REBECCA L. MAYER
THE C.P.A. COMMERCIAL LAW EXAMINATION
ID 499
MAY 20, 1967

Approved
May 24, 1967
J. Virgil Herring, Head
Department of Accounting
PREFACE

This thesis is written in partial fulfillment of the requirements of ID 499 of Ball State University, Muncie, Indiana. It is submitted as evidence of study done in the area of business law in preparation for the Uniform Certified Public Accountant Examination.

The thesis is written in two parts. Part I is a critical study of the Commercial Law examinations for the period from May 1963 to May 1966 in order to determine the scope of the examination and the major areas of commercial law tested and their frequency of presentation on the examination. Part I also includes a review of related studies of the Commercial Law examination. Part II of the paper is a review of the major areas of commercial law as determined in Part I of the paper.

I would like to express my appreciation to Dr. J. Virgil Herring of the College of Business at Ball State University for his assistance in the preparation of this thesis.
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INTRODUCTION

Saul Levy in his book *Accountants' Legal Responsibility* quotes Cooley as saying "In all those employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment."\(^1\)

One of the main reasons . . . for hiring the CPA is his ability to find any existing legal problems, to caution his client where others might arise, and to advise his client of the necessity of seeking legal counsel.

The Commercial Law examination "is meant to have particular application to points of law that are apt to present themselves in such an accounting practice and in situations generally encountered in auditing."\(^3\)

The law part of the examination seeks to test, through essay and other types of questions, the ability of candidates (1) to recognize the existence of a legal problem from consideration of certain indicated facts, the general nature of the problem, and the basic legal principles applicable, and (2) to grasp, in a general way, the possible outcome of applying these legal principles to the situation.

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\(^4\)Ibid., p. 5.
Robert G. Allyn contends that every candidate for the Certified Public Accountant examination should possess among other things "a thorough training in examination techniques peculiar to the Certified Public Accountant examination. This involves a knowledge of the type and nature of question or problem that might be encountered." 5 Part I of this thesis is a critical study of the Commercial Law examinations for the period from May 1963 to May 1966. The questions of the examination have been classified according to type of question, i.e., objective or essay. The questions have further been classified according to the area of commercial law with which they are concerned. To further facilitate an understanding of the nature of the examination, the questions were again classified according to the specific subject matter with which the candidate is required to be knowledgeable within each of the major areas of commercial law. Part I also includes a general review of related studies of the Commercial Law examination.

Robert G. Allyn also contends that every candidate for the Certified Public Accountant examination should possess a "thorough training in technical matters pertaining to the subject matter in the examination." 6 Part II of this thesis is a review of the major areas of law as determined in Part I of this thesis. It is not intended to serve as a text in commercial law, but rather it is a condensed summary of such texts.


6 Ibid.
PART I

THE ANALYSIS AND
CLASSIFICATION OF EXAMINATION QUESTIONS
I

CLASSIFICATION OF EXAMINATION QUESTIONS
ACCORDING TO TYPE OF QUESTION

The Commercial Law examination is made up of two basic types of questions: the essay question and the objective question. The essay questions consist of a narrative describing a situation in which a legal problem exists. The candidate is required to answer by listing, defining or stating a rule of law, or he is required to state an opinion as to how the problem might be resolved in court according to some legal rule. The essay questions were found to be worded in such a manner as to leave little question in the mind of the candidate as to what the problem might be. The candidate is asked not to show his power of reasoning in law, but rather he is ask to show his knowledge of legal rules.

The objective questions on the examinations studied (May 1963 to May 1966) were found to consist entirely of a true-false natured question in a multiple choice format. The following is an example of the nature of the questions. It is taken from the November 1964 examination.

A. X, Y, and Z desire to become partners in a business. This would be possible even though
   a. Z is a corporation.
   b. X is married to Y.
   c. Y is adjudicated incompetent.
   d. Z has been listed Public Enemy No. 1 by the FBI.
   e. X is an enemy alien.

The candidate is required to answer each of the five choices with a true or false response. The objective questions test the candidate's ability to recognize a legal problem not his ability to reason an answer.
II

ANALYSIS OF ESSAY QUESTIONS

I have classified the essay questions on the Commercial Law examinations from May 1963 to May 1966 as to the major area of commercial law with which the candidate was required to be familiar. Although each question consisted of more than one part, it was classified as a whole into one area of law.

The results of the classification are shown in Table I on the following page. As can be seen the area of law most frequently tested was that of the contract. Questions in this area are three times more frequent than any other area tested. It will also be readily apparent to any future candidate that the area of contract law has been tested in an essay question on every examination since May of 1963 until May of 1966 except the examination of November 1964. The other areas of commercial law were tested on a comparatively equal basis over the years that the examinations were studied.

The questions classified into the miscellaneous caption on the table were found to be largely concerned with a comparatively new area of concern to the accountant, that of the accountants' legal responsibility.
TABLE I

Classification of the Essay Questions
Appearing in the
Uniform Certified Public Accountant Examinations
in Commercial Law
for the Years May 1963 Through May 1966

<table>
<thead>
<tr>
<th>Date of examination</th>
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<td>Guaranty and Surety</td>
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<td>Bailments</td>
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</table>
III

ANALYSIS OF OBJECTIVE QUESTIONS

I have classified the objective questions on the Commercial Law examinations from May 1963 to May 1966 as to the major area of commercial law with which the candidate was required to be familiar. Each part of each question which required the candidate to respond with a true-or-false answer was classified into the one area of law to which it pertained.

Table II on the following page shows the results of the classification. As can be seen, most of the examinations asked questions which pertained to only three or four of the major areas of law listed on the table. It also should be pointed out that the chart showed a trend towards the asking of questions which pertained to a larger number of areas on one examination.

