PRINCIPLES OF BUSINESS LAW

FOURTEENTH EDITION

Robert N. Corley
Peter J. Shedd

14TH EDITION

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PREFACE

We are pleased to present this fourteenth edition of *Principles of Business Law*. As has been our tradition, it contains up-to-date coverage of business law topics while continuing to recognize that business students have needs quite different from those of law students. Whereas law students typically are expected to "search for the law," this text presents the legal principles essential to the businessperson in a straightforward manner.

Each chapter contains several component parts and is illustrated with cases. There are usually five cases dispersed throughout a chapter to illustrate important points and the reasoning of courts in applying the legal principles. Chapter summaries allow students to review the essential points of each chapter. At the end of each chapter are review questions that highlight key points of the chapter. By the time students have studied chapter text including cases, summary, and review questions, they should be comfortable with the basic principles presented in that chapter.

One suggestion often made by reviewers of this and previous editions is to include forms within the text or in an appendix. After careful consideration, we have decided not to follow this suggestion. It continues to be our philosophy that standardized forms may be perceived as appropriate and usable in situations when such forms need to be tailored specifically for a given transaction. If there is an underlying theme throughout this text, it is that every businessperson needs to have a good working relationship with a competent lawyer. This book is intended to illustrate why such a relationship is necessary in order for the businessperson to succeed in our complex legal-oriented society. The inclusion of forms may encourage the layperson to believe that complex transactions can be completed without a lawyer. Forms such as checks and notes used in simple transactions are readily available, and we encourage professors to make available to students forms for routine transactions used within a particular jurisdiction.

This fourteenth edition consists of fifty-one chapters divided into ten parts. The parts are designed as independent units, so that the material may be covered in any order. Indeed, even the chapters may be shifted from one part to another if the instructor so desires.

Part I serves as an introduction to various sources of the law and to the court

system. Chapter 4 discusses the litigation process in detail. Chapter 5 places special emphasis on the various tort theories used to impose liability, especially on the business community. Chapter 6 is a separate chapter on criminal law because of the increasing importance of white-collar crime and the problems business managers face as a result of the high crime rate. These first six chapters provide an important foundation for the student of business law.

Part II, "Contracts," is designed to give students an understanding of the basic and traditional concepts of contract including the role of the Uniform Commercial Code. Chapter 7 is an introduction to this subject matter. Since the UCC and traditional contract law intersect at the offer and acceptance stage, they are treated as a unified body of law in Chapter 8 to avoid duplication. The Uniform Commercial Code is attached to the text as an appendix, and appropriate sections are referred to in brackets within the text for easy reference. The next three chapters (9 to 11) discuss the other essential requirements for every valid contract. Chapter 12 involves issues of form and interpretation of contracts. Chapters 13 and 14 include a discussion of contract performance, excuses, and discharge. Finally, issues created when third parties become involved in contracts are discussed in Chapter 15.

Part III covers sales transactions. Without repeating the points emphasized under the law of contracts, it covers the specialized principles related to transactions in movable personal property. Chapters 16 and 17 serve as an overview of the important sections of Article 2 of the UCC that are not discussed in Part II with the contracts material. Chapters 18 and 19 cover the subjects of warranties and product liability theories.

Part IV, "Commercial Paper," covers Articles 3 and 4 of the UCC. Special emphasis continues to be placed on the liability of parties, including banks, in commercial paper transactions.

Part V, "Creditors and Debtors," begins with a coverage of Article 9 of the UCC and secured transactions. Chapters 24 and 25 cover the creation of a security interest, the perfection of a security interest, the priority issues that arise, and the parties' rights and duties on the debtor's default. Since the 1972 revision of Article 9 has been adopted by most of the states, it receives special attention, with decreased emphasis on the original 1962 version.

Chapter 26 is a logical extension of the preceding discussion on the use of personal property as security. It covers the use of real estate as security for debts. Chapter 27 on other laws assisting creditors emphasizes the complex area of suretyship. Chapter 28 gathers in one place much of the recent litigation aimed at protecting debtors and consumers. The material on debtor protection is written from the creditor's perspective as a typical loan transaction develops. Chapter 29 on bankruptcy includes an examination of the impact of recent amendments to the Bankruptcy Act.

