

THE LEGAL ENVIRONMENT OF BUSINESS:

A CONTEXTUAL APPROACH

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PREFACE

THE EVOLVING BUSINESS LAW CURRICULUM

Courses in business law have been an integral part of business curricula in colleges and universities for many years. Traditionally, these courses have tended to focus upon private law subjects such as contracts, agency, sales, and negotiable instruments as they relate to business activity. For more than two decades, however, this approach has been criticized as being too descriptive, narrow, and rule-oriented, thereby failing to provide the beginning student of business with an understanding of the law which will enhance effective decision-making in a dynamic society. Critics have called for more emphasis on the nature of legal systems and processes, the social and economic environment which affects and is affected by the law, and the public/regulatory aspects of law that increasingly constrain business activity.

While this debate between proponents of the "traditional" versus "environmental" approaches to business law education has not been fully resolved, certain trends seem unmistakable. At some colleges and universities the business law curriculum now reflects an effort to integrate the two approaches in a two- or even three-course sequence. Increasingly, however, one course has come to be devoted exclusively to the environmental/public/regulatory aspects of business law. Forces external to business schools have also contributed to this trend. It has become clear, for example, that credible accounting programs must incorporate more public law into their major requirements, as state accrediting agencies and the CPA exam require knowledge in this area. In addition, a major impetus for curricular reevaluation has come from the American Assembly of Collegiate Schools of Business (AACSB), the accreditation organization for college and university business schools. In calling for a broad approach to business education, one AACSB curriculum standard states:

The purpose of the curriculum shall be to provide for a broad education preparing the student for imaginative and responsible citizenship and leadership roles in business and society — domestic and worldwide. The curriculum shall be responsive to social, economic, and technological developments and shall reflect the application of evolving knowledge in economics and the behavioral and quantitative sciences.

Clearly reflected in this standard is a recognition that a narrow, tunnel-visioned approach to any component of the business curriculum is inadequate for preparing tomorrow's business leaders.

The AACSB also addresses more explicitly the necessity of including study of the legal environment in the business curriculum. Section IV(b) of the AACSB standards states that business programs must include:

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

Although this standard can presumably be met in various ways, it undeniably suggests the importance of the study of law as a dynamic set of influences which in turn reflects the ethical, social, and political environments in which modern business operates.

FEATURES OF THIS TEXT

This legal environment text is designed primarily for the undergraduate or graduate-level Legal Environment of Business course taken by students with, at best, a limited law background. Because of the book's breadth, it may also be appropriate for use in some Government and Business and Business Environment/Public Policy courses. Its purpose is to provide a meaningful portrayal of the interaction between law and business through presentation of both private and public law in the context of the political, historical, and socioeconomic environment within which both the law and businesses operate—hence the text's subtitle.

A quick perusal of the table of contents will reveal much standard subject matter, with some significant variations. Part I of the text (Chapters 1–4) provides a thorough presentation of the U.S. legal environment, including jurisprudence and legal concepts, the structure of the U.S. legal system, and constitutional and administrative law. In Part II (Chapters 5–8), the business organization as a legal entity is developed along with the largely private law framework encompassing such organizations. Here, basic principles of agency, corporate liability, contract law, sale of goods, product liability, and debtor-creditor relationships are interwoven with the business organization's efforts to adapt to and influence this legal environment. Part III of the text (Chapters 9–17) then flows logically into the public/regulatory (largely federal) law which influences key business relationships by seeking to protect various entities affected by economic activity. In this section, regulatory efforts to protect competitors (antitrust law), consumers, employees (EEO, NLRA, OSHA, etc.), investors (securities law), the physical environment (environmental law), and international trade are thoroughly developed.

Much of this subject matter treatment and organization resembles, at least superficially, that found in several other legal environment texts.

However, the outline masks a number of important distinctions. For example, in Chapter 1 of Part I the changing role of business in society and the increasingly complex set of external environments (e.g. economic, political, ideological, technological, etc.) within which business operates is established at the outset. The nature, sources, and types of law are then discussed as a reflection of these dynamic external forces. Case analysis is also introduced in Chapter 1 through the actual development of a case brief. In addition to fairly standard treatment of the U.S. legal system, constitutional, and administrative law, Part I also includes a unique presentation in Chapter 2 of the public policy process and public policy formulation as it occurs within the legal system. As a result, the legal system is seen not just as a descriptive structure, but rather as a central component of the public policy process whereby society seeks to allocate benefits and burdens.