In order to further aid in an understanding of the scope of the objective questions on the examination, the questions were analyzed as to the specific subject matter tested in each of the major areas of law. The questions, for purposes of this analysis, were classified according to the number of facts that the candidate was required to know in order to answer the questions. For example, question B on the May 1963 examination reads:

An instrument reads as follows:

"On demand pay to the order of Art Able two hundred dollars ($200.00).
To Bert Baker
Albany, New York
(Signed) Claud Charles"

Syracuse, New York

a. This is an inland sight draft.
b. Charles is the drawer of the instrument and has a conditional liability thereon.
Table II
Classification of the Objective Questions
Appearing in the
Uniform Certified Public Accountant Examinations
in Commercial Law
for the Years May 1963 Through May 1966

<table>
<thead>
<tr>
<th>Date of examination</th>
<th>1963</th>
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<td>Negotiable Instruments</td>
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<td>Guaranty and Surety</td>
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<tr>
<td>Bailments</td>
<td>50</td>
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<tr>
<td>Insurance</td>
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<td>Bankruptcy</td>
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<tr>
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<td>40</td>
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<td>Total number of questions</td>
<td>225</td>
<td>190</td>
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</table>
Part a. of this question was classified only under one subsection that of the definition of an inland sight draft. However, part b. was classified under the definition of the drawer of a negotiable instrument and also under liability of the parties to a negotiable instrument. In this case it was deemed that the candidate would need to know both areas to answer the question. The percentage results of this classification are shown in Table III which follows:

<table>
<thead>
<tr>
<th>TABLE III</th>
</tr>
</thead>
</table>

Classification of the Objective Questions

As to Specific Area of Law

(May 1963 - May 1966)

**CONTRACT LAW**

1. The contract in general:
   a. Requirements of the contract:
      1. Consideration - mutuality of obligation 10%
      2. Meeting of the minds:
         a. Offer 4
         b. Acceptance 10
      3. General Requirements 2
   b. Types 3
   c. Contracts in restraint of trade 2
   d. Discharge of a contract 5
   e. Illegal contracts 2

2. Special legal rules:
   a. Novation 3
   b. Parol evidence rule 7
   c. Quasi contract 5
   d. Promissory estoppel doctrine 2
   e. Statute of Fraud 6
   f. Assignment of contract right 3
   g. Defenses 9
   h. 3rd party beneficiary contracts 7
   i. Doctrine of substantial performance 7
   j. Remedy of specific performance 2
   k. Fairness in bargaining process 2
   l. Minors and auctions 5
   m. Anticipatory breach 2
   n. Damages 2
TABLE III--Continued

NEGOTIABLE INSTRUMENTS
1. The negotiable instrument:
   a. Requirements for negotiability
   b. Consideration
   c. Liability of parties
   d. Rules of construction
   e. Defenses
   f. Stop payments
   g. Discharge of a note
   h. Dishonor and protest

2. Definitions
   a. Holder in due course
   b. Certified check
   c. Demand paper
   d. Bearer instrument
   e. Time paper
   f. Holder for value
   g. Payer
   h. Drawer
   i. Holder
   j. Inland sight draft
   k. Presentment and acceptance

3. Types of endorsements
   a. Special
   b. Without recourse
   c. Unqualified
   d. Warranties of signature
   e. Miscellaneous

GUARANTY AND SURETY
1. The surety
   a. Remedies of surety
   b. Liability of surety
   c. Defenses of surety

2. General
   a. The relationship
   b. Parties
   c. Consideration
   d. Conditional guaranty
   e. Cosurety relation

10
### TABLE III -- Continued

#### PARTNERSHIPS

1. Partnerships in general:
   - Creation
   - Dissolution
   - Prima facie evidence as to existence
   - Characteristics of a partnership
   - Act of a partnership which require unanimous consent of all partners
   - The name of the partnership

2. The partners:
   - Requirements to be a partner
   - Rights and interests of the partners
   - Legal status of partners
   - Liability of incoming partner
   - Liability of partners on dissolution or retirement
   - Deceased partners

3. General definitions and information
   - Liability of partnership on contracts
   - Rights of the assignee
   - Determination of property ownership
   - Limited partners
   - Order of priority of claimants to an insolvent partnership

#### BAILMENTS

1. Creation
2. Care required in bailments
3. Examples of bailments

#### AGENCY LAW

1. Definitions
   - Special agent
   - Exclusive agency
   - Irrevocable agencies

2. Parties of an agency
   - Infants
   - Death of either party
   - Authority of agents
   - The CPA as an agent

3. General Information
   - Liability of parties
   - Ratification of contracts by the principal
   - Agency by estoppel
   - Notice
TABLE III -- Continued

CORPORATION LAW

1. The corporation in general
   a. Creation of a corporation 4%
   b. The corporate charter 2
   c. Legal status of a corporation 4
   d. By lawa 2
   e. Concept of legal capital 2
   f. Meetings of the board 2
   g. Termination 8

2. The corporation powers
   a. Acts requiring expressed authority 2
   b. Ultra vires acts of a corporation 2
   c. Implied and inherent powers 4

3. General definitions and information
   a. De jure 1
   b. De facto 2
   c. Domestic 1
   d. Proxy 2
   e. Cumulative voting 2
   f. Securities Act of 1933 2
   g. Foreign corporation 5
   h. Miscellaneous 5

4. Stock and stockholders
   a. Relationship of corporation with shareholders 7
   b. Stock certificates 3
   c. Subscriptions 2
   d. Preferred stock 5
   e. Common stock 9

5. Personnel of a corporation
   a. Promoters 8
   b. Directors 9
   c. Officers 8

INSURANCE

1. The specific policies
   a. Life 9
   b. Fire 11
   c. Property 10
   d. Right of subrogation 4

2. The insurance contract
   a. Requirements of contracts 3
   b. General on the policy 7
   c. Coinsurance clause 6
   d. Incontestable clause 7

3. Miscellaneous General Information
   a. Requirements to be an insurance company 3
   b. Insurable interest 30
   c. Defenses of the insurer 7
   d. The beneficiary 3
TABLE III -- Continued

CREDITOR'S RIGHTS AND BANKRUPTCY

1. General
   a. Federal Bankruptcy Act
   b. Insolvency in the equity sense
   c. Insolvency in the bankruptcy sense
   d. Voluntary petition into bankruptcy
   e. Involuntary petition
   f. Effect of commission of a bankruptcy offense

