

BUSINESS LAW

TEXT & CASES

FIFTH EDITION

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PREFACE

We have had but one goal in preparing the fifth edition of *Business Law: Text and Cases*: to make the text a more useful vehicle for the study of Business Law by future business managers at both graduate and undergraduate levels in our colleges and universities. In striving to attain this goal, we rejected the temptation merely to fine-tune the prior edition and have developed a number of new features that will be highlighted later in the preface.

This edition, nonetheless, retains the basic strengths of earlier editions, which can be described as follows:

First, we have continued to use a lucid, conversational writing style. In addition, we have tried to illuminate legal principles by frequent use of examples to show how these rules apply to “real world” situations.

Second, illustrative court cases are interspersed throughout the text materials, rather than relegated to chapter ends. As in previous editions, each case begins with a presentation of the facts by the authors so that students will not be confused by the sometimes difficult terminology used by the courts. The opinions of the courts, on the other hand, are carefully edited but retain the courts’ own language. This approach ensures that the students first have a clear idea of the elements of the controversy that are relevant to the text discussion and then gives them a feel for the way the court resolved it. It allows students to see how the court weighed conflicting evidence in deciding what the facts were, how it viewed particular facts as relevant or irrelevant to the issues at hand, and how it selected the legal principles that it felt to be dispositive of those issues.

Third, the text continues to be essentially a traditional one, rather than an environmental one. In other words, despite a rather full discussion of the legal system in Part I and of several regulatory topics in Part VII, most of the text is again devoted to such subjects as contracts, agency, sales, commercial paper, property, and business organizations.

CHANGES IN THIS EDITION

- A new chapter on Criminal Law and Business, providing coverage of fundamental concepts and an extensive treatment of white-collar and computer crime (Chapter 7)
- A new chapter on Contract Interpretation and Remedies for Breach of Contract (Chapter 19)
- A new chapter on The Legal Environment of International Business (Chapter 51)
- The chapter on Business Ethics, Corporate Social Responsiveness, and the Law completely rewritten (Chapter 10)
- Material on alternative dispute resolution completely rewritten (in Chapter 3)
- Coverage of new Article 2A of the Uniform Commercial Code—Leases—in several different chapters, including Sales: Introduction to the Law of Sales (Chapter 20), Sales: Warranties and Products Liability (Chapter 22), Secured Transactions (Chapter 29), and Personal Property and Bailments (Chapter 45)
- A substantial new section on increasing federal control over checks and the bank–depositor relationship, especially Federal Reserve Board Regulation CC (in Chapter 28)
- A substantial new section on new Article 4A of the Uniform Commercial Code—Commercial Electronic Funds Transfers (in Chapter 28)
- Expanded coverage of Business (Competitive) Torts (Chapter 9)
- Increased integration of sales contract principles from the UCC with material on contracts (in Chapters 11–19)
- Material on employment discrimination completely rewritten, with coverage of recent dramatic changes in the area of employment law (in Chapter 49)
- A new section on the employer’s right to discharge employees, including exceptions to employment-at-will (in Chapter 49)

- A new section on employee privacy, including employer use of lie detectors and drug tests (in Chapter 49)
- A new chapter on Antitrust Law (Chapter 48)
- Substantial rewriting of the remaining text
- Many new cases

ANCILLARY MATERIALS

Business Law: Text and Cases, fifth edition, is supported by a comprehensive ancillary package which includes an *Instructor's Manual and Transparency Masters*, a *Test Bank*, a set of preprinted tests, a *Computerized Test Bank*, and a *Study Guide*.

Each instructor has his or her own unique approach to the teaching of Business Law. Our *Instructor's Manual* is a tool that assists the instructor in integrating his or her style with the approach taken by the book. Each chapter includes helpful authors' suggestions for teaching the chapter. Chapter outlines have been added to assist the instructor in organizing lecture notes. Succinct case briefs are included for each case in the book. We have also added an annotated list of additional cases so that the instructor can easily supplement the cases found in the text. Each chapter in the *Instructor's Manual* ends with answers to end-of-chapter questions and problems.

The *Test Bank* contains over 2,000 multiple-choice and true-false questions. We have added numerous essay questions for the instructor to choose from.

A *Computerized Test Bank* is also available for this edition for use on the IBM PC®.