Much of Part II of the text is also distinctive. As noted previously, the law of contracts and sale of goods are frequently omitted from other legal environment textbooks, which is an omission that we consider to be a fundamental weakness. While this text makes no effort to develop these important topics in the depth found in traditional texts, it does present the basic uniform principles of contract and commercial law which are essential to function intelligently in the contemporary business world. Commercial law is also integrated uniquely with the complex and controversial subject of product liability in Chapter 7. In addition, Part II contains a distinctively blended treatment of agency, partnerships, corporations, and organizational liability in Chapter 5.

Part III attempts to present the most important areas of protective regulatory law that influence business activity. A thorough discussion of contemporary antitrust law is followed by three full chapters devoted to various components of the increasingly complex regulatory framework encompassing employee protection. Following treatment of securities regulation in Chapter 15, the text devotes full chapters to the timely and often omitted subjects of environmental and international law. Throughout Part III, the fundamental rules of regulatory compliance are liberally supplemented by discussions of the social rationale, effectiveness, and impact of these regulations and the business adaptations thereto.

Throughout the text, the approach to the subject matter is perhaps its most significant distinguishing feature. A consistent effort is made to avoid the "add-on" approach so often employed in other legal environment texts. For instance, rather than devoting a separate chapter or end-of-chapter sections to ethical considerations, this text integrates ethical issues into numerous chapters where appropriate. The text also maintains the business organization as the focal point for discussing the legal environment. Efforts by business to adapt to and influence public policy as manifested in the law are frequently discussed. The legal envi-

ronment of business as a constantly evolving reality is emphasized throughout. For example, Chapter 7 blends the topics of sale of goods and product liability by presenting the former as indicative of achievement of national uniformity and the latter as representative of a continuing need to achieve such uniformity. The most current legal issues and cases are also included to illustrate the evolutionary nature of the legal environment, e.g., corporate director and officer liability; the relationship and potential conflict between product liability and labor-management law, respectively, and liberalized corporate bankruptcy provisions; the "new antitrust" law, particularly as it relates to intensified merger activity; goals vs. quotas in affirmative action compliance; employment-at-will as an evolving contract and tort doctrine; insider trading and the duty to disclose in securities trading.

Most importantly, the text consistently attempts to go beyond simply an unenlightening description of legal rules by treating each substantive legal topic within an appropriate broader context. After discussing in Chapter 1 the external environmental forces within which business operates, each chapter thereafter contains some type of introductory section which presents the substantive law within the context of the pertinent social, historical, political, economic, and technological environment within which the law has evolved. As one of many examples, consider the topic of EEO law. Most legal environment texts begin this treatment with a brief one or two page introduction to fair employment, followed immediately by presentation of the statutory framework embodied in Title VII, the Equal Pay Act, etc. While this text includes the relevant statutory provisions as well as an unusually thorough treatment of affirmative action, it neither begins nor ends there. Rather, Chapter 13 begins by discussing discrimination as a continuing social issue, the concept of employment discrimination, and the historical evolution of EEO law prior to the 1960's. In addition, it ends with consideration of current controversies in EEO law such as comparable worth and the social goals of equal opportunity vs. equal results.

PEDAGOGICAL AIDS

The text is designed with a full complement of learning aids to enhance ease and effectiveness of use. Each chapter begins with a short quote to capture the reader's interest in the topic. For example, to impress readers with the existence of the litigious society Chapter 1 begins with a quote describing a lawsuit filed by a few Washington Redskins football fans to overturn a controversial referee's call which went against their team. Each chapter also includes three to six law case excerpts, with introductory remarks and end-of-case discussion questions. All legal terms introduced within the text appear in bold-faced type when they

are first defined, and each chapter also employs tables, charts, and illustrations to permit visualization of key points. Each chapter ends with a chapter summary and review questions. The latter are designed both to review key points and to apply or extend the chapter subject matter by use of case hypotheticals. Appendices are included in the text to describe the structure of the judicial system, and to present excerpts from pertinent statutes and the U.S. Constitution. A glossary and table of contents are also included.

