SCHAUM'S OUTLINE SERIES

THEORY AND PROBLEMS OF

BUSINESS LAW

DONALD A. WIESNER
NICHOLAS A. GLASKOWSKY

INCLUDING 1124 SOLVED PROBLEMS

SCHAUM'S OUTLINE SERIES IN BUSINESS

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BUSINESS LAW

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To Bev and Liz

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Preface

The purpose of this outline is to offer in a clear and systematic manner the information needed for an understanding and appreciation of business law as it is taught in colleges and universities. This volume presents material that is usually found in a first course in business law. It is intended as an aid to understanding current business law texts by offering statements and examples which clarify and reinforce an understanding of the subject. It is also a review for accounting students who must take the commercial law examination administered by the American Institute of Certified Public Accountants (AICPA).

Each chapter begins with a presentation of main principles and illustrative examples. This is followed by a section called Black Letter Law, which is a set of summary statements of the major principles just studied.

The problems which follow each chapter are of two types: multiple choice and essay questions. These are similar, and in some cases identical, to the problems in the commercial law examination given to certified public accounting candidates. The solutions to the multiple choice statements provide more than the correct answer, however, as they elaborate on what might be a wrong interpretation suggested by the other possible answers. All the solutions to the multiple choice problems and essay questions are the authors'. They are not the product of the American Institute of Certified Public Accountants.

Except for Part I: Introduction, each part of the outline (Contracts, Sales, etc.) ends with a topic test containing essay questions. These sets of questions test the student's ability to identify a specific legal issue without the assistance of a chapter heading. The ability to identify and characterize issues is of critical importance in the development of the decision-making skills required of the business student.

The reader is strongly reminded that decisions of courts are made by applying the law to a set of facts. The court (judge) will state the law in a case being tried. The jury (or the judge in a nonjury trial) will be the trier of fact and thus determine the outcome of the case in favor of the plaintiff or defendant under the law. As to business transactions, the law is ordinarily relatively clear. Through precedent and codification, such as the Uniform Commercial Code, it is usually possible to say generally what the law is. The more difficult problem is determining the facts.

Basically, a lawsuit can produce three different outcomes and two of the three are bad for the plaintiff. This is true because under our legal system *the burden of proof is on the plaintiff*. Briefly stated, the three possible outcomes are:

1. The *plaintiff* proves his or her case and *wins*.
2. The *plaintiff* fails to prove his or her case and *loses*.
3. The *defendant* proves his or her case and the *plaintiff loses*.

Proving the plaintiff's case is occasionally easy, often difficult, and sometimes practically impossible despite the plaintiff's perhaps justified belief in the right-

eousness of his or her cause. Very frequently the trier of fact must sort out sharply conflicting testimony and often it comes down simply to which party's testimony is believed or given greater weight. The plaintiff will win *only* if the court determines from all the evidence put before it that the plaintiff's allegations, statements, and/or contentions *are* the facts. The burden of proof is on the plaintiff, *not* on the defendant.

Throughout this book we state the facts of a situation in case examples and review questions. The reader should understand that these facts are what the trier of fact has found or will find to *be* the facts of the case. Here we must necessarily present the facts of each example or case as *given* so that we can proceed with the purpose of this book: reviewing with you, the reader, the manner in which the law is applied to the facts of business situations.

Finally, it is customary at this point for authors to thank those who have assisted them in typing and editing their manuscript. But since we used our personal computers and word processing software to create, edit, and print out the entire manuscript we have only ourselves to thank. Naturally, however, that means we are truly wholly accountable for any errors or omissions, and for these we must take full responsibility.

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PART I: Introduction

Chapter 1

Law and Business

1.1 OVERVIEW

A course in business law is taught in nearly all colleges and universities in the United States. Such courses are offered for the purpose of informing the professional business student and the layperson of the legal environment within which each must live and operate.

This book includes material which is traditionally taught in a first college course. Naturally, institutions vary as to the topics which they choose to include in a first course, and some topics included in a particular school's first course in business law may not be found in this volume.

1.2 SOURCES OF LAW

Law is both a system of conduct and the method by which this conduct is enforced. In the United States law comes from a number of sources which include constitutions, treaties, statutes, administrative regulations, executive orders, ordinances, and common law.