2. Debts of the bankrupt
   a. Aggressive collection procedures
   b. Composition agreements
   c. Assignment for the benefit of the creditors
   d. Fraudulent transfers
   e. Discharge
   f. Debts not discharges
   g. Debts allowed against an estate
   h. Preference and priority debts

3. Parties
   a. Referee
   b. Trustee
   c. Duties of the bankrupt

MISCELLANEOUS

1. Interest, usury, and banking
2. Real property
3. Estates
4. Wills
5. Trusts
6. Personal Property
IV
SYNOPSIS OF SIMILAR STUDIES

The American Institute of Accountants in its booklet Information For CPA Candidates gives two major groups into which the examination questions on the Commercial Law examinations fall: 7

Group I - Areas of Commercial Law in Which the CPA Candidate Should be Thoroughly Prepared.

1. Agency
2. Administrative Law
3. Bailments
4. Bankruptcy
5. Contracts
6. Corporations
7. Guaranty and Suretyship
8. Negotiable Instruments
9. Partnerships
10. Sales

Group II - Areas of Commercial Law Occasionally Included in the Examination.

1. Arbitration
2. Banking
3. Carriers
4. Estates
5. Insurance
6. Interest and Usury
7. Landlord and Tenancy
8. Liens
9. Patents, Copyrights and Trademarks
10. Personal Property
11. Real Property
12. Trusts.

Herbert C. Miller made a study of the questions offered over several years preceding his book in 1956, and he found that the questions fell largely into the following categories: 8

1. Contracts 19%
2. Negotiable Instruments 13
3. Sales 10
4. Partnerships 10
5. Corporations 9
6. Agency 8
7. Bailments and Carriers 5
8. Bankruptcy 5
9. Insurance 4
10. Real Property 4
11. Suretyship 4
12. Miscellaneous 9

In April 1967, Gaylord A. Jentz published a ten-year review of the scope and changes in the CPA examination in commercial law. His study is reproduced in Table IV on the following page.

Mr. Jentz pointed out four important factors brought out by his classification:

1. The relative consistency of questions being asked in certain fields of law. Noting that all examinations had questions dealing with the contract. "Also, the vast majority of examinations contained questions on corporations, negotiable instruments, partnerships, sales, suretyship, agency and some miscellaneous area of law of which 'professional responsibility' is most frequent." 9

2. That the overall coverage is enormous.


**TABLE IV**

**FIELDS OF LAW COVERED BY CPA EXAMINATIONS**

1957-1966

(Arranged in Order of Frequency)

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Table IV has been reproduced from the Accounting Review, Vol. XLII, No. 2. April, 1967.
3. "The multiplicity of areas covered within a single question."\textsuperscript{10}

4. A factor which emerged from the individual examination questions - that the candidate was required to know not only rules of law currently in effect, but the application of rules of the past.\textsuperscript{11}

\textsuperscript{10}Ibid., p. 365.

\textsuperscript{11}Ibid.
PART II

REVIEW OF THE MAJOR

AREAS OF COMMERCIAL LAW
I

LAW OF CONTRACTS

Contract law is one of the oldest and largest branches of law. It is said that in one form or another it has existed since the very beginning of organized society. Contract law is probably the most important one area of business law since other areas find their base in the contract; for example, the partnership agreement is a contract in itself.

The Contract is defined as "an agreement enforceable by law" or more precisely as "an agreement between two or more competent persons, having for its purpose a legal object, wherein each of the persons acts in a certain manner or promises to act or to refrain from acting in such a manner." From this definition the contract is logically broken down into four component parts: a) the agreement, b) mutuality or consideration, c) competent parties, and d) a legal object.

An agreement is defined as the "meeting of the minds." This rule, however, is limited in one important respect; namely, "that the intention of the parties is to be determined by their individual conduct and what each leads the other reasonably to believe - rather than their innermost thoughts, which can be known only to themselves." It is held by the courts that


13 Ibid., p. 169.
the minds have met when a written agreement is signed since each person signing the contract is presumed to know the contents thereof. An agreement is made up then of two component parts the offer and the acceptance.

An offer is "the communication by one party, known as the 'offeror' to another party, called an 'offeree,' of the former's willingness to act or refrain from acting as specified if the later will act or promise to act or refrain from acting as requested." An offer is not effective until communicated by the offeror or his duly authorized agent to the offeree. An offer to the public may be made through the newspaper or the posting of notice, but it is not effective to a particular individual until he learns that the offer has been made.\textsuperscript{14}

The Requirements of an offer are as follows:

1. it must have been made with an intention to contract, and
2. its terms must be definite and possible to measure with some precision, and
3. its major terms must be present. The major terms consist of a) the names of the parties, b) the subject matter, c) the price, d) the quantity, e) the time and place for performance, and f) similarly important items. Unexpressed terms may be supplied by trade usage.\textsuperscript{15}

Many advertisements are of a preliminary character used to induce a person to respond with an offer. In such cases it

\textsuperscript{14}\textit{Ibid.}, p. 169.

is understood that the detail terms will be reduced to writing and signed before a binding agreement is reached.\textsuperscript{16}

Claim checks or tickets often contain the terms of an offer in fine print. These terms generally limit the liability of the offeror. However, since the main purpose of the ticket is identification, in order for the contract to be effective, it must have either been read by the offeree or read to the offeree.\textsuperscript{17}

Under the Code, an offer for the sale of personal property will not fail for indefiniteness if the parties have intended to make a contract and if there is reasonably certain basis for an appropriate remedy.\textsuperscript{18}

When articles are sold at public auction, the offer is said to be made by the bidder and the acceptance by the seller at the drop of the auctioneer's hammer. The seller may, however, by statement in circulars prescribe the conditions under which the contract is concluded. If the terms of the auction are "without recourse" the item will be sold to the highest bidder. A retraction of a bid does not revive a previous bid. In the same manner when bids are accepted for construction work, the person submitting the bid is considered the offeror.\textsuperscript{19}

