

# THE LEGAL ENVIRONMENT OF BUSINESS

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EIGHTH EDITION

ROBERT N. CORLEY   O. LEE REED   PETER J. SHEDD



*Eighth Edition*

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This book was set in Baskerville by the College Composition Unit  
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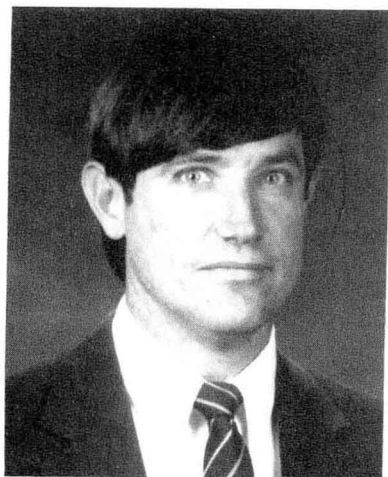
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# ABOUT THE AUTHORS



**Robert N. Corley** is a Distinguished Professor of Legal Studies Emeritus of the University of Georgia. He received his J.D. and B.S. degrees from the University of Illinois, where he taught for eighteen years. He was admitted to the Illinois Bar in 1956. Professor Corley is past president of the American Business Law Association and a past member of the editorial board of the *American Business Law Journal*. In 1985 he was awarded the Senior Faculty Award of Excellence by the American Business Law Association. Winner of numerous teaching awards at both the undergraduate and graduate levels, he has also taught in several national executive development programs. Since 1964 he has been senior author of *The Legal Environment of Business*. His contributions have shaped the content of the entire legal environment of business field.



**O. Lee Reed** holds a J.D. degree from the University of Chicago and a B.A. degree from Birmingham-Southern College. Presently, he is Professor of Legal Studies at the University of Georgia. The author of many scholarly articles, he is former editor-in-chief of the *American Business Law Journal*. He also has served as president of the Southeastern Regional Business Law Association. Professor Reed has received teacher-of-the-year awards from both undergraduate and graduate student organizations. He has been co-author of *The Legal Environment of Business* since 1977.



Peter J. Shedd is a Professor of Legal Studies at the University of Georgia where he received J.D. and B.B.A. degrees. Professor Shedd has extensive experience as a teacher, researcher, and author of business-related texts. He also has been an active member in the American Business Law Association and the Southeastern Regional Business Law Association. Professor Shedd has served as a staff editor of the *American Business Law Journal*. In 1980, he was recognized as the first recipient of the ABLA Faculty Award of Excellence for younger teachers in the business law and legal studies discipline.

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# PREFACE

Over a quarter of a century ago, Professor Robert L. Black of the University of Illinois and I believed that the traditional business law course would not adequately educate business students about the law. It seemed to us that issues relating to government regulation of business were more relevant than were many issues of private law such as the holder-in-due-course concept. This was because new legal theories had brought expanded rights to employees, consumers, investors, and others. These new rights imposed corollary duties on business which were often enforced by government regulatory agencies at all levels.

Although no university offered such a course, we prepared a text to emphasize public law areas rather than private ones and legal relationship rather than legal transactions. We called our text *The Legal Environment of Business* and suggested it as the title of a new course. With pride we note that many, if not most, accredited schools of business now offer such a course. With mixed emotions we note that many competing texts have been written using the same title, content, and basic approach. It is clearly the growth area of the business law discipline.

As we enter the last decade of the twentieth century, most business educators believe that courses about the role of law in business decisions are of paramount importance. These courses must cover both public law and private law subjects. Public law issues such as those relating to white-collar crime, insider trading, affirmative action, and billion-dollar mergers are leading news stories. The private law of contracts and agency is of concern to all businesses because of issues such as the right of an employer to terminate an employee whose contract is terminable at the will of the employer at any time without liability. The law of torts, especially product liability, is the subject of a highly emotional debate. Thus it is important that today's courses cover these relevant areas of the law and that they create an awareness of contemporary legal issues.

