Preface

Welcome to Business Law, Sixth Edition

New to the Sixth Edition We are excited to bring you the sixth edition of this book. The previous edition was used in business law and legal environment of business courses throughout the nation. The changes made in the sixth edition are geared to better meet the needs of instructors and students. Four changes deserve specific mention:

Latest Legislative and Administrative Developments: As you might expect, over the past few years, the law in the United States and within the international community has evolved, and exciting dimensions of the business/law dynamic have developed. This edition also captures the latest developments in legislative (e.g., the Defend Trade Secrets Act of 2016) and administrative fronts.

Current Cases: The sixth edition includes recent U.S. Supreme Court decisions (several from 2017) as principal cases, along with new cases from other federal courts and various state courts.

More Graphical Presentations: A host of new tables, exhibits, and other visual depictions of important concepts are included in this new edition.

Reorganization of Uniform Commercial Code Materials: Recognizing that many law courses—particularly those aimed at accounting students—focus on the Uniform Commercial Code, the sixth edition presents Uniform Commercial Code (and related) chapters together.

We believe we have improved the readability of this edition through a vigorous process of editing, in both content and grammar realms. The sixth edition continues our tradition of offering an expansive text that presents, in an interesting manner, the fascinating and ever-changing world of law within the business community. Welcome to the sixth edition!

Our Commitment to High Quality We believe this edition of the text is worthy of the trust you have placed in us to clearly deliver contemporary aspects of business law and the legal environment of business in a comprehensive, dynamic manner appropriate for a variety of learning styles.

The reader should note at the outset that *Business Law* was created not only to present traditional principles of legal studies as they relate to business but also to delve into new arenas pertaining to the interaction of law and business appropriate for business leaders of the twenty-first century. Some legal topics covered in the text have changed little in decades—in fact, some topics have changed little over centuries. Other topics are new to business law and are evolving at a quick pace in order to meet the changing needs of the commercial world and society in general. We strive to accurately present important legal principles that have weathered successful use in the business environment for many years while also stating popular precepts of law that are forming as yet unsettled areas of jurisprudence. This combination of age-old principles and cutting-edge developments is a characteristic of our legal system that makes its study exciting.

The text has a distinguished and long history, with the first edition being published more than twenty years ago by two faculty from the University of Georgia, Professors Peter Shedd and Robert Corley. The current author, Professor James F. Morgan, was brought on board to contribute to the second edition, using the firm foundation provided by Shedd and Corley. Each successive edition has embraced the original goal of creating a textbook of the highest quality in terms of scholarship and readability. We believe that *Business Law,* sixth edition continues that tradition.

Distinguishing Features *Business Law,* sixth edition, continues attributes that faculty and students of previous editions have found beneficial and that are, occasionally, features unique to this text. For example:

- **Touchstones**—examples of situations where the law is being applied or where controversy surrounds the application of a legal principle—are prominent in each chapter. This unique feature of the text serves as a starting place for in-class or Internet-based discussions of important legal points mentioned in the chapter.
- **Legal Reasoning**, a subject rarely examined as a specific area of study in competing offerings, is examined conspicuously, presenting aspects of deductive reasoning, analogical reasoning, and dialectical reasoning.

- **Ethics and Social Responsibility** are major focal points of an entire chapter (Chapter 2). Aspects of philosophy and jurisprudence are presented, along with a framework for making ethical decisions and popular models of social responsibility.
- **Intellectual Property**, while addressed in a variety of contexts throughout the text, is examined in considerable detail in a separate chapter (Chapter 12), where legal and business aspects of patent, trademark, copyright, and trade secret law are discussed. This chapter also covers cyberlaw and Internet-related aspects of intellectual property law.
- **Global Aspects** of the legal environment of business are emphasized. For example, Chapter 45 is devoted generally to legal aspects of international business. In other chapters, sections touch on specific aspects of conducting business on an international scale. All three chapters devoted specifically to the sale and lease of goods (Chapters 21, 22, and 23) contain materials focused on global aspects of the law of sales.
- **Law for the Entrepreneur** continues warrant treatment in a specific chapter (Chapter 46). It is rare for a textbook to devote coverage to this increasingly important topic, addressing significant issues that a small business owner or entrepreneur will face early in the life of a new commercial endeavor.
- **Forms of Business Organization** are also treated as a separate chapter, allowing the student to achieve an overview of popular forms of conducting business before examining details of each principal form of business in distinct chapters covering partnership, corporate, and limited liability company law.