Part VI, "Property," begins with a study of the general principles of the law of property. Chapter 31 discusses the various methods of acquiring title to both real and personal property. Chapter 32 discusses the lease of real estate and the bailment of personal property. Chapter 33 focuses on the use of wills and trusts in estate planning.

Part VII, "Agency," covers the subject in four chapters. Chapter 34 deals with the creation and general principles of the agency relationship. The next two chapters deal with agency and the law of contracts and the law of torts. Chapter 37 covers the

termination of the agency relationship. This chapter includes discussions of the declining importance of the "at-will" doctrine.

Part VIII discusses business organizations in three stages. In addition to the factors used in selecting the form of organization, these stages are (1) the method of creation of the various forms of organization, (2) the legal aspects of operating the various forms of organization, and (3) the law as it relates to dissolution of business organizations.

Part IX, "Government Regulation of Business," consists of five chapters that may be omitted if the students have had an introductory course in the legal environment of business that covers these subjects. Chapter 50 on securities regulation can easily be studied with Chapters 42 and 43 concerning corporations' formation and operation. This section includes a new chapter written by Patricia Rogers, San Francisco State University, on the conduct of international business. The growing importance of international transactions in education for business has prompted this new chapter. We are very grateful to Paul for bringing his highly recognized expertise to our text so that its users will have an excellent background in this area of growing importance.

Finally, Part X contains one chapter, "Accountant's Liability." This new chapter is designed to assist accounting majors in preparing for the CPA exam as well as to illustrate the growing trend in malpractice litigation.

One of the major innovations in this text is the inclusion of materials on ethics. To illustrate the close connection between law and ethics, three of the chapters include materials from the Boeing Company's "Business Conduct Guidelines." These guidelines are from a major company conducting worldwide business in a basic industry employing thousands of people. Its role in the military-industrial complex makes its ethics policies especially significant. We believe that students will benefit directly from this direct exposure to the real world.

Professor Barbara George of California State University has written a student study guide to accompany the text. We know that many students will benefit from its use, and we want to express our appreciation to her for its preparation. Professor Ida Jones of California State University at Fresno prepared the instructor's manual, and Professor Michael Harmon, Indiana State University prepared the case briefs. We thank them for their hard work and valuable expertise.

We should also like to acknowledge the assistance of the following professors who reviewed the manuscript and provided many helpful suggestions: Robert V. Nally, College of Commerce and Finance, Villanova, Pennsylvania; John S. Simmons, Nicholls State University, Thibodaux, Louisiana; William L. Yaeger, Duke University, Durham, North Carolina; Elaine D. Ingulli, Temple University, Philadelphia; and Marrell J. McNeal, Auburn University, Auburn, Alabama.

Two individuals made contributions to this edition that were invaluable. Scott Bar, our editor at Prentice Hall, provided constant support and encouragement during the preparation and production of the manuscript. Bob Walters supervised the production of this text and his prompt return of innumerable phone calls kept this project on schedule. We thank them both for a job well done.

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CONTENTS

PART IX GOVERNMENT REGULATION OF BUSINESS

PART X PROFESSIONAL RESPONSIBILITY

1 LAW

1. Definitions of Law
2. Classification of Legal Subjects
3. Sources of Law
4. Basic Constitutional Principles
5. Legislation
6. Interpretation of Legislation
7. Uniform State Laws

CASE LAW

8. Stare Decisis
9. Problems Inherent in Case Law
10. Rejection of Precedent
11. Conflict of Laws

THE SUBJECT MATTER of this text is business law. Legal concepts, principles, and rules provide the foundation for the conduct of business. The law guarantees individual rights including the right to property, which in a broad sense is involved in all business transactions. The law determines who may conduct business, how it is to be conducted, and what sanctions are to be imposed if its requirements are not met. Thus it is apparent that knowledge of the law as it relates to business is an indispensable ingredient in any successful business venture.

This text is divided into ten parts. Some parts, such as the one on contracts, cover subjects that deal directly with the conduct of business. Others, such as the one on government regulation of business, discuss the environment in which business is conducted.

Part I provides a background, an understanding of our legal system. We find out where our laws come from, how they are applied, and how they are changed. Our emphasis is on the various methods of resolving conflicts and controversies. Litigation and arbitration as a substitute for litigation are the major areas of study. There is also a discussion of the role of ethics as an influence on individual and business conduct. Finally, there is detailed coverage of the law of torts (private wrongs) and criminal law (public wrongs) as they pertain to business.