The trend toward coverage of both public law and private law issues is part of an evolutionary process in our discipline. The seven previous editions of this text were part of this process. The coverage has been expanded in some areas and reduced in others. What has evolved is the table of contents for this eighth edition which we believe includes discussion of those issues which will be most relevant to business school graduates in the years ahead.

## GUIDING PRINCIPLES

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In preparing this eighth edition, four basic principles have guided us: (1) The materials should actively prepare students for decision making in business rather than merely summarize for them the course content of various law school subjects; (2) Law is information that serves as a tool for generating policy and for making business decisions; (3) The law is only one influence on business decisions. Ethical considerations also play a major role in defining appropriate business conduct; and (4) Substantive rules of law are important and should be a part of the learning process.

## CASE TREATMENT

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The materials in this book include text discussions, summaries of important legislation, articles, and decided cases. We have deleted most of the procedural issues from the cases and have omitted case references and footnotes. Since we believe that students should be required to study judicial language and reasoning on substantive issues, we include those portions of each case that show the arguments of the parties and the court's resolution of the issues raised. We have shortened long cases without deleting the heart of the opinions.

## FEATURES

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This edition of *The Legal Environment of Business* contains many noteworthy features. Among the more important are:

- 1** *Clear, straightforward writing style.* We believe that the study of law is difficult enough without burdening students additionally by a complex writing style. The publisher has also aided readability by using color, large type, wide margins, and many headings throughout the text.
- 2** *Cases.* Each chapter contains several cases illustrating the text. Special pains have been taken throughout the book to include recent cases of interest to the business community. There are 62 cases new to this edition; each chapter contains one or more new cases. Thirty-five cases were decided in 1987 and 1988.
- 3** *Text in seven parts.* The seven parts each consist of three or four chapters. The instructor can therefore select the subjects to be covered and the order



of coverage. The last three parts deal with the law in its role of protecting employees, the general public, and society from harmful business activities.

**4 *New chapters.*** There are two new chapters. Chapter 5 is devoted to arbitration as a substitute for litigation. Arbitration is of growing significance to all business transactions, especially in international affairs. The second new chapter is a result of dividing Chapter 15 of the Seventh Edition (Consumer Protection) into two chapters—one dealing with consumer protection, the other with debtor protection.

**5 *International business.*** The topic of international business is of growing importance in the business curriculum. We are indebted to Professor Jere Morehead of the University of Georgia for preparing this chapter of the book. He brings to this chapter a background of dealing with these issues at the Justice Department and teaching a course in international business.

**6 *Appropriate private law coverage.*** Although this text primarily deals with public law issues, part three contains appropriate private law coverage as well. For instance, product liability and business-related accidents make it necessary for students to understand the tort system, which is the subject of two chapters. Since contracts form the basis for economic exchanges, and much government regulation affects contracts, one chapter is devoted to principles of contract law. This coverage also introduces contracts to students who will not take additional, specialized courses in private law subjects. Agency and suretyship are also discussed in parts of chapters.

**7 *Treatment of ethical issues.*** Many chapters discuss ethical issues of public and social policy which underlie legal rules. The text contains several references to the Caterpillar Tractor Company Code of Worldwide Business Conduct and Operating Principles, which are used to illustrate the approach of a major corporation to current ethical issues.

**8 *Chapter preview.*** Each chapter begins with a preview of the material covered in the chapter. This feature will help students relate their reading to key chapter concepts.

## STUDENT AIDS

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The text continues to include a glossary that defines legal terms used throughout the text so that students will not need access to a legal dictionary. The appendixes include the United States Constitution and excerpts from the antitrust laws and labor laws. We believe that students often benefit from reading the exact language of the Constitution and some of the major statutes that furnish the basic legal principles for substantial portions of the text.

Following this preface, there is a special section addressed to students. In this section we provide step-by-step instructions on how to study this textbook. We include as a part of the instructions a written example of the case briefing system so that students will know how to brief a case if the instructor asks them to do so.