A comprehensive *Study Guide* provides additional review and reinforcement of all topics covered in the text. Each chapter of the guide, which has traditionally been well received by students and instructors, begins with a chapter summary. The key term and matching exercises also provide an excellent review for students. The purpose of these two sections is to test the student's basic mastery of the concepts, laws, and rulings discussed in the text. Multiple-choice and true-false questions are provided, as well as case analysis problems which provide fact-patterns to which the student is asked to respond. All three types of questions will test the student's comprehension of the material in an examination setting.

The questions are similar in format and type to those included in the *Test Bank*.

Another feature of the *Study Guide* is the inclusion of legal forms. We include these forms to give the student a good idea of how legal concepts are employed in the business world.

ACKNOWLEDGMENTS

As with any major undertaking, this text owes its existence to the efforts of many individuals. We owe a special debt to bankruptcy attorney Leslie K. Prentice for her substantial assistance in the revision and updating of Chapter 30. We wish to thank Luis Rodriguez at Arkansas State University for his preparation of the *Test Bank*, Carol Rasnic at Virginia Commonwealth University for the *Study Guide*, John McGee at Southwest Texas State University for help with the *Instructor's Manual*, and the many reviewers who read the manuscript for this edition and provided valuable suggestions. They are Peter A. Alces (University of Alabama), William Burke (University of Lowell), Thomas Giordano (St. John's University), William Halm (Ferris State University), Don Hoy (Des Moines Area Community College), Avi Liveson (Hunter College), Gene A. Marsh (University of Alabama), Jon Patrick McConnell (Washington State University), Patricia Nunley (Baylor University), Robert Peace (North Carolina State University), Daniel Reynolds (Middle Tennessee State University), John Sherry (Cornell University), and Ronald L. Taylor (Metropolitan State College).

We also wish to thank our editors at The Dryden Press, Bill Schoof, Kathi Erley, Karen Shaw, and Charlene Posner, for their commitment to excellence.

In addition, we are grateful to our students for keeping us fresh and fully challenged, and to our families for their continued support.

Finally, we would be terribly remiss not to acknowledge the fundamental contributions of Professor Rate A. Howell, who was the lead author on the first four editions but who has now retired to engage in kinder and gentler pursuits. We not only express our sincere gratitude to Professor Howell, but also wish him the very best in his future endeavors.

John R. Allison, *Austin, Texas*
Robert A. Prentice, *Austin, Texas*

TO THE STUDENT

Welcome to the study of Business Law. Among our goals is the desire to help you learn (1) to understand how the legal system interacts with and to a large extent shapes business activity in this country; (2) to recognize specific legal concepts that will be useful in any business career; (3) to become comfortable with the interplay between legal and ethical principles so that you may better analyze the “musts” as well as the “shoulds” of conduct in a civilized society; and (4) to master the process of legal analysis which is, basically, an important form of problem solving that can be helpful in resolving any type of problem that might arise. Legal problems are, after all, only another type of business problem.

We have written this book to challenge you. Many legal concepts are complicated. They lose their meaning and relevance if they are oversimplified. This book is designed to allow you to learn as much as possible and not to shortchange the hard-working student with a thirst for knowledge. At the same time, the book contains a number of features to enhance learning which have enabled thousands of students using earlier editions to master the important concepts being presented. Do not be intimidated! The law is interesting, it is fun, and it is generally based on common sense.

Among the helpful pedagogical features of this book are (1) key terms defined in the glossary and highlighted in boldface type in the text; (2) chapter summaries designed to emphasize the key points in each chapter; and (3) questions and problems at the end of the chapters provided to illustrate key concepts and to give you an opportunity to apply the principles that you have learned from reading the text.

CASE ANALYSIS

This textbook will familiarize you with basic legal concepts, enable you to avoid legal problems in the course of your business activities, help you decide when it is necessary to call an attorney, and make it easier for you to deal with your attorney. The book is not designed to make you a lawyer or to give you all

of the legal reasoning skills that law school would impart. Nonetheless, you will definitely learn some of the techniques of legal analysis in reading this text, and one of the most important is the ability to “brief” a case.

The study of law is, to a large extent, the study of the written opinions of the judges who decide legal cases. The essence of legal reasoning has been said to be the ability to reason analogically among these opinions. Indeed, a law school textbook is often filled with cases, supplemented by a few questions but very little explanatory material. The students must analyze the cases, extract the key principles, and construct their own syntheses of the legal rules in that field of study.