EXAMPLE 1. Warren was arrested for depositing garbage on the street. A police officer cited him for violating Section 1090 of the City Ordinance. This ordinance is *legislation* (a *statute*) enacted by the city government. State constitutions and state statutes confer on cities the power to enact certain laws.

EXAMPLE 2. Margo promised that when she terminated employment with Sarget, Inc., she would not compete with them for 1 year. After leaving, she immediately began competing with Sarget. Sarget sued her for breach of contract. The rules under which Margo will be judged are generally found in *case law*, that is, previously reported court decisions addressed to the same or similar question. Case law is also called *common law*, *precedent*, or *judge-made* law.

1.3 JURISDICTIONS

There are, in effect, 51 "nations" or jurisdictions in the United States which exercise lawmaking power. These include the 50 sovereign states and the federal government. While the federal government is important and supreme in critical areas of society, day-to-day legal implications are frequently regulated by the states.

EXAMPLE 3. Toby is charged with slandering Spring's Burger Shop by telling others that it is rat-infested. The shop successfully sued Toby for slander (a civil wrong, or tort) in the state civil court. The state appeals court refused to disturb the result. Toby threatens that she "will take this case all the way to the U.S. Supreme Court." Usually the Supreme Court has no interest in, or jurisdiction over, this type of case. The state supreme court would be the final court, as no federal question appears to be involved.

EXAMPLE 4. Lanson brought an action against ILM for damages to his property when ILM was digging up the street. At the trial the court refused to permit Lanson's attorney to cross-examine a hostile witness. Lanson lost in the state trial court and state appeals court. If Lanson preserved his claim that his federally protected constitutional right to due process was violated, the issue is one that the U.S. Supreme Court could consider if it wished. When it wishes to do so, the Supreme Court grants *certiorari* (to be informed of).

1.4 BUSINESS-LAW PRINCIPLES

The principles of business law come from multiple sources. When the subject of contracts is studied, for example, the common law and case law will be seen as the most usual sources of the relevant legal principles. These principles are found in the reported decisions of the judges of the state and federal systems. In the field of business law, many common-law principles have been restated and modified by legislation. The most comprehensive legislation in this area is found in the Uniform Commercial Code (UCC). The UCC has in the main been enacted into legislation in all the states with the exception of Louisiana which, while it has enacted several UCC articles, has its own commercial code based on the early French law, commonly known as the Napoleonic Code.

The UCC modified many principles of commercial law, and this book will note such changes and repeat such principles in the appropriate sections.

EXAMPLE 5. Grant agreed to construct a swimming pool for Lash for $12,000. When Grant was half finished, he needed money and demanded that Lash pay him an additional $2,000. Fearful that Grant would abandon the job, Lash agreed to pay the extra amount. Under the common law this new promise to pay extra is unsupported with consideration and therefore it would not be enforceable. If, on the other hand, the original contract was for the sale of personal property (goods), the result could be different. Modification of a sales contract under Section 2-209 of the UCC generally does not require new consideration. The UCC changed existing common-law principles in regard to certain contracts such as the sale of personal property, or goods.

In this book statutory modifications and codification of the common law will be seen more extensively in some subjects than in others. The law of sales, as mentioned above, has been changed and is contained in a statute: Article 2 of the UCC. Principles governing commercial paper are found in Article 3, bank deposits and collections in Article 4, and secured transactions in Article 9. In all, eight areas of substantive law are treated in the UCC.

EXAMPLE 6. Gena issues a check to a department store, stops payment on it, and is successfully sued by the store. She settles the dispute by promising to make payments and giving a lien on her household furniture as security. The legal principles governing the check are found in Article 3 (commercial paper), the principles which apply to the stop-payment order are found in Article 4 (bank deposits and collections), and the security agreement by which she created the lien is treated in Article 9 (secured transactions).

This does not necessarily mean that statutory provisions are the last word. These provisions must be applied by the courts. Such interpretations and applications become the new case law, the definitive law on the point.

