketing, sales, management, finance and accounting, and manufacturing, and they must be able to act on this knowledge. The students, by assuming an advisory role with CIT, have a unique glimpse at the cross-functional nature of many business activities today.

## ACKNOWLEDGMENTS

Writing a textbook is always an arduous undertaking, even if the text is “merely” a revision of a previous edition. This edition has been no different, and in many ways it has been more difficult. There have been numerous substantive changes in the law since the last edition, and each of these needed attention. There are also several areas that are in a state of upheaval as we go into print, and trying to be as up-to-date as possible while meeting a production deadline can be a problem for the entire production team.

This edition of the book would not have been possible without the help, assistance, and guidance of our developmental editor Kurt Gerdenich. Kurt is always there when we need him. His good humor, his patience, and his support have been invaluable to us. Sharon Smith has also been tremendous. She has provided advice when needed and has assisted Kurt in helping us to put together this book. Robine Andrau of Pre-Press has worked diligently in making last minute corrections, updating materials as needed, and making our work look as professional as it looks. She and her staff were wonderful to us throughout the process.

Each of the authors owes a hearty “thank you” and a sincere “well done” to the other two authors. Each provided feedback, (positive) criticism, and support to the others during the hectic days of reading copyedited pages and page proofs. Each of us brings a unique personality to the process, and we have learned how and when to merge our talents to produce the best book possible. As authors, we have been a team for quite some time, working together through six editions of the text. We each write about an equal number of chapters, and we each have input into the chapters written by the other authors. We sincerely believe that our group effort has been successful and that the sum of our contributions is greater than the parts. We hope you enjoy using this book as much as we have enjoyed preparing it.

A special thanks to our families. They put up with the late nights, the short deadlines (and the shorter tempers) and provide support and input to help us get through the process every time we revise the text. Without their support, we would never be able to accomplish our goal.

Finally, a sincere thank you to the following reviewers, whose suggestions, criticism, questions, observations, and keen and insightful commentary on our work helped us to maintain our focus and to write a text that is user-friendly, readable, and enjoyable without losing content:

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Professor Davidson has published numerous articles on business law, the teaching of business law, and business ethics. He was named the Outstanding Teacher of the Year at Central Connecticut State College. In 1979 he received the Outstanding Faculty Award from Beta Alpha Psi, and in 1980 he was named the *Razorback Award* winner as the Outstanding Business Professor, both at the University of Arkansas. In 1984, Professor Davidson was awarded the Meritorious Performance Award at California State University, Fresno.

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