An offer continues and is effective until:

1. It is revoked by the offeror,
2. The terms of the offer revoke it,
3. A reasonable length of time has lapsed,

\textsuperscript{16}\textsuperscript{16}Dillavou, \textit{op. cit.}, p. 170.
\textsuperscript{17}\textsuperscript{17}Howard, \textit{op. cit.}, p. 49.
\textsuperscript{18}\textsuperscript{18}Dillavou, \textit{op. cit.}, p. 170.
\textsuperscript{19}\textsuperscript{19}Ibid.
4. The offeree rejects the offer or submits a counteroffer,
5. The subject matter is destroyed,
6. Subsequent illegality of the offer,
7. Death or insanity of either party,
8. Bankruptcy of either party, or
9. The offer is accepted.\textsuperscript{20}

An offer may be revoked at any time before it is accepted. Under the Code an offer may be revoked even if the offeror has promised to keep the offer open for a specific length of time, provided, no consideration has been given.\textsuperscript{21}

The reasonable length of time after which an offer is considered ineffective is determined by the offer itself. An oral offer becomes ineffective when the conversation ends if not accepted. The reasonable time of an offer in a fluctuating market is of short duration.\textsuperscript{22}

All counteroffers reject the original unless it is clear that the offeree is still considering the original offer.

In the case of death or insanity, no notice is required to be given the offeree.

A revocation \textit{must} be communicated to be effective regardless of how or by whom conveyed. A public offer is considered communicated if the revocation is made in the same manner as the offer was originally made.\textsuperscript{23}

An acceptance is an indication by the offeree of his willingness to be bound by the terms of the offer. Unilateral contracts

\textsuperscript{20} Howard, \textit{op. cit.}, p. 51.
\textsuperscript{21} Ibid.
\textsuperscript{22} Dillavou, \textit{op. cit.}, p. 172.
\textsuperscript{23} Ibid.
contracts with a promise on one side, for an act on the other side, for example, a reward for the return of lost property) are not accepted until completion of the requested act. The offeror is, therefore, at liberty to withdraw his offer at any point prior to the time when "substantial performance" has been completed. If the offeree has made a partial performance which has benefited the offeror, the offeror is obligated to pay for the benefit. 24

An acceptance can be made only by the person or persons to whom the offer was made. It must be an acceptance of the same terms of the offer with the exception that it may contain a minor new term. 25

Silence is never considered assent even if the offer is so stated that silence will be considered an acceptance. The offeror can not force the offeree to speak. An exception to this rule is where silence has been used as a means of acceptance in previous dealings. 26

An acceptance is considered effective under common law when communicated to the offeror. The medium of communication which the offeror used is considered the agent of the offeror; and therefore, the acceptance is considered communicated when deposited with the medium. If no medium is used or if none is named in the conversation, the mail is deemed to have been chosen. The acceptance is effective even if lost with the medium of communication and not received directly by the offeror. Under the Code, the offer is construed as inviting an acceptance in any manner and by any medium reasonable under the circumstance. The acceptance is effective as soon as placed with the medium. The offer may however specify a specific medium. 27

24 Ibid., p. 175.  
25 Ibid.  
26 Ibid., p. 178.  
27 Ibid.
The Code is limited in its application in that it does not apply to noncommercial transactions such as the sale of real estate or contracts involving service.\textsuperscript{28}

The second element of a contract, that of consideration is defined as "the surrender of or promise to surrender a legal right at the request of another" or "the price for which the promisor bargains in exchange for his promise." The value of consideration is usually unimportant as long as what is demanded is given. A promise with no consideration is unenforceable. The following may act as consideration: money, tangible property, action, or another promise as long as there is mutuality of obligation. The performance of a statutory duty such as appearing as a witness, or the performance of a past contractual duty or a moral obligation is not considered consideration. An exception is where a new promise is made to pay a debt released in bankruptcy, it is binding.\textsuperscript{29}

Certain contracts are held to be unenforceable in the courts. The circumstances under which they are unenforceable are:

1. The agreement is a contract for the sale of personal property and is subject to provisions of the Code which provide that if an agreement or a clause thereof is found by the courts to be unconscionable as a matter of law at the time of making,

2. The object sought to be accomplished by agreement is illegal.

3. The parties have failed to reduce the agreement to writing as required by the Statute of Frauds.

The Statutes of Frauds have the purpose of requiring written proof of claims based on certain kinds of promises, which because

\textsuperscript{28}\textit{Ibid.}, p. 164.  \textsuperscript{29}\textit{Ibid.}, pp. 199-205.
of their nature and on the basis of experience, are susceptible
to perjury by the promisee and his witnesses. Contracts which
are required to be in writing are:

1. Contracts of an executor or an administrator
to pay out of his own funds the debts of the estate,
2. Contract to answer for the debt of another,
3. Contracts made in consideration of marriage, except
mere mutual promise to marry,
4. Contracts for the sale of an interest in land,
5. Contracts which by their terms cannot be performed
within one year from their formation, and
6. Contracts for the sale of goods or choses in action
of value above a certain amount ($500.00 minimum under the
Uniform Sales Act and the Uniform Commercial Code section con­
taining the Code's statute of fraud covering sale of goods.)

Other contracts which would normally be binding are
voidable. Voidable contracts are those which for some reason
satisfactory to the court, may be set aside at the request of
one of the parties. They remain binding, however, unless the
injured party sees fit to avoid it. There are four classes of
voidable contracts based on 1) the capacity of the parties who
are contracting, 2) fraud, 3) duress, 4) misrepresentation or
mistake.

All persons are said to have the capacity to contract except
infants (to age 21, however, in some states a women is no longer
considered an infant at age 18), insane persons, intoxicated
persons (except that the contract is not voidable where a third
party would be injured), corporations unless the power is given
in the charter, and married women. In most states married women
now have the capacity to contract.

