

SEVENTH EDITION

BUSINESS LAW

PRINCIPLES AND
CASES IN THE
LEGAL ENVIRONMENT



DAVIDSON,
KNOWLES &
FORSYTHE

SEVENTH EDITION

BUSINESS LAW

PRINCIPLES AND CASES IN THE LEGAL ENVIRONMENT

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To my wife, Dee, and my children, Jaime and Tara, thanks for your help and support! And to our reviewers and adopters, thanks for making it worth the time and the effort.

Daniel V. Davidson

To my mother, Madge L. Knowles, and my aunt, Helen I. McDonald, the two who have known me the longest, loved me anyway, and taught me the most.

Brenda E. Knowles

To Jim and Mike Poptanich for their love and patience, and to my extended family, especially Aileen and Robert Zollweg and Mary Helen and John Poptanich. And to our students, your ideas and suggestions are greatly appreciated.

Lynn M. Forsythe

A BUSINESS-ORIENTED BUSINESS LAW TEXT

Business Law: Principles and Cases in the Legal Environment, Seventh Edition, offers students a business-oriented introduction to the legal and ethical topics that affect business. This perspective may seem obvious. After all, isn't a business law textbook by its very nature oriented toward the practice of business? While it might seem that they should, not all business law textbooks adopt such an orientation. 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, but rather to train future businesspeople to anticipate and avoid legal problems. If legal problems arise, it is critical to know how to recognize the nature of these problems and work with a lawyer to achieve solutions. Legal problems, even lawsuits, are business problems that can be managed.

Our strategy in revising this, our seventh, 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 also support more fully the teaching and learning process associated with using the text. Our association with West Legal Studies in Business allows us to offer a wide array of supplementary materials for instructors and students.

NEW COVERAGE IN THE SEVENTH 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 10 parts based on traditional topical areas of undergraduate business law. We have made the following content changes and updates to the seventh edition.

Part 1 Foundations of Law. Part 1 presents an overview of law and the legal system. The seventh edition provides extended coverage of ethics and international law topics. In particular, Chapter 1, "Introduction to Law," provides a more detailed discussion of theories of jurisprudence and a new exhibit outlining these theories. Chapter 2, "Business Ethics," has an increased focus on the application of ethical theories in the practice of business, including the introduction and discussion of some additional ethical theories and a new exhibit comparing a number of these theories.

Part 2 The American Legal System. Part 2 examines the court system and the legal system used in the United States. We have moved the coverage of constitutional regulation of business to this section. This encourages a discussion of fundamental constitutional law principles while maintaining the focus on *business* and the application of the legal system to business problems and concerns. The material on dispute resolution has been reorganized into one chapter for this edition. This chapter combines the materials in two chapters of the previous edition and is designed to show the similarities and the differences in the various types of dispute resolution. We examine a civil

trial and then look at a number of Alternative Dispute Resolution (ADR) approaches to the same problem. This section concludes with an examination of torts and business crimes, respectively. The criminal law coverage includes computer crimes. Simply put, the material in Part 2 has been rearranged to improve the flow of topics.

Part 3 Contracts. Part 3 examines the primary importance of contract law to business. The chapters contained here have been substantially updated, and some of the coverage has been relocated among the chapters. Chapter 9 is an introduction to contracts, discussing contract theories and the various areas included in contract law. Chapter 10 covers offer and acceptance, and Chapter 11 discusses consideration. Chapter 12 deals with voidable contract areas, “Contractual Capacity,” while Chapter 13, “Legality of Subject Matter and Proper Form of Contracts,” examines void agreements and unenforceable contracts, respectively. Chapter 14 discusses the rights of third persons and contract interpretation. The contract section ends with Chapter 15, “Contractual Discharge and Remedies.”

Part 4 Sales and Leases. Part 4 introduces the Uniform Commercial Code (UCC) in significant detail and examines the law of sales from an international perspective. Part 4 now offers comparisons of Article 2 contracts with Article 2A 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. There is also a brief discussion of several proposed United Nations Conventions that may soon be ratified and that will also affect international sales and other international business transactions.

Part 5 Negotiables. Part 5 discusses UCC Articles 3 (Revised), 4 (Revised), 4A, and 7. In addition, it includes a discussion of electronic fund transfers. This 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 of 1994. A new chapter has been added to this part. Chapter 28, “Other Credit Transactions,” discusses various types of consumer debt besides secured transactions and bridges the gap between secured transactions and bankruptcy. In addition, this part includes increased coverage of the Bankruptcy Reform Act of 1994 and looks at the proposed Bankruptcy Reform Act of 1999, which Congress has not yet approved.

Part 7 Agency. Part 7 explains the agency relationship and its importance in conducting a business enterprise. 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 employer and the employee for torts and crimes committed by the employee. Policy reasons for the rules are addressed. Protection of the employer’s confidential information and covenants not to compete are also discussed.

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, but rather on why a particular form should be chosen. The coverage includes an examination of the limited liability company (LLC) and the limited liability partnership (LLP), as well as the traditional business organizations: proprietorship, partnership, limited partnership, and corporation. Coverage of the Revised Uniform Partnership Act is increased, since it has been adopted by more states. We also include thorough discussions of franchising in Chapter 37 and securities regulation in Chapter 38.