The aim of a business law text is somewhat more modest. As you examine this book, you will see that it consists primarily of explanatory material that sets forth basic legal principles and then explains them with the aid of examples. Although the chapters are primarily textual, they typically contain several opinions from real cases to illustrate the most significant principles. The importance of these cases cannot be overstated. They put the abstract principles into a concrete, useful, and often interesting context.

Your professor will likely urge you to “brief” these illustrative cases as a way of familiarizing you with the basics of legal reasoning. This is a tried-and-true method of studying the law and, with practice, is easy to master because the briefing process is not complicated. A brief is to a case simply what a book report is to a book—your summary of the principal points of the court’s opinion. If you analyze the court’s opinion and summarize that analysis in your own words, you will more readily understand and retain its key points.

There is no one correct form for a brief, but a typical brief might contain these elements:

1. **Name of the Case.** The title of a case, e.g., *Smith v. Jones*, indicates the parties to the suit. When a case is first filed, a title of Smith v. (versus) Jones usually tells us that Smith is the *plaintiff*, the party who

seeks relief in court against the *defendant*, Jones. Note, however, that many of the cases contained in this text are opinions not of the trial court but of appellate courts. If the judgment of the trial court is appealed, the rule followed by most states is that the title of the case remains *Smith v. Jones* in the appellate court no matter which party is the *appellant* (the one bringing the appeal). In the federal courts, on the other hand, the appellant's name appears first. Under this rule, if Jones (defendant) loses in a U.S. district court and appeals to a U.S. court of appeals, the title of the case will become *Jones v. Smith* in the higher court. For this reason, when one sees a case in a federal appellate court (and in some state appellate courts), one cannot assume that Jones was the plaintiff in the suit simply because his or her name is listed first. The facts of the case must be read carefully to determine who brought the suit.

2. Citation. It is not important for you to master the legal citation system. Nonetheless, your professor may wish you to have a passing familiarity with it. The heading of the cases in this text will not only give the case name but also will specifically indicate which state or federal court rendered the decision. The major case in the first chapter, for example, is titled: *Soldano v. O'Daniels*, California Court of Appeal, 190 Cal. Rptr. 310 (1983). The California Court of Appeal is an intermediate appellate court in the California state system. (You will study the structure of the state and federal court systems in Chapter 2.) The rest of the citation tells us that this opinion may be found in a law library in Volume 190 of the California Reporter, at page 310, and that the decision was rendered in 1983. All important state and federal appellate court opinions are contained in bound volumes to which these citations refer. Recent innovations in computerized legal research have, in fact, led to an entirely new supplementary system of citation.

3. Facts. Lawsuits are filed because things have happened to people. Contracts have been breached. Products have exploded. Trade secrets have been stolen. Legal principles are "fact sensitive." To do justice in a particular case, legal principles must be tailored to the specific facts involved. In a trial, those facts are adduced in the form of testimony of witnesses and submission of documents. When an appel-

late court hears a case on appeal, the judges read a transcript of the important testimony given at the trial level. When any court issues its opinion, it will summarize the facts as it understands them from the testimony and documents presented by the parties. A typical legal opinion will begin with such a summary.

Your authors have taken the court's summaries of the relevant facts and further winnowed them down. You will note that each major case in this chapter begins with a factual summary printed in boldface. That summary will tell you what happened that led to a lawsuit being filed, what lawsuit was filed, and what if any action was taken before the case reached the court whose opinion is quoted. Some briefs contain the trial court ruling as a separate section rather than including it in a summary of the facts. In briefing the case, be sure to put the facts into your own words. The authors' summary can usually be boiled down even further, and it is helpful to your understanding of the case to go to this effort.

4. Issue. Judicial opinions are written largely to answer legal questions that are raised in the litigation. The cases that have been selected for inclusion in this text were chosen to illustrate particular legal principles. Each case answers one or two key legal questions. Detecting the issue in a case is sometimes the most difficult part of writing a brief. Sometimes the court will come right out and phrase the issue itself. (The *Soldano* opinion does this in the first sentence.) More commonly, you must deduce the issue for yourself after reading the opinion. The issue often revolves around the question of what should be the content of a particular legal rule.

5. Holding. This is simply the legal answer provided to the issue presented to the court.

6. Rationale. The most important part of an opinion is the judges' explanation for why they have ruled as they have. Their reasoning is contained in the rationale of the opinion. Our text presents excerpts from the judges' own reasoning that explains why they decided the cases as they did. Again, the best way for you to understand the judges' reasoning is to read the opinions carefully and then summarize that reasoning in your own words. A good brief is, in fact, brief. It contains the essence of the judges' reasons for ruling as they did, but no more.