EXAMPLE 7. A 2-year-old boy died of burns suffered when boiling water erupted from a defective vaporizer loaned to the family by an aunt who had just purchased the unit from a drugstore. Generally, only those who contract can sue for breach of contract, a breach of warranty here. However, since this is a sale of goods, Article 2 of the UCC is applicable. It provides (Section 2-318) in most states that a member of the purchaser's family may also sue. A state supreme court ruled that under these circumstances, a nephew was a member of the family within the meaning of the statutory language. This court decision, interpreting Section 2-318 of the UCC, is now precedent, or case law, in that state.

Not all statutory modifications of the common law are as extensive and comprehensive as the UCC. Statutes are frequently enacted to address specific problems.

EXAMPLE 8. After a particularly hard sell, a builder obtained Larson's signature on a home improvement contract. Once they have signed, both parties are bound under contract law. Because of abuses reported, state legislatures in some states enacted a law calling for a cooling-off period. This statute allows the homeowner, but not the builder, to call off the agreement within 3 days of making it. This statutory rule does not disturb other principles of contracts for home improvements. It only expresses a special rule to carry out a particular public policy.

1.5 THE TOPICS

This text presents material on contracts, sales, commercial paper, secured transactions, agency, partnerships, and corporation law. Contracts and agency principles are generally founded on common law. The other subjects, while governed generally by the common law, have been modified by attempts to cause the states to adopt so-called uniform codes or acts. It should be noted, however, that even where all or many of the states have adopted these uniform codes or acts, the provisions adopted often differ in detail among the adopting states. These differences in detail may be important in particular legal situations.

As mentioned previously, the common-law principles of sales, commercial paper, and secured transactions have been restated and modified by the UCC. Partnership rules have been restated in most states by the enactment of the provisions of the Uniform Partnership Act and the Uniform Limited Partnership Act. Corporation law also has been the subject of numerous attempts to make it uniform; the most prominent of these attempts is the Model Business Corporation Act. Reference to statutory modification (the code type as well as other attempts at uniformity) will be made in appropriate sections of this volume so as to provide the reader with the current sources of many of the basic principles of business law.

EXAMPLE 9. Certain basic principles govern the concept of agreement (offer and acceptance) in contracts. Although the sale of goods is treated under Article 3 of the UCC, certain parts of sales law will be noted under the general topic of contracts in respect to agreements involving the sale of goods. Those principles will, however, be repeated and elaborated upon later in the section on sales.

1.6 TORTS AND CRIMES

This outline does not concentrate on the topics of torts and crimes. However, such legal effects do occur from time to time in business settings. A *tort* is a civil wrong for which the injured party can sue for damages. Such a suit is a private civil action. A *crime* is an offense against society for which the state seeks from the accused a fine, his freedom, or even his life. It is a public action in which the state is the prosecutor. An incident may contain facts indicating both a tort and a crime.

EXAMPLE 10. Randle took a camera from a store display window without the retailer's permission. If such taking was done under circumstances the state defines as a crime, Randle may be prosecuted for larceny. However, whether or not Randle's action has criminal consequences, the retailer has a right under tort law to sue in a civil case for damages or the return of the camera. Randle's action was a civil wrong, a tort called *conversion*.

1.7 TORTS

Torts may be classified as *personal* torts or *property* torts. The former refers to those acts causing injury to one's person, one's reputation, and, in some cases, even to one's feelings. A property tort, on the other hand, describes an economic injury to property caused by the civil wrong. The person committing the tort is called a *tortfeasor*. Personal torts include acts constituting negligence, assault, battery, slander, libel, false arrest, and even emotional distress. Torts against property are trespass, conversion, and wrongful interference with a contractual relationship.

EXAMPLE 11. Barret had a busy day. Lying, he told his barber that his banker was a thief (slander). On his way to flag a taxi he beat out another person by raising his fist until the other surrendered his claim to the cab (assault) and then pushed an elderly woman out of the way for the cab (battery). He borrowed his secretary's gold pen and now refuses to return it (conversion) and agreed to pay his supplier an extra $1,000 if the supplier would quit doing business with another company despite the supplier's contract (wrongful interference with a contractual relationship). Further, without permisssion Barret parked his car in his neighbor's driveway (trespass).

The most frequent tort actions involve negligence. Negligence is proved when the plaintiff shows that the defendant owed a duty to the plaintiff, that the defendant fell below the standard of care of a reasonable person, and that such act proximately caused the injury complained of.