## SUPPLEMENTARY MATERIALS

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To supplement the textbook coverage, a comprehensive instructor's manual and test bank are available to adopters. The instructor's manual was prepared by the textbook authors. The test bank was prepared by Daphyne Saunders Thomas, James Madison University.

For students there is a study guide prepared by Professor O. Lee Reed. As one of the coauthors of the text, his special insight has enabled him to prepare a study guide that complements the text. As a learning tool, it should help students understand the more difficult subjects of the text. If the study guide is not available to students, it may be ordered for them by their bookstores on a rush basis directly from the publisher.

## NEW COAUTHOR

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I am pleased that Professor Peter J. Shedd of the University of Georgia is willing to join the Legal Environment team. He brings to the project a record of significant accomplishments in teaching, research, service, and university administration. As the first recipient of the American Business Law Association Award of Excellence for Junior Faculty, he established his national leadership in our discipline early in his career. He brings new ideas, enthusiasm, and superior writing and research skills to our text. For this edition he devoted his efforts to the chapters on business organization and securities regulation. I look forward to work with him in the years ahead and greatly appreciate his willingness to assume these added duties.

## ACKNOWLEDGMENTS

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The authors are grateful to the Caterpillar Tractor Company of Peoria, Illinois, for permission to quote extensively through the text from its Code of Worldwide Business Conduct and Operating Principles.

The authors also acknowledge the assistance of the following professors who reviewed the manuscript and provided many helpful suggestions: Edward Kaminsky, University of Central Florida; Lee J. Ness, University of North Dakota; Daphyne Saunders Thomas, James Madison University; and Burke T. Ward, Villanova University.

Finally, we wish a special note of gratitude to Annette Bodzin who once again has been everything that any author could ask for in a production editor.

**Robert N. Corley**

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# TO THE STUDENT

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## How to Study *The Legal Environment of Business*

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To gain the most from this textbook, you should learn how to study written material effectively. You can achieve effective study through use of the SQ3R method, a method widely taught by study-skills psychologists for learning textual material.

SQ3R stands for **survey**, **question**, **read**, **recite**, and **review**. As a study method, it has dramatically improved the grade-point averages of most students who have practiced it. It is based upon the concept that active study of written material improves memory and comprehension of information far better than passive reading. Unfortunately, many students have not recognized the difference between active study and mere passive reading.

Students often read a textbook chapter exactly as they would read a novel or a magazine article. They begin with the first sentence of the chapter and read straight through the material, pausing only to underline occasionally. This way of reading may be suitable for a novel, but it is quite inappropriate for a textbook. Psychologists insist that an active study method must begin with a **survey** of the material to be read. If you plan to spend two hours studying a thirty-page chapter, take three to five minutes in the beginning and survey the chapter. First, read the boldtype section headings; (each chapter of this book is divided into numbered sections). Second, read a sentence or two from the text of each section. The purpose of this survey is to familiarize you with the topics covered in the chapter. Fight the tendency to stop your surveying process in order to comprehend all of the concepts you are surveying. Comprehension is not the goal of surveying.

Following the survey of all the sections, go back to the beginning of the chapter. Ask yourself a **question** before reading each section. Ask it aloud, if possible, but silently if circumstances demand. The important thing is actually to "talk to yourself." Normally, each section heading can easily be turned into a question. If the section heading reads **Stare Decisis**, ask yourself the question, "What does stare decisis mean?"

Only after asking a question are you finally ready to **read** a chapter section. In reading keep your question in mind. By so doing you will be reading for a purpose: to discover the answer to your question.

Upon finishing each section, stop and **recite** the answer to your question.



As an example, at the end of the section on *stare decisis* say to yourself, “*Stare decisis* refers to the legal tradition that a judge in a given case will follow the precedent established in similar cases decided by courts in that jurisdiction.” According to psychologists, to recite this way greatly aids memory. Recitation also lets you know whether or not you have understood the material just read.

The last step of the SQ3R method is **review**. When devoting two hours to the study of a chapter, take the final fifteen minutes of that time to review the material. Review the questions taken from the headings of each chapter section and recite the answers to them, rereading material if necessary to answer accurately.

