

THE LEGAL ENVIRONMENT OF BUSINESS

THIRD EDITION

BLACKBURN KLAYMAN MALIN

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PREFACE

This third edition of *The Legal Environment of Business*, like its predecessors, is designed to fill the need for quality teaching material for the course on the legal environment of business. The success of the earlier editions indicates that many of our professional colleagues who teach the legal environment of business course share our commitment to quality instruction.

Changes and developments in the legal environment of business since publication of the second edition require that the text be brought up to date. Furthermore, from our experience in teaching the legal environment of business course and from the experience that has been so generously shared by those with whom we have communicated, we have learned much of what students and professors desire in a legal environment text.

This is a mainline legal environment of business book. Every effort has been made to be responsive to the accreditation standards of the American Assembly of Collegiate Schools of Business (AACSB). The AACSB standards define the common body of knowledge for business students as including:

... a background of the economic and legal environment as it pertains to profit and/or nonprofit organizations, along with ethical considerations and social and political influences as they affect such organizations.

This book, like its predecessors, consists of 19 chapters organized into 6 parts. Part I, Introduction to Law and Business, introduces the student to business ethics, the nature of law, legal reasoning, and the legal system. Part II, Public Law Basis of Business Regulation, presents the constitutional and administrative framework of government regulation of business and concludes with environmental law as an illustration of a substantive area of government regulation of business. Part III, Private Law Basis of Business Regulation, introduces the student to the subjects of contracts, torts, and business organizations, the legal foundation for many areas of government regulation. Part IV, Business and Financial Markets, consists of chapters on securities regulation and debtor-creditor relations. Part V, Business and the Marketplace, discusses economic regulation of a business's relations with its customers, competitors, and suppliers. It includes chapters on consumer protection, trade restraints, monopolies and mergers, other antitrust topics, and international business transactions. Part VI, Business and Its Employees, includes chapters on labor-management relations, equal employment opportunity, and labor standards and employee safety.

Adopters who used the second edition will find a reorganization of the book's parts. This results from the introduction of new material, such as the

chapters on contracts, torts, and business organizations, treated in Part III, a new part devoted to these topics. Furthermore, changing conditions in law and business have made it sensible to bring together chapters that were treated in separate parts in previous editions. For example, the growth of the financial services industry has prompted us to combine the chapters on securities regulation and debtor-creditor relations into a new part on financial markets. However, there is nothing sacred about the book's organization. Instructors can rearrange the sequence of the chapters without harm. Some instructors may even wish to omit entire parts or chapters from their course coverage to suit their time constraints or subject preferences.

Each chapter consists of approximately two-thirds text and one-third case material. We have attempted to provide a comprehensive and accurate presentation of the subject matter without being overly technical. The result is a book that is highly readable and designed for business school students.

In revising the book, we have retained the features that proved so successful in the earlier editions. Among these are: part introductions to orient the student to a part's subject matter and organization; excerpts of statutes, which are set off in the text where they are discussed; questions after cases; and problems at the end of each chapter.

The following features have been added to the book:

- Four new chapters covering the topics of *contracts, torts, business organizations, and international business transactions* have been included. We have added these chapters in order to reflect the direction in which the legal environment course is evolving.
- Special attention is given to the subject of *business ethics* by placing it as the first chapter in the book. Today, it is appropriate for legal environment of business courses to start with an examination of the ethical assumptions underlying the law. An introduction into ethics helps students view the law and their own positions from a broader perspective, and helps them to become aware of the value assumptions they might otherwise have accepted uncritically.

We have had considerable help in writing this book. Before undertaking this revision, we asked for input from professors who teach the legal environment of business course. We wish to acknowledge those who shared their expertise with us: professors Raymond J. Acciardo, Sr., of Russell Sage College, Luis Aranda of Arizona State University, Elizabeth Arnold of the University of San Diego, Dawn D. Bennett-Alexander of the University of North Florida, Michael Bixby of Boise State University, Herbert Bohlman of Arizona State University, Mark A. Buchanan of St. Cloud State University, George D. Cameron III of the University of Michigan, Donald L. Carper of California State University—Sacramento, Ronnie Cohen of Christopher Newport College, Patricia W. Coplan of the University of Texas at Tyler, Vernon Dorweiler of Michigan Tech University, Mary Jane Dundas of Arizona State University, Edward N. Duran of

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*John D. Blackburn
Elliot I. Klayman
Martin H. Malin*

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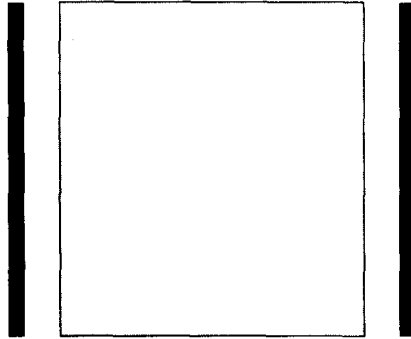
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INTRODUCTION

Legal study differs from other business study. Thus, business students need an orientation to the nature of legal study before they turn to the subjects of the business legal environment. This introduction provides a frame of reference that business students can use to analyze, apply, synthesize, and evaluate the various areas of law affecting business. The discussion explores the objectives of legal study by business students before explaining the nature of legal study.