As with previous editions, *Business Law,* sixth edition details major activities of government impacting business, particularly judicial decisions, legislative pronouncements, and agency actions. This edition includes many new principal cases. Often these new cases are ones that have just been decided, giving students the opportunity to see the current state of the law. Sometimes, however, we employ older cases that articulate particularly well a rule of law and the rationale supporting the decision of a judge or justice. Recently passed legislation is also explored in this edition. Finally, cutting-edge administrative agency developments are covered. Our hope is that this text will not only provide a foundation for the student to understand the state of the law as it relates to conducting business today but also offer tools students can employ to better understand the law as it continues to evolve in this decade and into the next.

A Special Note to Students

I remember being seated where you are now— a student in a business law/legal environment of business class. The thought that I would be on the "other side"—teaching courses in legal studies—never entered my mind when I was a student. Much less did I ever contemplate being involved in writing a business law textbook! However, I want to share with you two perspectives as the principal author of this text.

First, make no mistake, this sixth edition of *Business Law* was written from your perspective—from the viewpoint of a student. I thought back to my time in the classroom and attempted to present legal information and perspectives in the manner I would have liked to have had the subject presented to me years ago. I remembered what I liked about the business law class and what I did not like. I remembered what I liked about the textbook and what I did not. I paid attention to my perspectives based on memory, but also—and far more important—I have listened closely to the perceptions of my students in my business law classrooms. I have found students are generally ready to offer their thoughts on what they liked about previous editions of the textbook—along with what they would like to see changed. So, in preparing this new edition, I remembered aspects of my experience as a student of business law and also incorporated the insights of students I have taught. Thus, this edition is written with you in mind.

I also am able to write this book from the viewpoint of someone who has amassed information and perspectives from my experience as a legal professional. As an attorney, I have appeared in court representing clients and performed transactional work assisting clients in matters that have touched on all subjects covered in this textbook. I have worked as a law clerk to a judge, served as a *pro tem* judge hearing cases, and lobbied state legislators. Thus, I have an idea of how the legal system works from the "inside." I have taught at a law school, within a graduate (MBA) program in the business department, and at the undergraduate level. Finally, I have written articles, published both in the United States and internationally, for audiences of business managers, lawyers, and faculty in law and business schools. So, I sincerely trust that you find this text very readable and highly relevant to your studies in business or a related field.

As you proceed through these pages, my hope is that you not only *read* but also *think* about the subjects presented. Think about *how* a particular aspect of the law you are studying impacts individuals, businesses, and society. Think about *why* a specific legal doctrine or rule exists and *what interests* are served though its application. Think about whether the specific legal rule being studied is *beneficial*: Does it serve well the interests of individuals (e.g., employees), business (e.g., ownership), and society (e.g., potential customers)? And, if those interests are not served well, think about how the law could be *changed* to do better.

Welcome to the beginning of a truly fascinating voyage!

A Special Note to Faculty Colleagues

We hope to provide you a high-quality companion to your own classroom instruction. Previous editions have been subject to the eyes of thousands of students and scores of instructors. Moreover, all materials in this text have received editorial review and legal critique. We trust you will share in our belief that *Business Law,* sixth edition continues our efforts to present a textbook that represents well our discipline of legal studies in business. More specifically, we strive to offer to you a business law textbook that is *contemporary, comprehensive, clear,* and *compelling*.

First, we want to offer a contemporary text. Issues associated with ethics, globalization, diversity, and the Internet, among others, provide tremendous challenges to members of the business community today. Moreover, within the legal studies discipline, significant changes have occurred recently in a variety of areas—including health-care law, intellectual property, limited liability business structures, and negotiable instruments, to name just a few. Many principal cases have been decided within the past few years, and most Touchstones in this text address contemporary issues. Transformation is occurring in business and within the legal studies discipline, and thus, we attempt to capture major developments on both fronts within this text.