Fraud is defined as the intentional misstatement concerning

an existing material fact that induces another to act thereon to his damage. Even though all statements taken by themselves may be true if when taken together they have the effect to mislead, fraud is inferred. Silence by itself is not considered fraud unless there is a duty to speak. A vendor is responsible to disclose latent defects not apparent with inspection. Also, if a material fact has been misstated prior to negotiations, there is an obligation to make correction.

Misrepresentation has the same elements as fraud except that there is no intent. Misrepresentation may take the form of an action. To render an opinion is not a material fact unless the opinion is rendered by a person held to be an expert in the area. A mistake is the unconscious ignorance or forgetfulness of the existence of a material fact. Unilateral mistakes are those made by one party only. Normally they do not make the contract voidable unless the other party knew of the mistake and took unfair advantage of the other party. On the other hand a bilateral mistake is one in which parties reach an agreement on mutual assumption that certain facts which were material existed when they actually did not. In such cases the minds have not met or the contract is more onerous to one party, and the contract may be voided.

Duress occurs where the will of one party is coerced through fear of the other causing the contract to be involuntary and therefore voidable by the injured party.

Certain other types of contracts have no liability for breach. There is "excuse for nonperformance" of a contract where:

1. One party has waived performance by indicating that he did not intend to hold the party to the terms,

2. One party has prevented the other party from carrying out the agreement, or he or someone else has frustrated performance

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31 Dillavou, op. cit., p. 228.  
32 Howard, op. cit., p. 62.  
33 Dillavou, op. cit., p. 128.  
34 Ibid., p. 132.
of the contract,

3. The contract itself has become impossible of performance as contrasted with merely become more burdensome. Impossibility stems from the nature of the thing promised and not the ability of the person required to perform. Some major reasons for impossibility of performance are:

a) the enactment of a law or an act on the part of the government which has caused performance to be illegal,

b) death or incapacity in the form of illness of the contracting person where his personal services are required,

c) destruction of any subject matter that is essential in the completion of the contract,

d) there is an essential element lacking from the very beginning of the contract making completion impossible from its inception.

The Code allows substitute performance where performance as specified becomes impossible. It also offers the seller an excuse for nonperformance where it has become impracticable by the failure of presupposed conditions.\(^{35}\) A contract is not voidable because of "Unforeseeable difficulties" which are those conditions which seldom occur and are extraordinary in nature, such things as price changes, strikes, bad weather, and shortage of material are frequent and therefore not unforeseeable.\(^{36}\)

A contract can be discharged in the following manners:

1. Performance,

2. Non occurrence of a condition precedent,

3. Occurrence of a condition subsequent,

4. Impossibility,

5. An agreement such as a mutual promise to terminate or rescind, the creation of a substitute contract, novation (substitution of the parties of a contract) or waiver (voluntary surrender of a known right.

\(^{35}\)Ibid., p. 287 \(^{36}\)Ibid., p. 201.
6. An operation of the law such as the running of the 
statute of limitations, bankruptcy, merger, or material alteration 
of a written contract, or

7. Breach. 37

If each side of a contract has money as its consideration, the 
consideration must equal in value the promise made. Therefore, 
an agreement between a debtor and his creditor to have a debt 
discharged upon the "payment of a lesser sum" is unenforceable 
and the contract is not discharged unless the creditor intended 
to make a gift of the remainder or unless the lesser sum is 
accompanied with other consideration.

If a controversy arises over the amount owed, any amount 
will discharge the contract provided that it is not less than the 
smallest amount disputed and provided the dispute is made in 
good faith. Any discovery after payment which proves the amount 
to be larger will have no effect on the prior discharge. 38

Most contracts are assignable without the consent of the 
promisor unless the terms of the contract itself make it unen­ 
forceable. The assignment is effective between the assignee 
and the assignor as soon as it is made; however, it does 
not bind the obligor until he has notice of it. 39 A contract 
which is so personal as to involve a high degree of trust and con­ 
fidence may not be assigned without permission, nor is a contract 
assignable if it would place additional burden upon the obligor. 40

"A person who is not a party to a contract may nevertheless 
receive some benefit from the performance of the contract. Such 
a person is called a third person beneficiary. Third-party bene­ 
ficiaries are classed as 1) donee beneficiaries, 2) creditor 
beneficiaries, and 3) incidental beneficiaries." 41

37 Howard, op. cit., p.114. 38 Dillavou, op. cit., p.201.
39 Howard, op. cit., p. 112. 40 Dillavou, op. cit., p. 317
41 Howard, op. cit., p. 112.
Where performance of a promise in a contract will benefit a person other than the promisee, that person is a donee beneficiary if it appears that the primary intention of the parties of the contract was to make a gift to the beneficiary. Generally a donee beneficiary can hold the promisor liable for failure to perform a promise. Also, the promisee has a course of action against the promisor who breaches the contract. A typical donee beneficiary contract is the life insurance policy.

A third person falls within the designation of a creditor beneficiary if performance of a promise made in a contract will operate to discharge a real or a supposed debt or obligation owed by the promisee (debtor) to the third person (creditor). A third person who is a creditor beneficiary may generally maintain an action at law on a promise made for his benefit by another . . .

In order that a third person may enforce a promise made for his benefit, the parties to the contract must have included the promise directly or primarily for the benefit of such third person. Both parties must manifest in their contract an intention to bestow a benefit on the 3rd party. An incidental or indirect benefit is not sufficient to give a right of action for nonperformance of the promise . . .

The courts may imply that a contract is in existence where there actually is none. Such a contract is called a "quasi contract" and arises in situations in which the courts, in order to do justice and avoid unjust enrichment, impose a duty upon a party and consider the duty a legal remedy. The doctrine will not be used to enlarge upon the obligation created by an actual contract, expressed or implied, nor is it available as a basis for recovery for benefits voluntarily conferred on another without his knowledge or consent or under circumstances indicating the benefits are a gift. An example of the quasi contract doctrine is: A, a neighbor of B, hires C to paint his home. C by mistake paints B's home and B is aware that C is painting his home and

\[\text{Ibid., p.113.}\]

\[\text{Dillavou, op. cit., p. 166.}\]
does nothing to stop C. B would be unjustly enriched if he did not pay for C's service. Therefore, the courts will impose the duty upon B to pay.