Now, more than ever in our nation's history, law impacts on business decisions. Laws written to solve many of society's problems are directed at business, regulating its activity and its processes. This text will attempt to create an awareness of the role of law in business.

1. Definitions of Law

Our view of the law will be a broad one, and our first question will be: What is law? In everyday conversation, people use the word *law* in many different ways, but it is a word that is very difficult to define. In its broad context, it expresses a variety of concepts. Law has been defined as rules and regulations established by government and applied to people in order for civilization to exist. Law and legal theory, however, are far too complex for such a simple definition.

In attempting to define *law*, it is helpful to look at its purposes or functions. A basic purpose of law in a civilized society is to maintain order. This is the prime function of that body of law known as the *criminal law*. Another role of law is to resolve disputes that arise between individuals and to impose responsibility if one person has a valid, legal claim against another, as in a suit for breach of contract. It is important that we bear in mind that the law is not simply a statement of rules of conduct but also the means whereby remedies are afforded when one person has wronged another.

In one sense, almost every issue or dispute in our society—political, social, religious, economic—ultimately becomes a legal issue to be resolved by the courts. Thus it can be said that law is simply what the courts determine it to be as an expression of the public's will in resolving these issues and disputes.

In still another sense, *law* has been defined as the rules and principles applied by the courts to decide controversies. These rules and principles fall into three categories:

1. Laws, including the federal Constitution and state constitutions, that have been passed by legislative bodies
2. Common law, or case law, derived from cases decided by the courts
3. Procedural rules, which determine how lawsuits are handled in the courts and include matters such as the rules of evidence and related issues

The first two elements provide the rules of substantive law that the courts apply to decide controversies. The third provides the machinery whereby these rules of substantive law are given effect and applied to resolve controversies.

Many legal scholars have defined *law* in relation to the sovereign. For example, Blackstone, the great legal scholar of the eighteenth century, defined law as "that rule of action which is prescribed by some superior and which the inferior is bound to obey." This concept of law as a command from a superior to an inferior is operative in many areas. For example, the tax laws command that taxes shall be paid to the sovereign.

Another view of law is that it is a method of social control—an instrument of social, political, and economic change. Law is both an instrument of change and a result of changes that take place in our society. The law brings about changes in our society; society brings about changes in the law. The law—responding to the goals, desires, needs, and aspirations of society—is in a constant state of change. Sometimes the law changes more rapidly than the attitudes of the majority. In this event, the law and our legal system provide leadership in bringing about changes. At other times society is ahead of the law in moving in new directions, and changes in the law are brought about by the people. In the field of ecology, for example, various groups have put pressure on legislators to clean up the air and water. As a result, laws have been enacted, requiring devices to be installed to control pollution. Here public pressure resulted in the enactment of laws, and the law was a follower rather than a leader. It is important to note that the law is not static—that it is constantly changing and that the impetus for the changes may come from many different sources.

While we are on the subject of definitions, we should point out that the pronoun *he* can mean "he or she," and we intend that inclusive meaning in almost every instance. In order to save the reader from tiresome repetition of the phrase "he or she," we use *he* throughout.

2. Classification of Legal Subjects

Legal subjects may be classified in a variety of ways. Laws and legal principles are sometimes classified as substantive or procedural. The law that is used to decide disputes is *substantive* law. The legal procedures that determine how a lawsuit is begun, how the trial is conducted, how appeals are taken, and how a judgment is enforced are called *procedural* law. Substantive law is the part of the law that defines rights; procedural law establishes the procedures by which rights are enforced and protected. For example, A and B have entered into an agreement, and A claims that B has breached the agreement. The rules that provide for bringing B into court and for the conduct of the trial are rather mechanical, and they constitute procedural law. Whether the agreement was enforceable and whether A is entitled to damages are matters of substance and would be determined on the basis of the substantive law of contracts.

