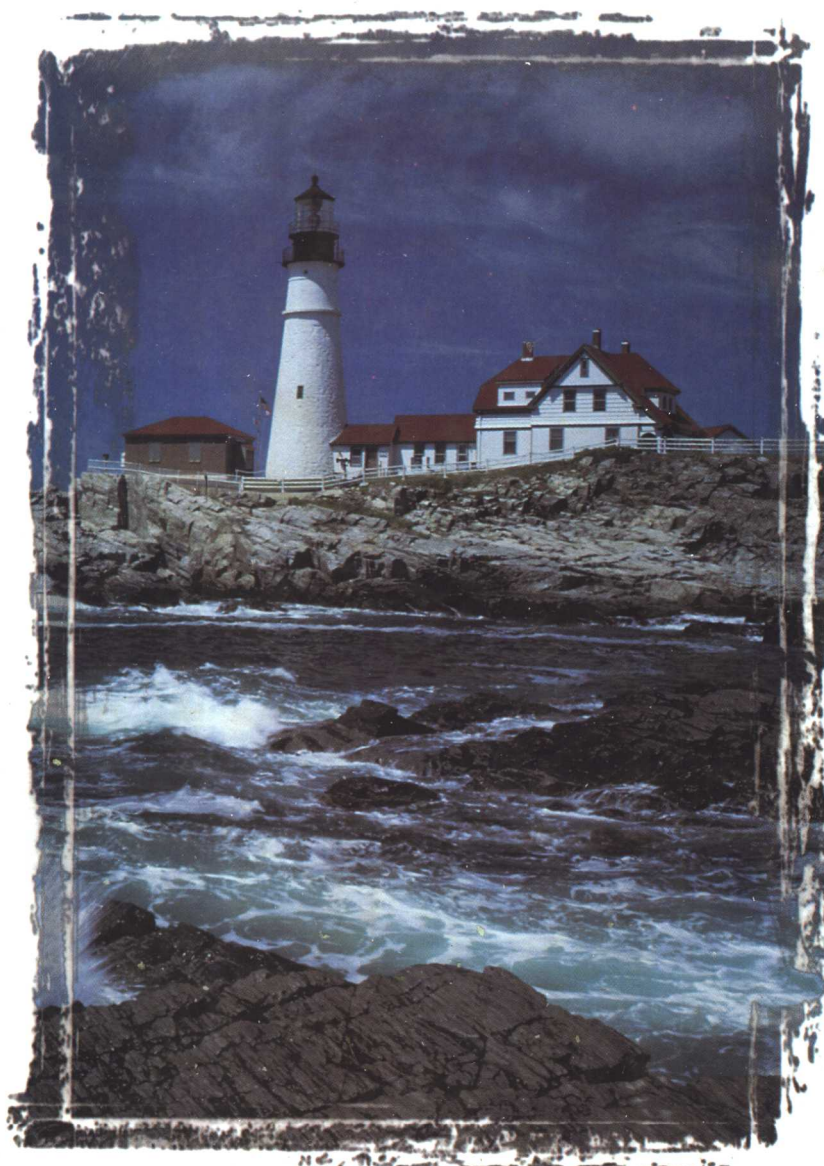


BUSINESS LAW
&
THE LEGAL ENVIRONMENT

COMPREHENSIVE VOLUME & SIXTEENTH EDITION



ANDERSON

FOX

TWOMEY

B U S I N E S S L A W

T H E L E G A L E N V I R O N M E N T

COMPREHENSIVE VOLUME  SIXTEENTH EDITION

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P R E F A C E

The 21st century is almost here. New technology and new methods of doing business are bringing new laws of business. It is with the present and the future in mind that we have written this Sixteenth Edition of *Business Law and the Legal Environment*. Our objectives are to bring to readers the law they will face as human beings, citizens, and persons in business and to help readers develop the critical thinking skills necessary to be successful citizens and businesspersons. Our goals have been to make this book (1) accurate, (2) understandable, (3) balanced, (4) life-oriented, and (5) thought provoking.