OBJECTIVES OF LEGAL STUDY BY BUSINESS STUDENTS

It is particularly appropriate at the beginning to inquire into the educational objectives of a book or course on the legal environment of business. Thus the following discussion focuses on the rationale and the objectives of legal study by business students.

Why Study Law in a Business School?

It is generally assumed that law is a subject taught to aspiring attorneys in a professional program within law schools. Historically, however, law was considered important to the lay public as well. In earlier days, legal study was an integral part of a liberal education. Today, legal study outside the law school is gaining renewed interest. This trend is a manifestation of a simple fact of modern life: Law is too important to be left to lawyers.

Business colleges have long recognized the importance of legal study in the curriculum. Business managers must realize that their business relations are also legal relations.

It is particularly important that business students study material on law and regulation. Managers deal not only with suppliers and customers but with an array of state and federal agencies. A list of the acronyms and initials of these agencies (e.g., SEC, NLRB, FTC, OSHA, and EEOC) sounds more like an alphabet soup than a collection of government entities. Woe to the uninitiated manager who does not even know what these abbreviations stand for, let alone the shorthand jargon (e.g., insider trading, price discrimination, bona fide occupational qualification) of the bureaucrats who work for those agencies. The plethora of regulations emanating from various government agencies requires managers to understand how public regulation affects their work. The language of business includes not only the items of the balance sheet but the legalese of government regulations.

What Are the Objectives of a Course on the Legal Environment of Business?

A course on the legal environment of business has many objectives. Some are general and resemble the objectives of other business law courses. Others are unique to a course on the legal environment of business. The following list includes both types. Two points should be noted: (1) the list is not exhaustive, and (2) the formulation of course objectives should be a cooperative effort involving the text authors, the instructor, and the students—it should not be an exercise that a text author or an instructor does alone. The following list is the authors' contribution toward such an effort. A course on the legal environment of business should help the student:

1. *Apply conceptual knowledge to problems.* A principal goal of legal environment courses is to teach conceptual knowledge for future use in decision-making situations. This is accomplished by communicating the concepts in a case-oriented setting and by giving the student practice in applying the concepts to case problems. The use of case study makes the student sort out relevant and important facts, determine the issues involved, and reach conclusions based on known rules, regulations, standards, and principles.
2. *Acquire a vocabulary of terms and concepts that will make it possible to understand further communications.* This will facilitate a continuation of learning beyond the limits of the classroom. A working knowledge of the legal terms and concepts used in business helps in understanding the sources that business people read every day. These sources include business papers and periodicals, technical journals, and financial reports.
3. *Develop the principles of inquiry, restraint, objectivity, and regard for considerations of public policy.* Understanding the “legal method” of resolving conflicts helps managers to develop restraint by not reaching conclusions too quickly on the basis of narrow thinking, to be more

objective, and to consider not only the immediate issue but also the broader considerations of economic and social benefit.

4. *Develop an understanding of the philosophy underlying the legal rules and regulations controlling business activity.* This will help managers understand their role in the improvement of the legal and regulatory system. Legislative bodies, administrative agencies, and courts should ensure that the legal and regulatory system reflects the consensus of public thought. Therefore, everyone should think critically about the present system and the desirability of change.
5. *Facilitate interdisciplinary communication in business.* Accountants, financial executives, marketing experts, and other business specialists must constantly communicate with one another. Frequently the subject matter will involve legal concepts with which all of them must be familiar.
6. *Develop an understanding of the principal areas of law and regulation affecting business transactions.* This will enable you to do a better business management job. Legal rules and regulations affect almost every business activity. Ignorance of these rules and regulations leaves a large void in the formal education of a business manager. The fact that there is a professional field of law practice does not free managers from the need to know about the legal environment of business. Many will not have lawyers on retainer, and even those who do cannot rely on their lawyers to instruct them on every business matter in which law is involved. Almost every business decision is affected in some way by existing rules of law.
7. *Develop an awareness of legal pitfalls.* This will enable you to seek legal assistance before losses occur.
8. *Satisfy the intellectual curiosity that drives every person to learn more about the principles and concepts that give meaning to observations and experiences.* Legal environment courses show how law and regulation interact with the business sector of the social order and give students a better understanding of the relationship between business practice and social development.