An "option contract" is an agreement based upon some consideration to hold an offer open for an agreed period of time. It is irrevocable for the period even if the party granting the option dies.

Under the doctrine of "promissory estoppel" if an offeree has relied on the offeror to keep his promise open the courts in order to do justice can enforce the promise. In order for the doctrine to be effective, the following elements must be present: 1) promise which is reasonably expected to induce action, 2) it actually induces the action, 3) injury occurs because of the promise, and 4) justice can be provided only by enforcing the promise.44

In any action for relief under a breach of contract, the injured party has the duty to reduce the actual loss to the lowest possible point.45

Also, in any action, involving a breach of a written contract "the parol evidence rule" prohibits the testimony of the party or other witnesses concerning oral understanding if the effect of such evidence is to alter, add to, or vary the terms of a written contract. The rule is not violated if the testimony is evidence

1. To establish that the agreement lacks an essential element.
2. To prove it is an invalid contract due to fraud, misrepresentation, mistake, duress or undue influence,
3. To supply a missing term,
4. To prove the existence of a condition precedent,
5. To clear up ambiguities.46

44Class notes, BE 353.2, Ball State University, Muncie, Indiana, Mr. Van Mele.
45Dillavou, op. cit., p. 298.
46Howard, op. cit., p. 105.
II

LAW OF NEGOTIABLE INSTRUMENTS

A negotiable instrument is "an instrument in writing, signed by the maker or drawer, containing an unconditional promise" to pay a sum certain in money on demand or at a definite future time to order or bearer, and when the instrument is addressed to a drawee, is one in which he is named or otherwise indicated therein with reasonable certainty. 47

Rights under a negotiable instrument are usually transferable by assignment so that the assignee may sue and recover if the transferor could sue and recover. 48

The Code classifies negotiable instruments according to the following types:

1. notes - unconditional promises in writing made by one person (maker) and signed by him, in which he promises to pay on demand or at a definite time a sum certain in money to the order of another person or to the bearer,

2. drafts - a bill of exchange directing another to pay. An inland draft is one drawn and payable in the same state or country.

3. certificates of deposit - issued by a bank to one or more persons who deposit money and take the certificates as evidence of it.

4. checks - a brief order or draft drawn by a depositor upon his bank which is payable on demand. 49

Section 3-104 of the Code gives the following requirements for negotiability

1. Be in writing; and
2. "Be signed by the maker or drawer; and
3. Contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and;
4. Be payable on demand or at a definite time; and
5. Be payable to order or bearer;"
6. Name the drawer or otherwise indicate who the drawer is. 

There are no requirements as to how or with what the instrument should be written as long as there is intent to reduce it to a tangible form. Likewise, the signature may take any form and be written, typed, printed, or made by a mark as long as there is intent that the party sought to be held liable.

The instrument must be a promise and not the mere acknowledgement of a debt, i.e. "I.O.U." The wording should be that of force and not a request such as "please pay," however the Code is more liberal on the wording. If the instrument names a certain fund out of which the draft is to be paid, it is non negotiable.

Lowell Howard lists the following matters which will not affect the negotiability of an instrument:

1. Omission of statement of consideration for the instrument or place where the instrument is drawn or payable.
2. Statement of collateral, provision for maintenance of collateral, and authority to sell same upon default.
3. A confession of judgment clause or waiver of rights given by statute to the obligor.
4. A full satisfaction endorsement provision.
5. A statement in a draft drawn in a set of parts to the

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50 Ibid., p. 474.  51 Ibid., pp. 202-209.
effect that the order is effective only if no other part had been honored.

6. The fact that the instrument is undated, antedated or postdated, and

7. Presence or absence of a seal.

Howard also gives the following rules of construction which apply to every instrument:53

1. Where there is doubt whether the instrument is a draft or a note, the holder may treat it as either. A draft drawn on the drawer is effective as a note.

2. Handwritten terms control typewritten and printed terms, and typewritten control printed.

3. Words control figures except that if the words are ambiguous, figures control.

4. Unless otherwise specified a provision for interest at the judgment rate at the place of payment from the date of the instrument, or if it is undated from the date of issue.

5. Unless the instrument otherwise specifies two or more persons who sign as maker, acceptor or drawer, or endorser and as a part of the same transaction are jointly and severally liable even though the instrument contains such words as "I promise to pay."

6. Unless otherwise specified, consent to extension authorizes a single extension for not longer than the original period.

A negotiable instrument must be delivered by its maker or agent in order to be issued originally and subsequently negotiated.54

The endorsement of a negotiable instrument has a twofold legal effect. Along with delivery it passes title to the instrument and it puts the indorser under liability to the indorsee and subsequent holders in due course. The endorsement can be in any form and at any place upon the instrument. All payees must endorse the

53 Ibid., pp. 210-211. 54 Ibid.
instrument unless they are partners, and the endorsement must be for the full value of the instrument. Under the Code the endorsement is effective even if it is forced by fraud, duress, or mistake and is also effective when made by a minor, a corporation outside its power, or by any other person without capacity, however, such persons may rescind liability of the endorsement except where it would injure a holder in due course. 55

The Code defines the type of endorsements in Section 3:

1. "A special endorsement specifies the person to whom or to whose order it makes the instrument payable"

2. "An endorsement in blank specifies no particular endorsee and may consist of a mere signature" Such an instrument may be negotiated by mere delivery"

3. Restrictive endorsement is one which is either conditional or purports to prohibit further transfer of the instrument including such words as 'for collection,' 'for deposit,' 'pay any bank,' or like terms.

In the same section the Code has made some major changes on the effect of the restrictive endorsement. It makes it possible for a restrictive endorsee to be a holder in due course. It permits intermediary banks to disregard a restrictive endorsement, and it permits further negotiation despite a restrictive endorsement.

Another type of endorsement brought out by Lowell Howard is the conditional endorsement which eliminates the liability as a guarantor of the endorsee. This type of instrument endorsement has no effect on negotiability.