SAMPLE BRIEF

If you took the *Soldano v. O'Daniels* case in Chapter 1 to 25 law professors and asked them to brief it, all their briefs would be similar, but no two would be alike. As in book reports, there is no absolute “right” or “wrong” brief in terms of either structure or content. We have included a sample brief of the *Soldano* case, however, to give you some indication of what a brief might look like.

NAME: **Soldano v. O'Daniels**

CITATION: **California Court of Appeal, 190 Cal. Rptr. 310 (1983)**

FACTS: Plaintiff's father was killed in a restaurant by a gunman after a bystander had gone to summon help at Happy Jack's Saloon. The bartender refused to call the police or to allow the bystander to do so. Plaintiff sued the bartender and the bar's owner. The trial judge granted summary judgment for defendants, ruling that they had no legal duty to help plaintiff's father in any way.

ISSUE: “Does a business establishment incur liability for wrongful death if it denies use of its telephone to a good samaritan who explains an emergency situation occurring without and wishes to call the police?”

HOLDING: Yes. The trial court's ruling is reversed.

RATIONALE: Although it has been criticized, the general rule is that citizens have no *legal* duty to help their fellow man in peril. The law has imposed some exceptions, such as where there exists a special relationship (for example, psychiatrist–patient), but these exceptions do not apply here.

Nonetheless, public policy supporting crime prevention demands creation of a new, limited exception in cases such as this. Although the law should not impose a duty on these defendants to actively assist the plaintiff's father or on anyone to allow someone claiming an emergency to enter their homes, there should be a duty not to obstruct the efforts of a good samaritan who wishes to call the police from a public establishment.

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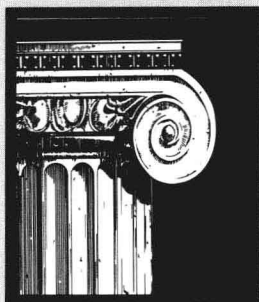
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THE LEGAL ENVIRONMENT OF BUSINESS

■ Part I of this text consists of ten chapters that are devoted to matters that cut across or substantially affect all areas of law. Its purpose is to lay the groundwork for an understanding of the somewhat narrower substantive bodies of law, such as the law of contracts and corporation law, that are covered in the parts of the text that follow.

These introductory matters are largely concerned with structures, processes, and analyses—the structure of our existing laws and court systems, the legal processes by which laws are made and applied to actual controversies, and analysis of the historical reasons responsible for these structures and processes.

Chapter 1 examines the nature and purpose of legal rules—the special characteristics that set these rules apart from other societal rules and the characteristics which these rules must possess if they are to remain an effective part of the legal system.

Chapter 2 provides familiarity with the structure and jurisdiction of the federal and state courts, while Chapter 3 examines the roles of the trial and appellate courts in the resolution of real controversies. We examine these “adjudicatory processes” of the law in these chapters so that actual court cases can be utilized in the text as early and effectively as possible. Chapter 3 also discusses alternative dispute resolution—means by which disputes are resolved without court litigation.

Chapters 4 through 6 deal with the most important *sources* of legal principles and processes. Chapter 4 explains the difference between “common law”—law that is made by judges in the courts, and

statutory law—law that originates in the legislatures. In Chapter 5, our paramount source of law—the Constitution—is explored; particular attention is paid to the role played by the Constitution in empowering and limiting the actions of government in regulating business activities. Chapter 6 discusses the role of federal and state administrative agencies as makers, interpreters, and enforcers of law through rule-making and decision-making activities.

Chapters 7 through 9 examine the various kinds of “wrongs” that our legal system must deal with. Chapter 7 briefly looks at the basic nature of criminal law and procedure, and then devotes most of its attention to “white collar crime”—that is, crime in business. Chapter 8 provides a broad overview of the law of torts, or civil wrongs, which are those kinds of wrongful conduct (such as negligence or defamation) that may be encountered in both business and nonbusiness settings. Chapter 9 then looks at “competitive torts,” a term we use to describe torts that occur almost exclusively in the course of competition among business firms. Tort actions arising out of the sale of defective products, however, are reserved for later discussion in Chapter 22 when we study the law of sales transactions.

Chapter 10 concludes Part I with an examination of the ethical questions and moral obligations that permeate business life. The chapter pays special attention to the relationship between law and ethics, and the ethical problems that often run as undercurrents beneath legal problems. ■