Law is also frequently classified into areas of public and private law. *Public* law includes those bodies of law that affect the public generally. Public law may be further divided into three general categories:

1. *Constitutional law* concerns itself with the rights, powers, and duties of federal and state governments under the U.S. Constitution and the constitutions of the various states.
2. *Administrative law* is concerned with the multitude of administrative agencies, such as the Federal Trade Commission and the National Labor Relations Board.
3. *Criminal law* consists of statutes that forbid certain conduct as being detrimental to the welfare of the state or the people generally and provides punishment for their violation.

Private law is that body of law that pertains to the relationships between individuals in an organized society. Private law encompasses the subjects of contracts, torts, and property. Each of these subjects includes several bodies of law. The law of contracts, for example, may be subdivided into the subjects of sales, commercial paper, agency, and business organizations. The major portion of this text covers these subjects, which constitute the body of law usually referred to as *business* law.

The law of torts is the primary source of litigation in this country and is also a part of the total body of law in areas such as agency and sales. A *tort* is a wrong committed by one person against another or against his property. The law of torts is predicated on the premise that in a civilized society, people who injure other persons of their property should compensate them for their loss. Chapter 5 discusses the law of torts.

The law of property may be thought of as a branch of the law of contracts, but in many ways our concept of private property contains much more than the contract characteristics. Property is the basic ingredient in our economic system, and the subject matter may

be subdivided into several areas, such as wills, trusts, estates in land, personal property, bailments, and many more. Part VI of this text is devoted to a study of property.

Any attempt at classification of subject matter, particularly in the area of private law, is difficult because the law is indeed a "seamless web." For example, assume that an agent or a servant acting on behalf of his employer commits a tort. The law of agency, although a subdivision of the law of contracts, must of necessity contain a body of law to resolve the issues of tort liability of employer and employee. Likewise, assume that a person is injured by a product he has purchased. The law of sales, even though a part of the law of contracts, contains several aspects that could best be labeled a branch of the law of torts. Therefore it is apparent that even the general classifications of contract and tort are not accurate in describing the subject matter of various bodies of law.

3. Sources of Law

Our law comes from four basic sources: (1) constitutions, (2) legislation, (3) judicial decisions, and (4) the rules, regulations, and decisions of administrative agencies. Assuming that administrative agencies are part of the executive branch of government, our law comes from all three branches.

A unique characteristic of American law is that a very substantial part of it is found in cases decided by our courts. This concept of decided cases as a source of law comes to us from England and is generally referred to as the *common law*. Our common-law system, which relies on case precedent as a source of law, must be contrasted with civil-law systems, which developed on the European continent. The civil-law countries have codified their laws—reduced them to statutes—so that the main source of law in those countries is to be found in the statutes rather than in the cases. Under the common-law system, of course, we have a large number of statutes and ordinances, but these are only a part of our law.

In the United States, common law has been the predominant influence. Since most of the colonists were of English origin, they naturally followed the laws and customs of their mother country. But in Louisiana, and to some extent Texas and California, the civil law has influenced the legal systems, because these states were founded by the French and Spanish. However, much of the law in every state of the United States is statutory, and statutes are becoming increasingly important. Case law, or common law, remains an important source of law because of the extreme difficulty in reducing all law to writing in advance of an issue being raised.

As you read further, remember that the judicial system has established a general priority among the various source of law. Constitutions prevail over statutes, and statutes prevail over common-law principles established in court decisions. Courts will not turn to case decisions for law if a statute is directly in point.

4. Basic Constitutional Principles

In our constitutional system, the Constitution of the United States and the constitutions of the various states provide the basis of our legal system and our supreme law. All other laws must be consistent with them, or they are void. Most state constitutions are modeled after the federal Constitution. They divide state government into executive, legislative, and judicial branches, giving each branch checks and balances on the others. Constitutions also define the powers and functions of the various branches.

The Constitution of the United States and the constitutions of the various states are the fundamental written law in this country. A federal law must not violate the U.S. Constitution. All state laws must conform to, or be in harmony with, the federal Constitution as well as with the constitution of the appropriate state.

Two very important principles of constitutional law are basic to our judicial system. They are closely related to each other and are known as the *doctrine of separation of powers* and the *doctrine of judicial review*.