We offer a comprehensive legal studies book that presents to instructors a wide array of topics for possible examination with students. Why are so many legal topics included in the text? Because we know that each instructor of a course in business law (or legal environment of business or legal studies in business) has a slightly different (well sometimes widely different) group of topics that they may wish to cover in a single quarter, semester, or yearlong class. That is the nature of our discipline, and we view that diversity of subject areas as a strength. We believe the large number of possible topics that might be included in a business law course, the varying emphasis that might be provided to a specific legal subject area, and the degree of instructor passion associated with certain legal topics all enrich the student learning experience.

So, in writing *Business Law,* we embraced this variety of approaches to the discipline because students, ultimately, benefit if the instructor can teach a selection of business law topics with which they have a familiarity and that they believe are most relevant to students of business. For example, many of our colleagues desire that their students be most familiar with private-law topics, including contracts, torts, partnerships, and corporations. Others hold the position that matters of public law are most critical, so they focus their course on consumer law, environmental law, employment law, and antitrust law. In addition, a large number of those who teach business law attempt, not surprisingly, to cover, in considerable detail, both private-law and public-law topics. The point is, regardless of the topics an instructor selects to cover (in a one-quarter course, a one-semester course, or a full-year course), this text provides comprehensive coverage of the topics generally captured by the terms *business law* and *legal environment of business*.

Next, we desire to present the subject matter clearly. While the law is certainly complicated, that characteristic does not mean that the subject cannot be offered to the reader unambiguously. The reader will note that plain language is the norm; where legal terms are employed, they are defined. Fact-based examples of legal doctrines are used liberally. Also, each chapter has, on average, at least one visual depiction of the specific subject area being addressed, with the hope of assisting those who learn more easily through a diagram, table, or other visual form of presentation.

In terms of readability, we recognize that this text is aimed at students of various academic levels within a campus community. Some students will be studying selected chapters within the context of a business law or legal environment class as part of the general business curriculum at a community college or university. For the chapters most often used in such a course of study (e.g., Chapter 14, "Agreement: Offer and Acceptance"), we write at a level that respects the preliminary stage of business education for the most typical reader of such a chapter. For those students near the end of their four-year degree or in graduate school, we offer a more sophisticated presentation for chapters that are often read by those students (e.g., Chapter 28, "Secured Transactions"). For all readers, though, we trust you will find the material presented in a clear fashion.

Lastly, we believe you will find the material compelling. The study of law within the business environment is an exciting enterprise that requires the student to do far more than memorize rules. In point of fact, rules are just the beginning of our system of justice. Within this text, you will explore the almost endless number of interests that must be addressed within a vibrant society, particularly within the realm of business, and these interests often compete with one another. For example, within the realm of bankruptcy, the law must strike a balance between allowing a debtor hope for a new financial life and holding the debtor responsible for past financial obligations made to creditors. Sometimes, interests within a particular relationship are treated differently by the law because of the status of the parties. Within the employer-employee relationship, for example, an employee may quit working for an employer for no reason. An employer, however, may have to possess a reason to legally terminate certain types of employees. The employer and employee are both parties within the same relationship, yet the law imposes different obligations. Or, take a third example: As a general rule, the law attempts to provide a system characterized by both structure and fairness. However, structure and fairness cannot always coexist. A variety of strident rules govern the formation of a contract. The law recognizes that although certain promises may fall short of meeting the formal requirements of a contract, a court will enforce those same promises in order to prevent unjust enrichment of one of the parties. These are just three scenarios that illustrate the dynamic nature of law where the law is recognized as a complex mechanism for expressing societal interests; the law is so much more than simply a set of rules. There is considerable depth in the law, and that richness should be part of any study of law. We write the text in a manner that attempts to capture this fascinating aspect.

Pedagogical Design

The chapters in *Business Law,* sixth edition consist of three basic parts: text, cases, and problems. First, the text is written in a style designed for business students and students in related disciplines. We have composed the text of this book without much of the legalese to which law school students become so familiar. The textual material is crafted to present both the richness of the law and the dynamic interaction between law and business. To the extent possible, the focus of the writing is directed toward introducing students of today to the legal issues they will face throughout their careers.