By accurate, we mean that we have done everything possible to ensure that the content of the book is as up-to-date as modern publishing technology will permit. Accurate also means that new doctrines and minority trends have been identified. Accordingly, we have endeavored to make this book anticipatory as well as retrospective. In the process of doing so, we hope to emphasize the dynamic character of the law.

Understandable means that legalistic jargon and words of art must be translated into ordinary English. We have replaced linguistic provincialisms and obscure words with ordinary language that can be understood by the modern student.

Balanced means that from the myriad discrete legal topics that might have some significance for undergraduate students of business law, those with the greatest relevance have been selected. If all the volumes of professional treatises relating to business were added together, the number would exceed 1,000. The business law student is given one book. Obviously, careful choice is necessary to bring the great mass of the law down into a one-volume text for beginners. In addition, great care must be exercised to treat all portions of the student's book with the appropriate degree of intensity.

Life-oriented requires the book to be devoted to those areas that the undergraduate student of today will most likely meet in future years. Consequently, it means avoiding the unusual, the bizarre, the headline cases that have no real value for the businessperson. Above all, life-oriented brings out the interrelationship between the law and life: the law is shaped by the environment, and the law gives direction to the environment. For the purpose of curriculum compartmentalization, law is a separate subject, but as far as life is concerned it is an inseparable part of living. The more the student can appreciate this interrelationship, the better will be the student's understanding both of law and of life.

Thought provoking means the text and cases require students to develop critical thinking skills enabling them to analyze the positions of the parties, identify flaws in arguments, and evaluate the appropriateness of legal remedies. Moreover, the end-of-chapter materials ask students to identify basic questions, to apply existing principles to the solution of such basic questions, and to make intelligent decisions when there are no preexisting principles to govern the exact basic ques-

tions that are involved. This system not only brings the student back to the orientation of law to life, but it also assures the teaching of law a permanent place in the pattern of higher education. Where appropriate throughout the book, ethical, public policy, and international dimensions are integrated into the text.

The objectives set forth above have guided the writing of this book for more than a third of a century. Though our focus on these objectives has never wavered, the specific content of the book has evolved to keep pace with changing times. The early 1960s witnessed the integration of the Uniform Commercial Code in the Seventh Edition as a result of the growth in the number of states adopting the UCC. In subsequent years that coverage has been continually updated to keep pace with amendments to the UCC and other uniform and model acts. Curriculum trends have us placing increasing emphasis upon environmental and regulatory topics.

THE LEGAL AND REGULATORY ENVIRONMENT OF BUSINESS

Part 1 of the book brings together various chapters relating to societal or public law that form the general background for individual business transactions. To borrow terms familiar to the economist, Part 1 deals with macro law while much of the balance of the book relates to micro law. It is important that the student see the background of macro law. It is also important that the student recognize that the legal environment of business is the sum of the macro and micro areas.

More specifically, Part 1 deals with the regulatory environment in which business operates. The social forces behind the creation and evolution of the specific principles and substantive rules that govern disputes and transactions between individuals are explored. A comprehensive discussion of the federal and state court structure and the procedures involved in a lawsuit, from commencement to execution of the judgment, is included. The Constitution, as the foundation of the legal environment of business, is presented. The increasing role played by the administrative agencies in the government regulation of business is fully discussed.

This allocation of the indicated material to Part 1 is in harmony with the increased concern for an environmental approach to the teaching of business law. At the same time, this focusing on societal or public law is not made at the expense of the treatment of the areas of private law. There has been no lessening of attention to accuracy of content, clarity of expression, and thoroughness of subject matter coverage. In addition to the topics discussed in Part 1, other chapters throughout the book are appropriate for a course that focuses on public law. Although every chapter in the text possesses the potential for an environmental approach, some chapters lend themselves to this mode of teaching more readily than others. An outline of chapters emphasizing public law follows.