While the SQ3R method may be used effectively to study any subject, the **case briefing system** is uniquely designed to aid in the study of court decisions. In studying law, students frequently write up case briefs of each decision they read. Whether you are required to write up every decision is up to your individual instructor. However, the case briefing system provides an excellent framework for comprehending complicated judicial reasoning processes, and you should brief cases whether required to do so or not.

To avoid getting lost in a maze of judicial terminology, you should ask yourself a standard set of questions about each case decision and read to discover the answers to these questions. These standard questions lie at the heart of the case briefing system. They are:

- 1 Who is the plaintiff and who is the defendant?
- 2 What are the facts of the case? (Who did what to whom? What is the behavior complained of?)
- 3 Did the plaintiff or the defendant win in the lower court(s), and which party is appealing? (All decisions in this textbook come from appellate courts.)
- 4 What was the legal issue or issues appealed?
- 5 Does the plaintiff or the defendant win on the appeal?
- 6 What rules of law and reasoning does the appellate court use in deciding the issue?

Here is an illustration of a written case brief. It is a brief of the first case in the book, which is found on page 52. Before looking at the brief you should now read that case. To understand the case you need to know that a “summary judgment” occurs when a court determines that no genuine factual dispute exists and that either the plaintiff or the defendant is entitled to judgment as a matter of law. No evidence is presented before a jury. The court (judge) rules in favor of the plaintiff or the defendant on the basis of what the law is rather than on which facts (who did what to whom, etc.) are believed.

**Case Brief**

WOODRUFF v. GEORGIA STATE UNIVERSITY, 394 S.E.2d 697 (Ga. 1983) [The notation following the name of the case indicates that the case may be found in volume 394 of the *Southeastern Reporter*, second series, starting at page 697. The Supreme Court of Georgia decided the case in 1983.]

**Plaintiff and Defendant**

The plaintiff (who brings the lawsuit against the defendants by filing a complaint) is Woodruff, a student. The defendants are the Georgia Board of Regents, Georgia State University, and certain Georgia State professors.

**Facts**

Woodruff was pursuing a master's degree program in the music department. She received an "F" on the basis of plagiarism, appealed that grade to a university appeals committee, and got the grade changed to "incomplete." Thereafter, she claims, her music department professors were "hostile and sarcastic" to her. When she finally received her master's degree and sought to enter the doctoral program at another university, none of her Georgia State music professors would give her the recommendations required by the other university. She sued the defendants in state court, alleging constitutional violations, tort, and breach of contract claims.

**Lower Court**

The trial court granted summary judgment in favor of the defendants. The plaintiff appealed. The case is now before the Supreme Court of Georgia.

**Issue Appealed**

Is a dispute concerning academic decisions of a public university a justiciable controversy, i.e., will a court decide the merits of such a dispute?

**Who Wins**

The defendants.

**Reasoning**

Judges are "ill-equipped" to make policy decisions that belong properly to other public officials. In particular, judges should not review a teacher's academic assessment of a student's work. This protects teachers and the school system from the "unbearable burden of continuous legal turmoil." It also shields the courts from "an incalculable new potential for lawsuits...."

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As with the SQ3R method, the case briefing system assists you best when you pause after reading each case to recite answers to the questions raised by the system. These questions should either be memorized or written down for easy reference while reading case material.

Regular use of the SQ3R method and the case briefing system will substantially raise the grades of most students. The secret to your own success, however, is for you to continue to practice these methods despite an initial awkwardness in their use. The temptation to slide back into a passive reading of the material must be overcome.

**Robert N. Corley**  
**O. Lee Reed**  
**Peter J. Shedd**

# THE LEGAL ENVIRONMENT OF BUSINESS



# *Part One*

# INTRODUCTION

*1*

The Law and Lawyers

*2*

The Powers and Functions of Courts

*3*

Court Systems

*4*

Litigation

*5*

Arbitration