The doctrine of separation of powers results from the fact that both state and federal constitutions provide for a scheme of government consisting of three branches—legislative, executive, and judicial. Sepa-

ration of powers has both a horizontal and a vertical aspect. The vertical aspect is that there is separation between the federal government and the state government. Each has its own functions to perform. The horizontal aspect of separation of powers ascribes to each branch a separate function and a check and balance on the functions of the other branches. The doctrine of separation of powers implies that each separate branch will not perform the function of the other and that each branch has limited powers.

The doctrine of judicial review is the heart of the concept of separation of powers. This doctrine and the doctrine of supremacy of the Constitution were established at an early date in our country's history in the celebrated case of *Marbury* v. *Madison*.[1] In this case, Chief Justice Marshall literally created for the court a power the founding fathers had refused to include in the Constitution. This was the power of the judiciary to review the actions of the other branches of government and to set them aside as null and void if in violation of the Constitution. In creating this power to declare laws unconstitutional, Chief Justice Marshall stated:

> Certainly, all those who have framed written constitutions contemplated them as forming the fundamental and paramount law of the nation, and consequently, the theory of every such government must be that an act of the legislature, repugnant to the constitution, is void. This theory is essentially attached to a written constitution and is, consequently, to be considered by this court as one of the fundamental principles of our society.

Justice Marshall then decided that courts have the power to review the actions of the legislative and executive branches of government to determine if they are constitutional. This doctrine of judicial review has, to some extent, made the courts the overseers of government and of all aspects of our daily lives.

5. Legislation

Much of our law is found in legislation. Legislative bodies exist at all levels of government. Legislation is created by Congress, state assemblies, city councils, and other local government bodies. The term *legislation* in its broad sense also includes treaties entered into by the executive branch of government and ratified by the Senate.

Legislation enacted by Congress or by a state legislature is usually referred to as a *statute*. Laws passed by local governments are frequently called *ordinances*. Compilations of legislation at all levels of government are called *codes*. For example, we have local traffic codes covering all aspects of driving automobiles, and state laws such as the Uniform Commercial Code that cover all aspects of commercial transactions. The statutes of the United States that attempt to regulate general conduct are known as the U.S. Code.

Legislation at all levels contains general rules for human conduct. Legislation is the result of the political process expressing the public will on an issue. Courts also play a significant role in the field of statutory law. In addition to their power of judicial review, courts interpret legislation and apply it to specific facts. Courts interpret legislation by resolving ambiguities and filling the gaps in the statutes. By its very nature, most legislation is general, and interpretion is necessary to find the intent of the legislature when the statute was enacted. This is discussed further in the next section.

Legislative bodies have procedural rules that must be followed if a law is to be valid. Among the typical procedural rules are those relating to the way amendments are added to a proposed law, the way proposed statutes are presented for consideration (reading aloud to the members, etc.), and the manner of voting by the members of the legislative body.

6. Interpretation of Legislation

Theoretically, legislation expresses the will or intent of the legislature on a particular subject. In practice, this theory suffers from certain inherent defects. First of all, it is not possible to express the legislative intent in words that will mean the same thing to everyone. Statutes, by their very nature, are written in general language that is frequently ambiguous.

Second, the search for legislative intent is often

[1] 1 Cranch 137 (1803).

complicated by the realization that the legislative body in fact had no intent on the issue in question, and the law is incomplete. The matter involved is simply one that was not thought about when the law was passed. Therefore, sometimes the question about legislation is not what did the legislature intend, but what would it have intended had it considered the problem. Both of these problems result in an expanded role for courts in our legal system.

One technique of statutory interpretation is to examine the legislative history of an act, to determine the purpose of the legislation or the evil it was designed to correct. Legislative history includes the committee hearings, the debates, and any statement made by the executive in requesting the legislation. Legislative history does not always give a clear understanding of the legislative intent, because the legislature may not have considered many questions of interpretation that confront courts.

Judges use several accepted rules of statutory interpretation in determining legislative intent. Many of these rules are based on the type of law being construed. For example, one rule is that criminal statutes and taxing laws should be strictly or narrowly construed. As a result, doubts as to the applicability of criminal and taxing laws will be resolved in favor of the accused or the taxpayer, as the case may be. Another rule of statutory construction is that remedial statutes (those creating a judicial remedy on behalf of one person at the expense of another) are to be liberally construed, in order that the statute will be effective in correcting the condition to be remedied.