SUGGESTED LEGAL AND REGULATORY ENVIRONMENT OUTLINE

Chapters:

1. Law and Determination of Legal Rights
2. Ethics, Social Forces, and the Law
3. The Constitution as the Foundation of the Legal Environment
4. Government Regulation of Competition and Prices
5. Administrative Agencies

- 6. The Legal Environment of International Trade
- 7. Crimes
- 8. Torts
- 20. Personal Property (protection of intangible proprietary rights; trademarks; copyrights, patents, trade secrets)
- 29. Consumer Protection
- 37. Bankruptcy
- 42. Regulation of Employment
- 43. Equal Employment Opportunity Law
- 49. Securities Regulation
- 52. Environmental Law and Community Planning

An introductory course that emphasizes societal or public law may include the chapters above and other appropriate chapters selected for the course. An introductory course emphasizing private law may cover selected chapters from Part 1, The Legal and Social Environment of Business, and chapters on contracts, personal property, or agency. The instructor may choose to cover additional topics in this introductory course, depending on the ability level of the students and the time allotted to the course at the institution. The remainder of the book may be covered in advanced courses.

PREPARATION FOR CPA EXAM

As was true in previous editions, this Sixteenth Edition provides strong preparation for the business law section of the CPA exam. This text is used as an authoritative source for the business law section of the exam. The business law section of the CPA exam is now called “Business Law and Professional Responsibility” (LPR). Many new topics have been added and are covered in detail in this Sixteenth Edition of *Business Law and the Legal Environment*. If you are preparing for the exam, note the highlighted sections in this text. The sections marked “CPA” are areas that are heavily tested by the CPA examiners. The new content specifications of the LPR section of the CPA exam and their weights are set forth below. You will also note the chapter in this text where these areas are covered in detail.

LPR—Content Specification Outline

Text Chapter

- I. Professional Responsibilities (15 percent)
 - A. Code of Conduct and Other Responsibilities
 - 1. Code of Professional Conduct
 - 2. Proficiency, Independence, and Due Care
 - 3. Responsibilities in Consulting Services
 - 4. Responsibilities in Tax Practice

Chapter 19

- B. The CPA and the Law
 - 1. Common Law Liability to Clients and Third Parties
 - 2. Federal Statutory Liability
 - 3. Working Papers, Privileged Communication, and Confidentiality
- II. Business Organizations (20 percent)

Chapters 39–41

- A. Agency
 - 1. Formation and Termination
 - 2. Principal’s Liabilities
 - 3. Disclosed and Undisclosed Principals
 - 4. Agent’s Authority and Liability

Chapters 44–46

- B. Partnerships and Joint Ventures
 - 1. Formation and Existence
 - 2. Liabilities and Authority of Partners and Joint Owners
 - 3. Allocation of Profit or Loss
 - 4. Transfer of Interest
 - 5. Termination and Dissolution

Chapters 47, 48, 50

- C. Corporations
 - 1. Formation, Purposes, and Powers

2. Stockholders, Directors, and Officers
3. Financial Structure, Capital, and Distribution
4. Merger, Consolidation, and Dissolution

Chapter 54

- D. Estates and Trusts
 1. Formation and Purposes
 2. Allocation Between Principal and Income
 3. Fiduciary Responsibilities
 4. Distributions and Terminations

Chapters 9–18

- III. Contracts (10 percent)
 - A. Formation
 - B. Performance
 - C. Third-Party Assignments
 - D. Discharge, Breach, and Remedies

Chapters 36, 37

- IV. Debtor-Creditor Relationships (10 percent)
 - A. Rights and Duties—Debtors and Creditors
 1. Liabilities and Defenses
 2. Release of Parties
 3. Remedies of Parties
 - B. Rights and Duties—Guarantors
 1. Liabilities and Defenses
 2. Release of Parties
 3. Remedies of Parties
 - C. Bankruptcy
 1. Voluntary and Involuntary Bankruptcy
 2. Effects of Bankruptcy on Debtors and Creditors
 3. Reorganizations
- V. Government Regulation of Business (15 percent)