A "holder in due course" is a person who is an endorsee of a negotiable instrument who has accepted the instrument in good

55 Ibid., p. 214.
faith and before it is over due and who is a holder for value. Under common law the instrument must also be complete and regular on its face. A holder in due course is not subject to the personal defenses of lack of consideration requirement of a contract, fraud in endorsement, payment before maturity, counterclaims, duress or undue influence or non delivery of a completed instrument. Under the Code, however, a holder in due course is subject to the real defenses of lack of legal efficacy at its inception - fraud in the execution, non delivery. Under the Negotiable Instruments Act, he is subject only to the defenses of forgery, incapacity and material alteration. 56

Liability on negotiable instruments falls into two classifications that of primary parties (makers of promissory notes and drawers who have accepted bills of exchange, including drafts and checks) who's liability runs until the statute of limitations and that of secondary parties (drawers of bills of exchange and endorsers of negotiable instruments) who's liability does not exist until the following conditions have been met - the note has been presented and dishonored, notice has been given of the dishonorment. 57

According to Miller the unqualified endorser has two types of liability a) that which occurs after conditions precedent as mentioned above and b) that of the warranties which all endorsements carry - that the endorser has good title to the instrument, that the instrument is genuine in all respects, that all prior parties has capacity, and that the instrument is valid and subsisting. A restrictive endorsement does not warrant the last item. 58

Normally liability follows the order of endorsement, however, the injured party may recover from any endorser.

56 Ibid., pp 219-234. 57 Ibid., p. 235. 58 Ibid., p. 172.
III

LAW OF SALES.

A sale is based on one of two types of contracts - a contract of sale or a contract to sell.

In a "contract of sale" the title passes immediately from the seller to the buyer. It is at the present time also that the risk passes even though the transfer of possession may be deferred until some future point in time.

In a contract to sell all risk of loss remains with the seller until the title passes. The title to ascertained goods (those which the parties have identified as the specific goods to be delivered - no other goods may be substituted) passes as soon as the contract is made unless otherwise stated or unless the seller is to do something to make the goods in deliverable condition. The title to fungible goods (coal, wheat, lumber of which the mass has been identified) passes immediately. Title to unascertained goods passes when they are appropriated by one of the parties with the assent of the other. If the goods are placed with a public carrier title passes with the FOB point.\textsuperscript{59}

The seller of goods always gives the following warranties:

1. That the seller has good title to the goods and that they are free from any liens unknown to the buyer,

2. The goods are fit for the buyer's purpose if the buyer has disclosed it,

3. If the goods are bought from description, merchantability is implied. If any of the above warranties are breaches the

buyer has the following remedies:

1. Accept the goods and sue for damages arising out of the breach,
2. Accept the goods and use the breach as a basis for price reduction,
3. Refuse to accept the goods and sue for damages,
4. Rescind the contract. {60}

The seller has the following remedies for breach on the part of the buyer:

1. He may sue for the purchase price,
2. He may repossess the article in the case where there was fraud

A conditional sales contract has a clause permitting the seller to retain title to the article sold as security on the unpaid portion. Even though the seller has title, the buyer has all risks incident to ownership. {61}

The Code has modified the time of the title transfer by stating that the title passes according to the intention of the parties.

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{60} Ibid., p. 186.

{61} Ibid.
A partnership is defined as "an association of two or more persons to carry on, as co-owners, a business for profit." An agreement to share profits acts as prima facie evidence that a partnership exists unless the sharing of profits is in lieu of wages, salary, or rent, etc. 62

As used in this definition persons include individuals, partnerships, corporations and other associations. By the definition a partnership has the following characteristics:

1. Mutual agreement - the agreement originates in a contract which may be in any form desired and either written or oral. Each partner acts as an agent for the partnership and his actions bind the partnership if within the expressed or implied powers of the individual,

2. Limited life - any change in the relationship of the partners terminates the contract and dissolves the partnership.

3. Unlimited liability - each partner is jointly and individually liable for the debts of the partnership, and his individual assets may be attached by the partnership's creditors,

4. Ownership of an interest in a partnership indicates interest as a co-owner,

5. Each partner is entitled to participation in profits. 63

The capacity to become a partner is coexistent with the capacity to contract: therefore, an infant may become a

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62 Ibid., p.195.

partner, but he may also withdraw from the partnership at any time with no liability beyond his investment. Also, a corporation may become a partner if not beyond its charter.

Hugh W. Babb and Charles Martin in their book Business Law classify the different types of partners:

1. Ostensible partners - active and known partners,
2. Active partners - may or may not be ostensible as well,
3. Secret partners - active and not known or held out as a partner,
4. Dormant partners - inactive and not known or held out as a partner,
5. Silent partners - inactive but may be known as a partner,
6. Nominal partners (partner by estoppel) - is not a true partner in any sense and was not a part of the partnership agreement. However, he holds himself out to be a partner or allows others to make such representations, and therefore, becomes liable to 3rd persons who have relied on him or his name to give credit,
7. Subpartner - one who is not a member of the partnership but contracts with one of the partners to participation in the interest of the partner's profit of business. No consent is required by the other partner since he has no control or voice in the partnership. He is not liable to creditors.
8. Limited or special partners - risk only their investment in the partnership. He must refrain from being active in management.

The partnership name may designate the actual partner, an assumed name, or the name of another person (this later is prohibited in some states.) The name is the property of the partnership and may be sold unless it is the name of a partner or the name is associated with a personal skill. 65

"A partner has implied or apparent authority to:

1. Sell partnership personality held for purpose of sale in the ordinary course of business. The power to sell included the power to make customary warranties,

2. Buy for cash or on credit goods that may reasonably be considered as necessary in relation to the firm's business or apparently within the usual method of carrying it on . . .

3. Borrow money, if the firm is a trading corporation . . .

4. Pay partnership debts out of partnership funds or by a transfer of partnership assets . . .

5. Collect or compromise debts due the firm
Give a satisfaction of judgment.

6. Execute commercial paper in the firm name for partnership purposes if the firm is a trading partnership . . .

7. Make contracts of guaranty, suretyship, or indemnity which are for the benefit of the firm of within the scope of its business. . . .