There are also rules of construction that aid in finding the meaning of words used in legislation. Words may be given their plain or usual meaning. Technical words are usually given their technical meaning. Others are interpreted by the context in which they are used. For example, if a general word in a statute follows specific words, the general word takes its meaning from the specific words.

Statutory construction is not always based on the type of statute or the words used. For example, if a statute contains both specific and general provisions, the specific provision controls. A frequently cited rule provides: A thing may be within the letter of the statute and yet not within the statute because it is not within the statute's spirit nor within the intention of the makers. This rule allows a court to have a great deal of flexibility and to give an interpretation contrary to the plain meaning. The power of courts to interpret legislation means that in the final analysis, a statute means what the court says it means.

7. Uniform State Laws

Since each state has its own constitution, statutes, and body of case law, there are substantial differences in the law among the various states. It is important to recognize that ours is a federal system in which each state has a substantial degree of autonomy; thus it can be said that there are really fifty-one legal systems—a system for each state plus the federal legal structure. In many legal situations it does not matter that the legal principles are not uniform throughout the country. This is true when the parties to a dispute are *citizens* of the same state and the transaction or occurrence creating the dispute happened in that state; then the controversy is strictly *intrastate* as opposed to one having *interstate* implications. But when citizens of different states are involved in a transaction (perhaps a buyer in one state contracts with a seller in another), many difficult questions can arise from the lack of uniformity in the law. Assume that a contract is valid in one state but not in the other. Which state's law controls? Although a body of law called conflict of laws (see page 9) has been developed to cover such cases, more uniformity is still desirable.

Two methods of achieving uniformity in business law are possible: (1) having federal legislation govern business law, and (2) having uniform laws concerning at least certain phases of business transactions adopted by the legislatures of all states. The latter method has been attempted by a legislative drafting group known as the National Conference of Commissioners on Uniform State Laws. This group of commissioners appointed by the governors of the states endeavors to promote uniformity in state laws on all subjects for which uniformity is desirable and practical. Their goal is accomplished by drafting model acts. When approved by the National Conference, proposed uni-

form acts are recommended to the state legislatures for adoption.

More than one hundred uniform laws concerning such subjects as partnerships, leases, arbitration, warehouse receipts, bills of lading, and stock transfers have been drafted and presented to the various state legislatures. The response has varied. Very few of the uniform laws have been adopted by all the states. Some states have adopted the uniform law in principle but have changed some of the provisions to meet local needs or to satisfy lobbying groups, so that the result has often been "nonuniform uniform state laws."

The most significant development for business in the field of uniform state legislation has been the Uniform Commercial Code. It was prepared for the stated purpose of collecting in one body the law that "deals with all the phases which may ordinarily arise in the handling of a commercial transaction from start to finish. . . ." The detailed aspects of the Code, as it is often called, make up a significant portion of this text, and sections of the Code are referred to in brackets throughout this text where appropriate. Its provisions are set forth in Appendix A.

The field of commercial law is not the only area of new uniform statutes. Many states are adopting modern procedures and concepts in criminal codes and other uniform laws dealing with social problems. In addition, the past few years have seen dynamic changes in both state and federal statutes setting forth civil procedures and revising court systems. The future will undoubtedly bring many further developments to improve the administration of justice. The trend, despite some objection, is to cover more areas of the law with statutes and to rely less on precedent in judicial decisions, or common law, as a source of law. Many of these new statutes tend to be uniform throughout the country.

CASE LAW

8. Stare Decisis

Notwithstanding the trend toward reducing law to statutory form, a substantial portion of our law has its source in decided cases. This case law, or common law, is based on the concept of precedent and the doctrine of *stare decisis*, which means "to stand by decisions and not to disturb what is settled." *Stare decisis* tells us that once a case has established a precedent, it should be followed in subsequent cases involving the same issues. Judicial decisions create precedent by interpreting legislation and by deciding issues not covered by legislation.

When a court decides a case, particularly upon an appeal from a lower-court decision, the court writes an opinion setting forth, among other things, the reasons for its decision. From these written opinions rules of law can be deduced, and these make up the body of case law or common law.