Chapters 42–43

- A. Regulation of Employment
 1. Payroll Taxes
 2. Employee Safety
 3. Employment Discrimination
 4. Wage and Hour

5. Pension and Other Fringe Benefits

Chapter 49

- B. Federal Securities Acts
 1. Securities Registration
 2. Reporting Requirements
 3. Exempt Securities and Transactions
- VI. Uniform Commercial Code (20 percent)

Chapters 30–34

- A. Commercial Paper
 1. Types of Negotiable Instruments
 2. Requisites of Negotiability
 3. Transfer and Negotiation
 4. Holders and Holders in Due Course
 5. Liabilities, Defenses, and Rights
 6. Discharge

Chapters 24–28

- B. Sales
 1. Contracts Covering Goods
 2. Warranties
 3. Product Liability
 4. Risk of Loss
 5. Performance and Obligations
 6. Remedies and Defenses

Chapter 35

- C. Secured Transactions
 1. Attachment of Security Interests
 2. Perfection of Security Interests
 3. Priorities
 4. Rights of Debtors, Creditors, and Third Parties

Chapters 51–53

- VII. Property (10 percent)
 - A. Real Property
 1. Types of Ownership
 2. Lessor-Lessee
 3. Deeds, Recording, Title Defects, and Title Insurance

NEW TOPICS

New or expanded topics in this Sixteenth Edition include: NAFTA (Chapter 6); arbitrating international business disputes (Chapter 6); U.S. laws on counterfeit goods and grey market goods (Chapter 6); non-accountant defendants in malpractice liability (Chapter 19); bailments—court refusal to enforce explicit exclusions of liability in automobile rental contracts (Chapter 22); leases of personal property (Chapter 24); bankruptcy law (revised Chapter 37); compensatory and punitive damages for insurer bad faith breach of the insurance contract (Chapter 38); negligent hiring and retention of employees (Chapter 41); regulation of employment and equal employment opportunity law (new Chapter 42 and 43); limited liability companies (Chapter 46); the SEC's new small business initiative and securities industry self-regulation (Chapter 49); the fiduciary duty of corporate directors-officers (Chapter 50).

UP-TO-DATE WITH THE CODE

Recently a wave to reform the UCC began. Thus far, five new articles or revisions have been adopted as official parts of the Code. The first footnote in Appendix 3 of this text lists the states that have adopted these new articles. This book is up-to-date with these changes in the Code. Selected sections of the statute are presented in Appendix 3. In addition, Article 2A, Leases, is covered in Chapter 24; the 1990 versions of Articles 3 and 4 are covered in Part 5 of the text; Article 4A is covered in Chapter 34; and Article 6 is handled briefly in Chapter 24.

Part 5 of the text, on negotiable instruments and funds transfers, features a unique comparative discussion of both the old (1952) and the new (1990) Uniform Commercial Code, Articles 3 and 4. The text is set in double columns making it possible for instructor and student to study only the 1952 version, to study only the 1990 version, or to study and compare both versions. Readers in states adopting the new code Articles will of course be interested in these up-to-date materials. But, in addition, the comparison of the new Articles with the former versions furnishes an excellent opportunity for the student to see how business practices and new technologies give rise to new situations that call for new law.

CASE SUMMARIES

As in previous editions, this Sixteenth Edition contains ample case summaries integrated with the text of each chapter. We have retained popular, precedent-setting cases, while at the same time adding many new decisions.

FEATURES

Opening outlines are now included in each chapter. These outlines are followed by chapter objectives, which identify main points to be learned. A new feature is a "Law in Practice" section at the end of each chapter that presents several practical points related to the chapter content. Popular features continued in this edition include illustrations within the chapters and end-of-chapter summaries designed to assist students in assimilating the material.