Part 9 Government Regulation of Business. Part 9 addresses the regulatory issues regularly faced by businesses, including coverage of antitrust law, consumer protection, environmental protection, and labor and fair employment law. Chapter 40, “Consumer Protection,” is devoted entirely to consumer law and stresses concepts that relate back to Chapter 28, “Other Credit Transactions,” from Part 6. There is also one chapter devoted to environmental law—Chapter 41, “Environmental Protection”—that addresses most of the major environmental statutes. This coverage includes a discussion of some of the policy reasons behind the statutes and the penalties to be faced for violations. The final chapter in this section is “Labor and Fair Employment Practices,” a detailed examination of the rights and responsibilities of management and its employees.

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. The first chapter in this part discusses real property, government regulation of real property, and the types of joint ownership. Transfer on death ownership has been added to this edition. The second chapter examines personal property and bailments. The third chapter addresses intellectual property, including a discussion of copyright law and of computers and the law. The part and the text conclude with a consideration of techniques for transferring wealth, including wills, estates, and trusts. Recent changes in transfer tax laws are included.

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 them unique to this text.

Court Cases

Each chapter contains three court cases primarily in the language of the court. Cases are organized into the following parts:

- Facts—the facts of the case
- Issue(s)—the issues, in the form of questions, on which the decision hinges
- Holding—the court’s answer to the issue(s)
- Reasoning—the reasoning the court used in reaching its decision

We have made an effort in this edition to include more judicial language in the cases. Our selection of cases includes both classic, landmark opinions and current, cutting-edge cases. In addition, all of the court cases end with a Business Considerations question and an Ethical Considerations question. These questions illustrate the impact of court cases on business and how business decisions may lead to litigation. Ethical considerations show how ethics constantly affect decision making. Limiting ethical concerns to a cursory examination in an obligatory ethics chapter profits no one; rather, an emphasis on ethics should be an integral part of business decision making.

Call-Image Technology (CIT) Business Application Thread Case

We have included an integrated, continuous business “thread” case, or scenario, throughout the text. This “thread” case profiles the experiences of a hypothetical video-phone business, Call-Image Technology (CIT), owned and operated by a “local” family known to the students. Each chapter begins with an Agenda that highlights the major legal issues relevant to CIT. Within each chapter there are three CIT Application Boxes that address particular legal issues and call for students to offer guidance to the firm.

Each application box is categorized by the relevant functional area of business—management, manufacturing, finance and accounting, sales, marketing, and international business. 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 page 2 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.

You Be the Judge Boxes

"You Be the Judge" boxes, included in every chapter, highlight newsworthy scenarios involving legal or ethical problems. They illustrate the real-world legal problems of businesses. 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, the 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 10 discussion questions, five legal case problems, one business applications case, one ethics applications case, and one critical thinking case. The legal case problems ask students to test their understanding of principles and terms covered in the chapter, and the business applications, ethics applications, and critical thinking problems ask students to apply these concepts to business situations. All 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.

SUPPLEMENTAL RESOURCES

The seventh edition of *Business Law* now has a site on the World Wide Web devoted to teaching and learning resources for the text (<http://davidson.westbuslaw.com>). Come visit to see for yourself.

The following supplemental resources are available with the seventh edition:

- *Study Guide to Accompany Business Law: Principles and Cases in the Legal Environment* (0-324-04294-9).
- *Telecourse Study Guide* (0-324-04297-3)
- *Instructor's Manual* (0-324-04298-1)
- *Test Bank* (0-324-06169-2)
- ExamView testing software (0-324-06170-6)
- Microsoft PowerPoint Lecture Review Slides (download at <http://davidson.westbuslaw.com/>)
- Telecourse Videos—30 half-hour telecourse videos, developed by INTELECOM in conjunction with the third edition of *Business Law*, provide coverage for key topics in business law. Contact your local Thomson Learning/West Legal Studies Sales Representative for more details.

- *The New York Times Guide to Legal Studies in Business* (ISBN 0-324-04160-8), by Marianne Jennings and Jamie Murphy. More than just a printed collection of articles, this guide gives you access, via password, to an online collection of the most current and relevant *New York Times* articles that are continually posted as news breaks. Also included are articles from *CyberTimes*, the online technology section of the *New York Times* on the Web. Correlation guides for all West/South-Western legal studies in business texts are available on the South-Western/*New York Times* Web site at <http://nytimes.swcollege.com>.
- InfoTrac College Edition. This online library contains hundreds of scholarly and popular periodicals, including *American Business Law Journal*, *Journal of International Business Studies*, *Environmental Law*, and *Ethics*. A package can be created that provides students access to InfoTrac College Edition when they purchase this textbook. Contact your local Thomson Learning/West Legal Studies Sales Representative to learn more.
- Videos. Qualified adopters using this text have access to the entire library of West videos, a vast selection covering most business law issues. There are some restrictions, and if you have questions, please contact your local Thomson Learning/West Legal Studies Sales Representative or visit http://www.westbuslaw.com/video_library.html.