For the instructor, an Instructor's Manual will be available for all adopters. While almost all law texts now have an accompanying instructor's manual, our experience has been that most appear to have been hastily put together by someone other than the text's author(s). The Instructor's Manual accompanying this text has been carefully developed *by the authors* to effectively supplement the text. For each chapter, the manual includes: a chapter outline; a useful section of authors' comments and teaching suggestions; case briefs for each text excerpt as well as answers to end-of-case questions; answers to end-of-chapter review questions; an extensive test bank of true-false, multiple choice, and case questions; and a list of additional references pertinent to the chapter's subject matter.

For the student user, a Student Resource Guide will also be available. Once again, this manual has been carefully written by the text authors to enhance student learning and maximize the efficient use of the text. For each text chapter, the Student Resource Guide includes: an extensive list of key points for review, presented in outline form to conform with the chapter's organization; a list of legal terms introduced in the chapter; a set of completion questions utilizing these terms; a battery of objective questions (true-false, multiple choice, and matching) for review of the chapter; a set of two or three expanded case problems; and answers to the objective questions.

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PART ONE

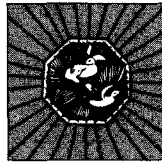
THE LEGAL ENVIRONMENT

- CHAPTER 1 THE LEGAL ENVIRONMENT OF BUSINESS IN CONTEXT
- CHAPTER 2 THE U.S. LEGAL SYSTEM AND PUBLIC POLICY FORMULATION
- APPENDIX THE JUDICIAL SYSTEM: ORGANIZATION AND OPERATION
- CHAPTER 3 THE BUSINESS FIRM'S CONSTITUTIONAL RIGHTS
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CHAPTER 1

THE LEGAL ENVIRONMENT OF BUSINESS IN CONTEXT

On a bright Sunday at St. Louis's Busch Memorial Stadium, a St. Louis Cardinal receiver caught, then dropped, a pass in the end zone. The officials huddled for three minutes and finally decreed that the receiver had held the ball long enough for the touchdown to be valid. St. Louis won the game, and frustrated Washington fans, in the eternal tradition of sports, wrote off another loss to "lousy referees." All but a handful of them. They filed a lawsuit in Federal court, trying to overturn the officials' decision.¹



As the incident above exemplifies, our nation is becoming increasingly dominated by laws and litigation as methods of resolving social problems and disputes. While an unprecedented number of lawsuits has swamped the court system, our various legislative and regulatory bodies continue to promulgate growing numbers of new laws and regulations. Until recently, the growth of our legal system has been a part of the more general expansion of government at all levels. The growth of government has diminished somewhat in the last few years, but laws and regulations which impact on our lives have continued to proliferate.

One of the areas in which the growth of laws and regulations has been most evident is in the realm of business and commerce. Of course, private business activity has always had an important legal dimension. Relationships among businesses or between businesses and their constituencies, e.g., consumers, employees, stockholders, are often contractual in nature, with legally enforceable rights and duties inherent in them. In fact, the legal system is an important aid to business. Businesses could not function effectively without the enforcement of contracts, the protection of private property, the prevention of fraud, and the establishment of a monetary system, all of which are provided by the legal system. In this century, however, and particularly in the last 25 years, business has come to be viewed as an important social institution whose activities must sometimes be limited and regulated in the

¹"Too Much law?" *Newsweek*, Vol. XCV, No. 2 (January 10, 1977), p. 42.

public interest by various levels of government. As a result, today's managers must be knowledgeable not only in the functional areas of business, but also in the vast array of governmental laws and regulations which impact daily upon business operations. All participants in contemporary business activity must be familiar with the legal environment of business, and providing this familiarity is the primary objective of this text.

THE CHANGING ROLE OF BUSINESS IN SOCIETY

In an important sense, the legal environment of business is an expression of social concern for the rapidly changing and increasingly complex external environment in which business functions. This environment consists of various economic, political, cultural, and other forces which now have a much greater effect on business activity than was the case even 25 years ago. We have fundamentally redefined the role of business in society as concerns about occupational safety, equal employment opportunity, consumer protection, pollution control, and income protection have become high social priorities. Most of the newer laws and regulations affecting business represent society's attempt to develop public policy which addresses these social priorities.²

Throughout much of our earlier history, however, businesses were viewed almost solely as economic institutions. Their responsibility was to produce goods and services to satisfy human wants, to provide employment, to protect stockholder interests by engaging in profitable ventures, and to provide for internal stability and growth. As long as businesses fulfilled these responsibilities, they were fully discharging their responsibilities to society. This view still has some proponents today, including the Nobel prize-winning economist, Milton Friedman, who has argued:

The view has been gaining widespread acceptance that corporate officials and labor leaders have a social responsibility that goes beyond serving the interests of their stockholders or their members. This view shows a fundamental misconception of the character and nature of a free economy. In such an economy, there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profit so long as it stays within the rules of the game, Few trends could so thoroughly undermine

²For an expanded discussion of this subject see Rogene A. Buchholz, *Business Environment and Public Policy* (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1982), Ch. 1.