A section on Analysis of Court Opinions is presented on pages 155–156. This section includes a chart designed to assist students in identifying and analyzing ethical issues in the cases.

Also included is an opinion in court language, in excerpted form, at the end of each part of the book. These cases provide teaching flexibility and can be used to develop analytical and critical thinking skills. Information about analyzing these cases precedes the Part 1 case, and appears on pages 155–156. A glossary, a case index, and a subject index are included, as well as appendices on How to Find the Law, the U.S. Constitution, excerpts from the Uniform Commercial Code, the United Nations Convention on Contracts for the International Sale of Goods (CISG), the Uniform Partnership Act, and the Revised Model Business Corporation Act.

ICONS AND MARGINAL STATEMENTS

To attract student interest and highlight key points, this edition contains icons in the margin. The icons are the following and have the meaning indicated:



LIVING LAW. This icon signifies examples provided so students can see the relevance and application of legal principles.



ETHICS/SOCIAL FORCES. This icon highlights text or questions that pose ethical issues or discuss social forces influencing the law.



INTERNATIONAL. This icon denotes legal concepts that affect business on a global scale.

Condensed statements have also been added to the margin to summarize key points. Students are encouraged to add their own notes. This will make the text even more valuable to them as a current study aid and as a future reference.

STUDENTS' SUPPLEMENTS

Accompanying this Sixteenth Edition are two student study guides authored by Ronald L. Taylor of Metropolitan State College of Denver. These study guides contain an outline of each chapter in the text expanded by general rules, limitations on these rules, and study hints. Review and application questions are given for each chapter. The two study guides differ in that one contains the solutions and one offers the solutions in a separate key. "The Legal Tutor on Contracts" and "The Legal Tutor on Sales," also authored by Ronald Taylor, provide the opportunity to develop analytical ability, improve academic performance, and expand knowledge through the use of interactive IBM-compatible software.

INSTRUCTOR'S MATERIALS

An instructor's manual was prepared by Kim Tyler of Shasta College in conjunction with the text authors. This manual contains a paragraph explaining the significance of each chapter, chapter outlines, suggested answers to chapter objectives, lecture notes including teaching suggestions, rules of law illustrated by case summaries, video projects that correspond with CNBC video news clips, and answers to end-of-chapter questions and case questions.

A printed test bank containing over 2,850 questions and a set of achievement tests prepared by Arthur M. Magaldi of Pace University, are available. Answers to the achievement tests are contained in a separate key. The test questions may also be obtained in an easy-to-use IBM or Macintosh software package, MicroExam III.

A set of color transparencies has been developed to enhance classroom presentation of text concepts.

Videos, custom designed for use with this text, are available to adopters. Video topics correspond to each part of the Comprehensive Volume of the text. Other video topics include the UCC, employment law, and the business law portion of the CPA exam. A CNBC video is also available with this edition.

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WRITE THE AUTHORS

Any teacher may write to any of the authors regarding any questions as to teaching methodology or specific rules of law. We represent in the aggregate over a century of teaching and will be happy to respond to your questions.

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TO THE STUDENTS

This Preface cannot be closed without a word to you. To the key points we have summarized in the margins, add notes of your own. Try to look behind the rule of law to see the business and societal needs that gave rise to the rule of law. To the extent that the law is a window through which you look out on the world, you will not only understand the law better, but you will have a better understanding of, and feeling of, belonging to that world. Above all, you will reap the benefits of a truly higher education: a development of the mind to analyze, decide, and communicate. Good luck.

Ronald Anderson, Ivan Fox, David Twomey

ABOUT THE AUTHORS

Ronald A. Anderson, Professor of Law and Government, Drexel University, taught the subjects covered by this book for 40 years. He is the internationally renowned author of the definitive, 16-volume treatise, *Anderson on the Uniform Commercial Code*, published by Clark Boardman Callaghan. He has written many other well-respected professional works.