8. Employ necessary servants or agents, and engage legal council. . . .

9. Conduct litigation by or against the partnership. . .

10. Partners may ratify the unauthorized act of a copartner . . . 66

Termination of the partnership occurs when the business has been completely terminated.

Dissolution of the partnership is a point in time when any partner ceases to be associated in carrying on the business causes of dissolution include expiration of the agreed time,

65 Ibid., p. 275. 66 Ibid., pp. 287-289.
withdrawal (voluntary or involuntary) of any partner, admission of an incoming partner, agreement of all partners, supervening illegality, bankruptcy or a court decree. The sale of his interest by a partner does not of itself work a dissolution of the partnership nor does the buyer automatically become a partner. The dissolution of the partnership terminates the authority of any partner to make a contract binding upon the other partners unless the partner had no notice of the dissolution. Also if no notice is given to third parties and they act upon the basis that the partnership is being bound, the partnership in fact is bound. 67

A withdrawing partner retains liability for all the action prior to his withdrawal and an incoming partner has liability for action subsequent to his membership only unless he agrees to assume more.

A partner's rights and duties are in a large measure defined in the partnership agreement, however, if the agreement is silent the following rules prevail:

1. Upon liquidation each partner is to be repaid his contribution and share equally in the remaining increase in value,

2. The partnership must indemnify every partner for ordinary and necessary expenses incurred by him,

3. Profits are shared equally-losses are shared in same manner as profits

4. Interest is paid only on advances of capital above the original contribution,

5. Rights to participate in management are equal. A majority vote rules except when assigning the firm property to a trustee, confessing a judgment, disposing of the firm's goodwill, submitting the partnership agreement to arbitration, and doing any act which would make impossible the conduct of the partnership business,

67 Ibid., pp. 287-294.
6. No partners are to be compensated for their services unless in agreement,
7. Each partner may inspect the books,
8. Each partner has a fiduciary relationship,
9. Each partner has a right to an accounting.68

V

LAW OF CORPORATIONS

A corporation is a legal entity competent to contract and to hold title to property in its corporate name. It is created by the state and is subject to such regulatory statutes as exist in the state where it is chartered. Its members are limited in liability to the extent of their investment.

A corporation usually results from a petition for a charter forwarded to the state by its promoters. The application sets forth the following:

1. The purposed name of the corporation,
2. The purpose of the corporation,
3. The location of the corporation's office,
4. The number of shares for which authority is requested,
5. If classes of stock are to be issued, the designation of each and a statement of the relative rights, preferences, and limitations of the shares of each class of stock,
6. Definition of series of stock to be issued,
7. Designation of the secretary of state as agent upon whom legal processes may be served in an action against the corporation.
8. Name and address of registered agent upon whom process against the corporation may be served,
9. The duration of the corporation if other than perpetual. 69

Promoters are not entitled to compensation for their

69 Ibid., pp. 304-305.
services. Any contracts which they make before incorporation are not binding to the corporation; however, they themselves are bound. Their relationship to the corporation is that of a fiduciary. 70

A corporation has the powers which are expressed in its charter plus any necessary to carry out any expressed powers. Expressed powers usually conferred are the following: 1) to have a corporation name, 2) to own and carry property in its name, 3) to sue and be sued under its name, 4) to have a corporate seal, 5) to make by laws, and 6) to borrow money for corporate purposes. 71

In order for a corporation to invest in the stock of another corporation or become a member of a partnership it must be stated in its charter.

The rights and liabilities of subscribers to stock are largely determined by the corporate charter. Unless otherwise stated all stock carries the right to vote, the right to inspect any and all corporate records for any proper purpose, the right to a list of stockholders, and also the preemptive right.

Directors are elected by shareholders. They need not be shareholders, and aren't compensated unless stated in the by laws. If officers of the corporation are also directors, they should not be present at meetings where salary is discussed. Their meetings are either scheduled or unscheduled.

Shares of stock are readily transferable, and the title passes with the certificate. Watered stock is stock sold for less than par value. The purchaser of which can be held liable to the corporation for the additional amount necessary to bring the capital stock to its full value.

70 Miller, op. cit., p. 203.

71 Babb, op. cit., p. 316.
Stockholders' meetings can be properly held only when notice has been given to all stockholders. Business can be conducted only when a quorum is present, except where a different number is stated in the charter. Each shareholder is entitled to one vote for each share of stock he owns and may vote in person or by means of a proxy vote.

A corporation is domestic with reference to the state or country in which it was organized, and foreign with reference to any other.\(^72\)

A corporation may be dissolved by the following non-judicial means: 1) Expiration of the period specified in the charter, 2) Surrender of the charter, 3) Action of stockholders, 4) Consolidation, 5) Merger, 6) Occurrence of a condition subsequent, and 7) Legislative repeal under powers reserved by the state.\(^73\)

A corporation may also be dissolved by the following judicial means: 1) Action of the Attorney General, 2) Directors' petition for judicial dissolution, 3) Shareholders' petition for judicial dissolution, and 4) Shareholders' petition for judicial dissolution under Deadlock statutes.\(^74\)

\(^72\) Ibid., p. 309.
\(^73\) Ibid., p. 314.
\(^74\) Ibid., p. 315.
VI

LAW OF AGENCY

"The agency relationship is present when one person, the agent, is authorized to act for and under the control of another person, the principal, in business dealings of a contractual nature with third persons. An agent can, generally, be authorized to do anything which the principal himself could do; however, the purpose of the agency cannot be criminal, immoral, or against public policy.

Agents are divided into a variety of classes depending upon 1) the nature and extent of their authority, 2) the character of the calling, and 3) the obligations they assume."75

The relationship of principal and agent and the authority of an agent may be created by 1) express appointment, 2) implication, 3) estoppel, 4) operation of law, and 5) ratification.

75 Ibid., p. 263.
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