Stare decisis gives both certainty and predictability to the law. It is also expedient. Through the reliance on precedent established in prior cases, the common law has resolved many legal issues and brought stability into many areas of the law, such as the law of contracts. The doctrine of *stare decisis* provides a system so businesspeople may act in a certain way, confident that their actions will have certain legal effects. People can rely on prior decisions and, knowing the legal significance of their action, can act accordingly. There is reasonable certainty as to the results of conduct.

Courts usually hesitate to renounce precedent. They generally assume that if a principle or rule of law announced in former judicial decision is unfair or contrary to public policy, it will be changed by legislation. It is important to note that an unpopular court ruling can usually be changed or overruled by statute. Precedent has more force on trial courts than on courts of review; the latter have the power to make precedent in the first instance.

The doctrine of *stare decisis* must be contrasted with the concept of *res judicata*, which means "the thing has been decided." *Res judicata* applies when, between the parties themselves, the matter is closed at the conclusion of the lawsuit. The losing party cannot again ask a court to decide the dispute. *Stare decisis* means that a court of competent jurisdiction has decided a controversy and has, in a written opinion, set forth the rule or principle that formed the basis for its decision, so that rule or principle will

be followed by the court in deciding subsequent cases involving the same issues. Likewise, subordinate courts in the same jurisdiction will be bound by the rule of law set forth in the decision. *Stare decisis*, then, affects persons who are not parties to the lawsuit, but *res judicata* applies only to the parties involved.

9. Problems Inherent in Case Law

The common-law system as used in the United States has several inherent difficulties. First of all, the unbelievably large volume of judicial decisions, each possibly creating precedent, places "the law" beyond the actual knowledge of lawyers, let alone laypersons. Large law firms employ lawyers whose major task is to search case reports for "the law" to be used in lawsuits and in advising clients. Today, computers are being used to assist in the search for precedent, because legal research involves examination of cases in hundreds of volumes. Because the total body of ruling case law is so extensive, it is obvious that laypersons who are supposed to know the law and govern their conduct accordingly do not know the law and cannot always follow it, even with the advice of legal counsel.

Another major problem involving case law arises because conflicting precedents are often cited to the court by opposing lawyers. One of the major tasks of the court in such cases is to determine which precedent is applicable to the present case. In addition, even today, many questions of law arise on which there has been no prior decision or in areas where the only authority is by implication. In such situations the judicial process is "legislative" in character and involves the creation of law, not merely its discovery.

It should also be noted that there is a distinction between precedent and mere *dicta*. As authority for future cases, a judicial decision is coextensive only with the facts upon which it is founded and the rules of law upon which the decision is actually based. Frequently, courts make comments on matters not necessary to the decision reached. Such expressions, called dicta, lack the force of an adjudication and, strictly speaking, are not precedent the court will be required to follow within the rule of *stare decisis*. Dicta or implication in prior cases may be followed if sound and just, however, and dicta that have been repeated frequently are often given the force of precedent.

Finally, our system of each state having its own body of case law creates serious legal problems in matters that have legal implications in more than one state. The problem is discussed in more detail in section 11 of this chapter.

10. Rejection of Precedent

The doctrine of *stare decisis* has not been applied in a fashion that renders the law rigid and inflexible. If a court, especially a reviewing court, finds that the prior decision was "palpably wrong," it may overrule and change it. By the same token, if the court finds that a rule of law established by a prior decision is no longer sound because of changing conditions, it may reverse the precedent. The strength and genius of the common law is that no decision is *stare decisis* when it has lost its usefulness or the reasons for it no longer exist. The doctrine does not require courts to multiply their errors by using former mistakes as authority and support for new errors. Thus, just as legislatures change the law by new legislation, courts change the law from time to time by reversing former precedents. Judges, like legislators, are subject to social forces and changing circumstances. As personnel of courts change, each new generation of judges deems it a responsibility to reexamine precedents and adapt them to the present.

The argument is frequently made that changes in the law should be left to the legislative process. If a rule of law does not represent the judgment of society, the people through the political process will cause the appropriate legislative body to change it. The argument that an issue is more appropriate for legislative resolution is often unpersuasive. Such an argument ignores the responsibility of courts to face difficult legal questions and to accept judicial responsibility for a needed change in the common law. Courts often meet changing times and new social demands by expanding outmoded common-law concepts. Many cases produce changes that have a profound effect on social and business relationships. Many judges believe that it is the responsibility of the courts to