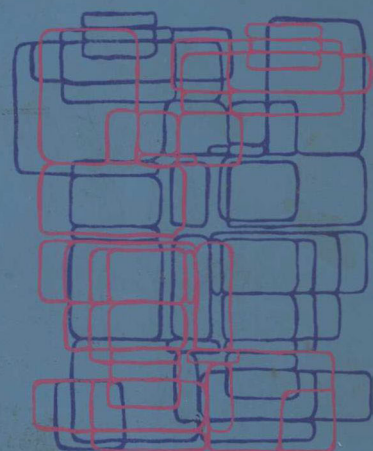


FUNDAMENTALS OF BUSINESS LAW

Second Edition



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2nd edition

FUNDAMENTALS OF BUSINESS LAW

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Prentice-Hall, Inc., Englewood Cliffs, New Jersey 07632

Library of Congress Cataloging in Publication Data

Corley, Robert Neil.

Fundamentals of business law.

Includes index.

1. Commercial law—United States. I. Robert,
William J., joint author. II. Title.
KF889. C64 1978 346'.73'07 77-24289
ISBN 0-13-331926-1

©1978, 1974 by Prentice-Hall Inc., Englewood Cliffs, New Jersey 07632

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Printed in the United States of America

10 9 8 7 6 5 4

Prentice-Hall International, Inc., *London*
Prentice-Hall of Australia Pty. Limited, *Sydney*
Prentice-Hall of Canada, Ltd., *Toronto*
Prentice-Hall of India Private Limited, *New Delhi*
Prentice-Hall of Japan, Inc., *Tokyo*
Prentice-Hall of Southeast Asia Pte. Ltd., *Singapore*
Whitehall Books Limited, *Wellington, New Zealand*

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PREFACE

Most students in business law are not headed for legal careers but rather careers that require a knowledge of fundamental principles of law. It is to these students at every level of higher education that *Fundamentals of Business Law* is directed.

To accommodate the needs of today's students, we have attempted several techniques to facilitate the learning of the subject matter. We have used numerous section headings to readily identify subject-matter content. In order to save the students valuable time while utilizing the combination text-and-case approach, a somewhat different method of presenting cases has been adopted. Carefully prepared briefs have been inserted to illustrate the text material. There are approximately six such case briefs for each chapter. There are 229 such cases in this second edition, of which 124 are new. We believe that all the advantages of studying actual cases will result from this format but that they will be more easily understood and more readily followed by students by being presented in this manner.

The text is divided into seven parts so that individual instructors may select those particular subjects with which they wish to deal, in the order of their choosing. It is our intention that the textbook be sufficiently flexible for either the quarter-system school or the semester-system school and that there be adequate material for at least two courses.

Part I, in addition to introducing students to the various sources of law and the judicial system, contains separate chapters on the criminal law and the law of torts. There is a separate chapter on criminal law due to its increasing importance to society as a whole and because so much of the attention and effort of our legal system is in that area. The chapter on torts places special emphasis on the problems of the fault

system and the trend toward no-fault in the automobile accident area. In addition, the problems related to malpractice by professional persons are highlighted.

Part II, on contracts, covers the traditional contract subjects; in addition it focuses on many of the new developments of the law under the Uniform Commercial Code. The Code is attached to the text as an Appendix, and the appropriate sections are noted in the text. Students will be able to refer directly to the appropriate Code sections as they study, thus enhancing their understanding and retention of the subject matter. The Code as it relates to contracts is summarized in the last section of each chapter, and the differences between the Code and the common law are noted. We believe this approach to be unique and, from our experience in the classroom, quite helpful to students.

Part III discusses property, including personal property, bailments, real estate transactions, and wills, estates, and trusts. The chapter on wills, estates, and trusts is new to this edition. This portion of the text pays special attention to transactions involving property. Studying property law from a transactional approach is of immediate practical value.

Part IV is devoted to the Uniform Commercial Code. Without repeating those points emphasized under the law of contracts, it covers the traditional subjects of sales, commercial paper, and secured transactions. There is a separate chapter on warranties and product liability, recognizing the major importance of these topics to all businesses in our economy. The discussion of commercial paper places increased emphasis on the liability of the parties in transactions involving commercial paper, especially the liability of banks. It also recognizes the decreased importance of the "holder in due course" concept as the result of the 1976 FTC rule. Because secured transactions are so important to creditors and to sellers of goods, two chapters are devoted to this subject.

Part V contains three quite important chapters that deal with the law as it relates to creditors and debtor/consumers. The special chapter on the laws assisting debtors and consumers gathers in one place much of the recent legislation aimed at protecting consumers. It highlights the new FTC rule on holders in due course and the Moss-Magnuson warranty law. Other material emphasizes the trend from "let the buyer beware" to "let the seller beware." The chapter on bankruptcy is designed to give students a thorough understanding of bankruptcy in practice as well as in theory. An attempt has been made to make students aware that bankruptcy is an uncomplicated and common proceeding in which the debtor is able to keep a substantial amount of his property while ridding himself of his debts.

Part VI, on agency and employment, places special emphasis on several aspects of the employer-employee relationship that have developed in recent years. There is a separate chapter on labor-manage-

ment relations, covering labor law in detail. This chapter is a significant part of the text because of the extremely important role played by labor unions in the decision-making process of American industry. This part of the text also highlights the legal aspects of discrimination in employment. The chapters dealing with agency place emphasis on the law of torts and workmen's compensation. A special chapter on agency and the law of torts, in recognition of the important role that *respondeat superior* plays in our legal system, is also included.