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 ends 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 Agenda, CIT business application thread case, and the You Be The Judge cases uniquely contributes to a showing of 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 workforce) pose for them. These include issues ranging from employee privacy to labor law, from employee use of CIT computers to sexual harassment. By following the case, students are immersed in these problems and are asked to offer advice as questions arise. 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. *Business Law* supports the current trend toward integrating business disciplines.

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 warranted our 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, Bob Sandman. Bob 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 Bob in helping us put together this book.

Chris Schabow and the staff at The Left Coast Group have done an excellent job. They have been cooperative and supportive throughout the process, and their attention to detail helped to create a professional and integrated text.

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 seven 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 and the short deadlines and provide support and suggestions to help us get through the process every time we revise the text. Without their support and encouragement, 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 commentaries on our work helped us maintain our focus and write a text that preserves content but is user-friendly, readable, and enjoyable:

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Mesa Community College

A B O U T T H E A U T H O R S

Daniel V. Davidson

Daniel V. Davidson received both his B.S. in Business Administration and his J.D. from Indiana University School of Law, Bloomington. He is an inactive member of the Connecticut Bar Association. He has taught at Central Connecticut State College in New Britain; St. Cloud State University in Minnesota; the University of Arkansas, Fayetteville; and California State University, Fresno. He recently finished serving as the Associate Dean of the College of Business and Economics at Radford University in Virginia and is Professor of Business Law.

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.

Professor Davidson is a member of Alpha Kappa Psi, Beta Gamma Sigma, Sigma Iota Epsilon, and Beta Alpha Psi. He is also a member of the Academy of Legal Studies in Business and its Southern Regional. He has held all of the offices in the Southern Regional, including President, and is currently serving as the Senior Advisory Editor for the *Southern Law Journal* and the *Proceedings* of the region's annual meeting.

Brenda E. Knowles

Brenda E. Knowles received a B.A. *magna cum laude* from the University of Evansville, an M.A. from Miami University, and a J.D. from the Indiana University School of Law, Bloomington. She is Professor of Business Law and Director of the Honors Program at Indiana University South Bend, where she has been the recipient of the Amoco Foundation Excellence in Teaching Award, a systemwide, all-university teaching award. She has received other systemwide and divisional citations for excellent teaching. She also has been active in FACET, the faculty colloquium on excellence in teaching, which is a systemwide, all-university effort to encourage effective teaching and learning in the academic community. In 1995, Professor Knowles was named Director of the Honors Program (a position theretofore always held by liberal arts faculty members). In 1997, the Student Association at Indiana University South Bend chose her as the campus's "Outstanding Educator."

Professor Knowles specializes in research on employment discrimination, pedagogy, and intellectual property law. She publishes her work in professional journals and has won an award for her research. In addition, she has been recognized both nationally and locally for her professional and civic accomplishments, most recently through the W. George Pinnell Award for outstanding service to Indiana University.

Professor Knowles is an active member of the Academy of Legal Studies in Business and of several regionals. More specifically, having held every office, she is a past president of both the ALSB and the Tri-State Regional. Professor Knowles presently serves as the Chairperson of the ALSB's Research and Teaching Mentorship Programs, and, in 1994, she won the ALSB's Master Teacher Award. In 1998, she received the ALSB's Senior Faculty Excellence Award. Moreover, she is a member of Beta Gamma Sigma. She is licensed to practice law in Indiana and is a member of the American, Indiana State, and St. Joseph County Bar Associations.

Lynn M. Forsythe

Lynn M. Forsythe received her B.A. from the Pennsylvania State University and her J.D. from the University of Pittsburgh School of Law. She has passed the bar examination in the states of California and Pennsylvania. She is Professor of Business Law at the Craig School of Business at California State University, Fresno. Professor Forsythe has also held administrative positions, including Director of Graduate Business Programs, Interim Department Chair, and Co-Chair of the AACSB Reaccreditation Committee. She currently is the Assessment Coordinator for the Legal Environment option.

Professor Forsythe is the author of numerous articles on business law and business law pedagogy. She has held the positions of Editor-in-chief, Staff Editor, and Reviewer for *The Journal of Legal Studies Education*, and is currently the Advisory Editor for this journal. She received the 1992 School of Business Faculty Award for Educational Innovation and previously was awarded a university Meritorious Performance Award. She has been an estate and gift tax attorney for the Internal Revenue Service and has taught business law, administrative law, government regulation of business, real estate law, business ethics, estate planning, and business and society.

Professor Forsythe is a member of Beta Gamma Sigma and Alpha Kappa Psi. She has been active in the American Bar Association, for which she chaired subcommittees and panels, including an American Law Institute–American Bar Association advanced program. She is active in the Academy of Legal Studies in Business, for which she served as academic program coordinator for the 1983 meeting, liaison to the National Conference of Commissioners on Uniform State Laws, a member of the Executive Committee, co-chairperson, and chairperson of its Business Ethics Section. She has held all the offices, including President, in the Western Regional Academy of Legal Studies in Business.

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