EXAMPLE 12. A supermarket owner has a produce section with green beans piled high on the display counter. A customer picks out the beans, and some beans fall to the floor. A different customer walks by, fails to see a bean on the floor, slips on it, falls, and injures herself. The retailer had a duty to maintain safe premises. A failure to correct the dangerous situation in timely fashion may mean falling below the standard of care. If such omission was the proximate cause of the injury (a broken bone, for example), the retailer would be liable for negligence.

In the above example the defendant might raise the question of the plaintiff's negligence in not watching where she was walking. This would be a charge of *contributory negligence*. If found to be true, it could be a complete defense. Many states have abolished contributory negligence as a complete bar to a plaintiff's recovery, substituting instead the *doctrine of comparative negligence*. Under this principle, each party bears some of the consequences.

EXAMPLE 13. Tuttle was driving unsafely, and Berenson was walking carelessly. Except for both acts Berenson would not have been struck by Tuttle's automobile. Both were negligent. Under contributory negligence Berenson would collect nothing from Tuttle. Berenson, who suffered $10,000 in injuries, would receive $6,000 under comparative negligence if, for example, the jury found him 40 percent negligent and Tuttle 60 percent.

The plaintiff's negligence does not always operate to diminish recovery. This is seen where the "last clear chance" doctrine applies.

EXAMPLE 14. A minor was skipping down the center of a school driveway (negligence) when she saw a car approaching. She tried to stop but slipped and fell, leaving her left foot extended onto the driveway. The car ran over her foot. The driver cannot use this negligence against the minor if the last clear chance doctrine applies. Such applies when a plaintiff puts herself in peril by her own negligence, the driver becomes aware (or should have been aware) of the peril from which the plaintiff cannot or is not extricating herself, and the defendant has a reasonable opportunity to save the other from harm but fails to do so.

Negligence actions are numerous and expensive. Therefore some jurisdictions have enacted a so-called no-fault doctrine in dealing with automobile cases. Economic losses are collected from one's own insurance company irrespective of fault. Main goals of the plan include the establishment of a system which provides prompt and certain payment for reasonable loss.

EXAMPLE 15. An injured motorist claimed that the no-fault statute deprived him of his right to full recovery in tort. The new statute exempted a negligent driver from liability for up to $2,000 to the extent that the injured's own insurance covered the loss. The injured motorist contended that he would have recovered $800 for "pain and suffering" under tort law but for the new statute. The court held the no-fault statute constitutional. It noted that the plan created bore a reasonable relation to legislative objectives (e.g., relieving court congestion), that the plan pared the high cost of automobile insurance, and that the prompt recovery features provided a reasonable substitute for rights abrogated or modified.

1.8 CRIMES

Criminal law is written in statutes and describes antisocial behavior and the sanctions which follow conviction. More serious offenses are called *felonies*; less serious ones are termed *misdemeanors*. Felonies provide grave consequences to the convicted, usually requiring incarceration in a state penal facility for a period of more than a year. Further, some civil rights are suspended, such as the right to vote or hold public office. Felonies include the crimes of treason, murder, rape, arson, robbery, embezzlement, burglary, and other offenses proscribed by federal and state governments. Criminal trials are quite technical and require the state to prove every element of the crime.

EXAMPLE 16. Assume that the state statute defines larceny as (1) taking and (2) carrying away (3) the personal property (4) of another (5) with specific intent to deprive the true owner of it permanently. Starr, aged 17 years, lived next door to Farro, who has just purchased a new car. It was parked in Farro's driveway. Starr looks it over, admires it, and spots the keys in the car. He cannot resist. Starr jumps in the car for a ride. The car never returns in one piece, as it is wrecked on the next block. The state could prove that Starr was guilty of taking and carrying away the personal property of another, but the circumstances do not suggest that Starr meant to take it permanently. Technically, there is no showing of larceny, as one element is missing. Starr may be guilty of a lesser crime, i.e., "using an automobile without the owner's permission," which is a lesser felony or misdemeanor in some states.

Misdemeanors are less serious offenses. State or federal statutes describe whether the crime is a felony or a misdemeanor. Generally the punishment prescribed suggests the characterization. As a rule of thumb, an offense calling for imprisonment in other than a state prison, or for less than a year, is probably a misdemeanor rather than a felony.