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Professor Twomey was graduated from Boston College and earned his MBA at the University of Massachusetts at Amherst. After two years of business experience, he entered Boston College Law School and earned his Juris Doctor. He is a member of the Massachusetts, Florida, and Federal Bars. Professor Twomey is a nationally known labor arbitrator and was elected to membership in the National Academy of Arbitrators. He has written a great number of books and articles on labor and employment law and other business law topics.

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PART 1

The Legal and Social Environment of Business

- 1 Law and Determination of Legal Rights
- 2 Ethics, Social Forces, and the Law
- 3 The Constitution as the Foundation of the Legal Environment
- 4 Government Regulation of Competition and Prices
- 5 Administrative Agencies
- 6 The Legal Environment of International Trade
- 7 Crimes
- 8 Torts



CHAPTER 1

Law and Determination of Legal Rights

A. NATURE OF LAW AND LEGAL RIGHTS

1. Legal Rights
2. What are the Sources of the Law?
3. Uniform State Laws
4. Classifications of Law

B. DETERMINATION OF LEGAL RIGHTS

5. Contract Selection of Law or Forum
6. Courts
7. Administrative Agencies
8. Alternative Means of Dispute Resolution
9. Disposition of Complaints and Ombudsmen

OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Give two examples of the evolutionary character of legal rights.
2. List the agencies or bodies that interpret and apply law.
3. Name seven alternatives for resolving disputes without formal court action.

Why have law? If you have ever been stuck in a traffic jam or jostled in a crowd leaving a stadium, you have been in a position to observe the need for order to keep things running smoothly and efficiently. What is true on a small scale for traffic jams and crowds is true on a large scale for society in general. The order, or pattern of rules, that society establishes to govern the conduct of individuals and the relationships among them we call “law.” Law is society’s way of keeping things running smoothly and efficiently.

A. NATURE OF LAW AND LEGAL RIGHTS

Law consists of the body of principles that govern conduct and that can be enforced in courts or by administrative agencies.

1. Legal Rights

Legal rights evolve over time.



What are legal rights? Who has them? In answering these questions, we tend to make the mistake of thinking of society as being unchanging. But consider the evolution of the concept of the “rights of the human being” and the right of privacy.

(a) The “Rights of the Human Being” Concept. Our belief in the American way of life and in the concepts on which our society or government is based should not obscure the fact that at one time there was no American way of life. In the past, many religious leaders, philosophers, and poets spoke of the rights and dignity of people, but rulers disregarded such pretensions and governed people in a rigid system based on status. A noble had the rights of a noble. A warrior had the rights of a warrior. A slave had very few rights at all. In each case, the law saw only status; rights did not attach to the human beings, but to their status. In the course of time, serfdom displaced slavery in much of the Western world. Eventually feudalism disappeared and, with the end of the Thirty Years War in 1648, the modern nation-state began to emerge. Surely one might say that in such a “new order,” a human being had legal rights. But the person had rights not as a human being; only as a subject. Even when the English colonists settled in America, they brought with them not the rights of human beings but the rights of British subjects. Even when the colonies were within one year of war, the Second Continental Congress presented to King George III the Olive Branch Petition asking the king to recognize the colonists’ rights as English subjects. For almost a year the destiny of the colonies hung in the balance, with the colonists unable to decide between remaining loyal to the Crown, trying to obtain recognition of their rights as English subjects (a “status” recognition), or doing something else.

Finally, the ill-advised policies of George III and the eloquence of Thomas Paine’s *Common Sense* tipped the scales. The colonists spoke on July 4, 1776, not in terms of the rights of English subjects but in terms of the rights of people existing independently of any government. Had the American Revolution been lost, the Declaration of Independence would have gone rattling down the corridors of time with many other failures. But the American Revolution was won, and the new government that was established was based on *human beings* rather than on *subjects* as the building blocks. The concept of rights of human beings replaced the concept of rights of subjects. With this transition, the obligations of a monarch to faithful subjects were replaced by the rights of human beings existing without