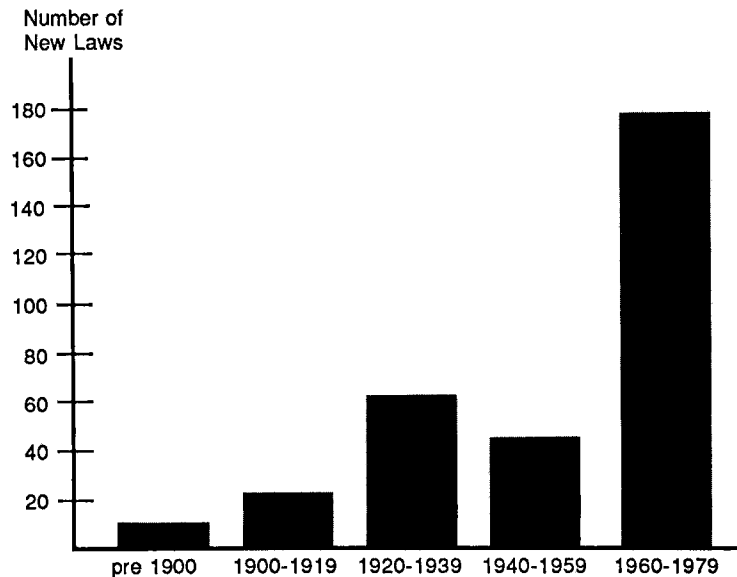


Chart 1-1 NEW REGULATORY LAWS PASSED BY CONGRESS

Source: Joint Economic Committee, Congress of the United States, *The Economy of 1981: A Bipartisan Look*, 97th Congress, 1st session, 1981, p. 290.

the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine.³

In spite of protests from persons such as Friedman, social responsibility has clearly become an additional obligation of business in the last 25 years. Although the traditional economic responsibilities remain important, external forces have led to a call for a new social contract between business and society. For example, consider the following comments made by the Committee for Economic Development, an independent group of leading business executives and educators:

Today it is clear that the terms of the contract between society and business are, in fact, changing in substantial and important ways. Business is being asked to assume broader responsibilities to society than ever before and to serve a wider range of human values. Business enterprises, in effect, are being

³Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 133.

asked to contribute more to the quality of American life than just supplying quantities of goods and services.⁴

Although businesses have responded in a number of independent ways to this call for social responsibility, the obligation has also become firmly imbedded in public policy. Numerous laws relating to workplace safety, equal employment opportunity, pollution control, product safety, and the like have expanded the legal environment of business, and these laws have typically established new governmental agencies such as the Environmental Protection Agency, the Occupational Safety and Health Administration, and the Equal Employment Opportunity Commission to regulate the social responsibility of business.

It is important to note that this new regulatory atmosphere is fundamentally different from the earlier, more limited, economic regulation of certain businesses. Laws designed to maintain competition in the economy (i.e., the antitrust laws) and to regulate certain "public interest" business activities (e.g., public utilities) have been with us for some time. The new regulations, however, are much more socially pervasive, rather than narrowly economic in nature. In spite of recent concerns about excessive regulation, there is little doubt that government pressure for socially responsible business behavior will continue as a major force in the external environment of business.

THE EXTERNAL ENVIRONMENT OF BUSINESS

What has caused this growing concern for corporate social responsibility and the corresponding proliferation of laws and regulations? As noted earlier, today's legal environment of business is, to a large extent, a reflection of a number of dynamic forces which have reshaped the overall external environment in which business operates. These interrelated and sometimes conflicting forces are summarized briefly in the following sections.

ECONOMIC FORCES

Every society must make decisions about what to produce, how to produce it, and who gets the resulting output. In addition, every society must decide how to allocate its scarce resources in order to produce as much as possible for its citizens. The United States still relies more heavily than most nations on a private market system, i.e., capitalism, to

⁴Committee for Economic Development, *Social Responsibilities of Business Corporations* (New York: CED, 1971), p. 12.