NATURE OF LEGAL STUDY

The peculiar feature of legal study is the inclusion of excerpts of legal cases in the text. These cases are unlike the business cases usually included in business school case courses. In fact, these legal cases are not really “cases” at all. They are legal opinions written by judges, usually on appellate courts. These opinions resolve the legal issues in the dispute brought before the courts. These written legal opinions constitute the cases presented in this book. The cases illustrate the application of the principles of law (provided in the textual material preced-

ing each case) to particular legal disputes. These cases, plus the text and the discussion by your instructor, form the standard substance from which students will learn about the legal environment of business.

The cases selected have been chosen by the text authors for their value in teaching. Most of the cases in this text are recent cases illustrating trends in the law. These permit the student and instructor to evaluate the decision against the background of their own current experience. Some cases have been selected because they proceed on unsound assumptions or somehow fail to solve the problems at hand. They provide the maximum opportunity for class discussion and criticism. Others have been included because they are the great landmark cases. From these latter cases the student will learn “sound law” and come into contact with dominant ideas.

Reading Cases

The first thing the student should do is read the textual material immediately preceding a case. This material presents the fundamental legal principles in a general manner. After this, the student should read the case following the textual presentation. Do not read a case as you would read a novel, skimming lightly for the thread of the plot. Read the case as carefully as you would read a page of statistics, accounting, or finance. You should read each word, looking up the unknown words in the glossary. The old proverb “To read many times is not necessarily to understand” is worth cherishing, plain as it is.

In reading cases, it is necessary to bear in mind the points of law you are seeking. It does not suffice to read legal opinions merely as narratives. The cases are presented to illustrate particular areas of the law, and your legal analysis of the cases should be structured to make your reading profitable. You not only must know what you are looking for; you ought also to have a method that will help you in your search. As the learned Justice Cardozo once said, “Cases do not unfold their principles for the asking. They yield up their kernel slowly and painfully.”¹

Your reading of these cases, then, must be systematic. Keep in mind that an appellate judge does *not* always write his or her opinion with an eye toward functional, simple, orderly legal analysis. Our American legal system is one of the few in the world in which people are not specifically trained to become judges. Our judges have usually been trained to become lawyers (though even this is not always a prerequisite). Then, depending on the particular judicial procedure, some of these lawyers are either elected to a judgeship or appointed to this office of honor and power. When people become judges, lightning does not strike them with the knowledge and expertise necessary to write meaningful

¹ B. Cardozo, *The Nature of the Judicial Process* 29 (1921).

(or even lucid) legal opinions. They sometimes experience great difficulty in formulating their decisions. However, important decisions may be made in such instances. Problems in case selection arise when an important decision is contained in an opinion written by a judge who may have had great difficulty in committing his or her thoughts to paper. Sometimes, the authors have included such cases within the text. In such instances, your analysis may be impeded by obscure language. Also, many of the legal opinions in your text have been edited to conform to necessary space limitations or so that a case which in its entirety illustrates many points of law could be used to illustrate a single point. Therefore, realize that sometimes a case may appear confusing because it is confusing.

A Sample Case

It will be helpful at this point to actually read a case. The case that follows is fairly typical of those you will encounter in the rest of the book. However, you should know a few things before reading the case.

The case involves an area of law known as the law of torts. Tort law is basically the law of accidents. You will read more about this subject in Chapter 7.

Before a court will require someone to compensate the victim of an accident, the court must conclude that the person who caused the victim's injury was under a duty to protect the victim from the very injury that occurred. Thus the concept of a "duty" is basic to an understanding of when one person will be liable to another.

There are several kinds of duties. There are social duties, such as when two people agree to go out to dinner. There are moral duties, such as the duty to come to the aid of another. There are the voluntary duties that we agree to undertake, such as when we enter into business contracts. And there are duties that society imposes upon us by law. Not every moral duty is recognized by the courts as creating a legal duty which will be enforced by the courts. The case which follows addresses the question of whether a duty should be recognized so as to require one party to pay for the other's injury.

The case involves a type of lawsuit known as a *wrongful death action*. This type of lawsuit is brought on behalf of a dead person's beneficiaries (for example, spouse, parent, children) against someone who negligently caused the death of another. Thus, a husband can bring a wrongful death action against someone who negligently caused the death of his wife and recover compensation for the loss of his spouse.

One final note is in order here. In a lawsuit, the party who brings the lawsuit is called the **plaintiff**; the party who is being sued is called the **defendant**. Now, on with the case.