Part VII 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 organization. In addition, there is a discussion of special types of business organizations, such as the Sub-Chapter S corporation and the professional service association. There is also a separate chapter on government regulation of business organizations. This chapter, in addition to discussing the power of government to regulate business, illustrates government regulation with a discussion of the antitrust laws. Because antitrust is the legal link with our economy and most business students have several courses in economic theory, we feel this chapter has particular importance. It is also designed as background material for courses in marketing.

Throughout the text, a substantial amount of attention has been given to the public aspects of the law as it relates to business. The heavy emphasis on consumerism and the chapters on labor law and government regulation of business are but a few examples of the emphasis on our legal environment. We believe that a modern course in business law must contain these matters in addition to the generally accepted, traditional content.

We are pleased that Barbara George has written a student workbook 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. We also want to express our appreciation to Professor O. Lee Reed of the University of Georgia for assisting in the preparation of the teacher's manual. He brought valuable insight based on a successful teaching career to its preparation. Professor Sanford Searleman of Adirondack Community College (New York) did an in-depth review of the manuscript and we are grateful for his helpful comments. Finally, we want to thank Betty Hampel of Champaign, Illinois, and Donna Weber of Athens, Georgia, for their valuable assistance in the preparation of the manuscript.

Robert N. Corley

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INTRODUCTION TO THE LAW

1 LAW

Introduction Before starting the study of business law, one should have an understanding of our legal system—where our laws came from, how they are applied, and how they may be changed. The beginning chapters of this text will discuss the legal system of our society, and the remaining chapters will consider the law as it relates to business.

Now more than ever before in our nation's history, the direct relationship between law and the social problems facing our society has a direct and substantial impact upon business and its decision-making processes. Solutions to many of society's problems are found in laws regulating business activity. For example, the basic approach to solving the problems of air and water pollution is found in the law. In the area of employment, legislation now affects the hiring of employees as well as their promotion, especially with regard to minority groups and women. In the field of consumer protection, new laws have been enacted regulating the debtor-creditor relationship and other matters of consumer interest. These laws have been passed in order to give better protection to many groups of people. The law thus serves as a scheme of social control of the business community.

WHAT IS LAW?

Our view of the law will be a broad one, and our first consideration will be the question: What is law?

In everyday conversation people use the word *law* in many different ways. Actually the word *law* is very difficult to define. There is a field of law that is known as "jurisprudence," which analyzes the concept of

law and is concerned with the philosophy of law. Throughout the centuries people have attempted to define *law* and to set forth its role in society.

In attempting to define *law*, it is helpful to look at its purposes or functions. It is fundamental that 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. Between these two extremes of what might be called law and order on the one hand and settlement of disputes on the other, there are many situations that cannot be so clearly defined. For example, the income tax laws require that a person pay an income tax. If he fails to do so, or if he fails to declare all his income or takes improper deductions, he may be subjected to penalties, but he has also failed to live up to his obligations to society. In any event it is important that one bear in mind that the law is not simply a statement of rules of conduct but is also the means whereby remedies are afforded when one person has wronged another.

In one sense all issues and disputes in our society—political, social, religious, economic, or otherwise—ultimately become legal issues 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 will in resolving these issues and disputes.

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 also 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 does the attitude of the majority of society. In this event the law and our legal system provide leadership in bringing about changes. At other times our society is ahead of the law in moving in new directions, and changes in the law are brought about by the people. For example, in the field of ecology various groups have put pressure on legislators to clean up the air and water. As a result, laws have been enacted that require that devices be installed to control pollution. Here the 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.

In still another sense *law* has been defined as the rules and principles that are applied by the courts to decide controversies. These rules and principles fall into three categories: (1) laws that have been passed by legislative bodies, including the federal Constitution and the state constitutions; (2) common law, or case law—the law that is

5 derived from cases decided by the courts; and (3) procedural rules,
Law which determine how lawsuits are handled in the courts and include
such matters as the rules of evidence and related issues. The first two
elements provide the rules of substantive law that are applied by the
courts to decide controversies. The third provides the machinery
whereby these rules of substantive law are given effect and applied to
resolve controversies.

Classifications In order to understand the many different aspects of law, it is
of Law helpful to look at the various areas or classifications of law. As
noted above, laws are sometimes classified as *substantive* or
procedural. The law that is used to actually decide disputes may be
classified as *substantive law*. On the other hand, the legal procedures
that provide 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, and
procedural law establishes the procedures whereby 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;
private law includes the areas of the law that are concerned with the
relationship between individuals.

Public law may be divided into three general categories: (1)
constitutional law, which 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*, which is
concerned with the multitude of administrative agencies, such as the
Interstate Commerce Commission, the Federal Trade Commission, and
the National Labor Relations Board; and (3) *criminal law*, which
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. These public-law subjects will be
discussed later in this and subsequent chapters.

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. For example, the law of contracts 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 such areas as agency and sales. A *tort* is a wrong committed by one person against another or his property. The law of torts is predicated upon the premise that in a civilized society people who injure other persons or their property should compensate them for their loss.

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.

SOURCES OF LAW

Introduction The unique characteristic of American law is that a very substantial part of it is not to be found in statutes enacted by legislatures but rather in cases decided by our courts. This concept of decided cases as a source of law comes to us from England. It is generally referred to as the *common law*. Our common law system of heavy reliance 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, but these are only a part of our law.

In our system, statutes must be in keeping with the constitutions—federal and state—and the courts can overrule a statute that is found to violate constitutional provisions. Statutes and constitutions are classified as “written law.” Also included under this heading are treaties that by the federal constitution are also a part of the supreme law of the land. Case law, as opposed to written law, is not set forth formally but is derived from an analysis of each case that uncovers what legal propositions the case stands for. It is not proper to call this “unwritten” law because it is in fact in writing. However, it must be distinguished from statutory law in that it is not the product of the legislature but is rather the product of the courts. 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,