Second, each chapter contains three edited cases. These case opinions, presented in the judge's actual language, illustrate a point of law discussed in the text. In order to improve readability, we have lightly edited the prose in the courts' official opinions, particularly regarding the elimination of citations to many cases and statutes not important for our purposes. The reader will discover that each case consists of basic facts (set forth in italics for ease of understanding). This portion of the case provides a true-to-life view of business, almost always in a fairly contentious setting. Each case then presents the legal analysis of a judge or justice, allowing the student to experience the legal process as the law is explained and applied.

A further comment or two about the cases included in *Business Law*: While almost all of the cases were decided recently, a small number of judicial opinions are classic cases from prior decades. These cases are featured in order to illustrate the rich history associated with many legal doctrines we take for granted today. Also, the cases come from both state and federal courts and from all reaches of the United States (there is even an occasional case from outside the United States to illustrate how other countries make legal decisions).

Third, review problems, including questions and factual scenarios, are included at the end of each chapter. Many students learn best by being able to apply what they have read in a chapter, so we have crafted various types of learning exercises to allow students to use the legal principles explained in the text.

Numerous aspects of this text were designed to help enhance the reader-friendly student-centered nature we hope is conveyed throughout the book. Of particular interest, in this pedagogical sense, are the following items:

- A Chapter Outline provides a detailed list of the subject matter covered in each chapter.
- A Chapter Preview serves as an introductory statement to help students understand how the chapter's topic fits into the overall business transaction.
- A Business Management Decision, which starts each chapter, whets students' appetites for the chapter's discussion.
- Marginal definitions reinforce the meaning of key terms and phrases.

- Touchstones, found in each chapter may consist of an edited case, newspaper article, law review article, or other source of legal information. The purpose of this feature is to highlight interesting aspects of the legal subject being presented.
- A Case Concepts Review, which follows every case, asks questions to assist students in their comprehension of the case's major points.
- A Chapter Summary assists in the review process.
- A Matching Problem at the outset of the review questions in almost all chapters provides students with a quick method to test their knowledge of key terms and phrases.
- Numerous fact-oriented Review Problems allow students to become comfortable in applying their understanding to business transactions.
- Strategic Focal Points provide students an opportunity to review an extended fact situation, consider relevant legal factors, and then see how business responds.

For further ease of learning, the reader will quickly discover two characteristics of this textbook. We have italicized significant words, phrases, and sentences throughout the text in an effort to assist the reader in recognizing particularly important aspects of the text. Also, as commented previously, we have added a large number of visual depictions of legal principles—sometimes in the form of a diagram showing the relationship between and among principles, sometimes in the form of a chart geared at comparing principles, and sometimes in other forms aimed at further enhancing the learning process.

In addition to these pedagogical devices, *Business Law,* sixth edition includes a detailed set of appendices. A glossary for student referral also is provided.

Topics Covered

The forty-six chapters in *Business Law,* sixth edition are divided into ten distinctive parts that permit the reader to view chapters within a broader context as represented by the term chosen to describe the part. In other words, this structure allows students to have a logical skeleton with which to see the "big picture" of business law, consisting of the major parts of the discipline along with specific chapters presented in each part of the text.

Most instructors will wish to cover all chapters within a particular division; however, there is sufficient flexibility in this scheme of organization to allow an instructor to select only specified chapters within a particular part. Further, we believe that dividing the text into ten parts provides maximum flexibility for ease of coverage, regardless of whether one is structuring a course for a single quarter, one semester, or an entire academic year.

Part I serves as an *introduction* to our legal system. Chapter 1 presents the importance of studying the legal environment of business, the purpose of law, and the principal sources of law. Chapter 2 approaches three closely related topics: ethical behavior, social responsibility, and legal reasoning. Addressing the area of procedural law, the text includes material explaining the structure of the court system (Chapter 3), litigation procedure (Chapter 4), and alternatives to litigation as a dispute-resolution system (Chapter 5). The U.S. Constitution is the focus of Chapter 6, with a specific emphasis on the constitutional grounds available for government to regulate business.

Part II consists of six chapters discussing *foundational legal concepts* that are essential for students to understand prior to their coverage of the remaining topics in this text. Chapter 7 covers criminal law, since society is increasingly holding business owners and managers, as well as business entities, responsible for criminal violations. Chapters 8 and 9 place special emphasis on the various theories used to impose tort liability on businesspeople and their organizations. Chapters 10, 11, and 12 provide a treatment of the law of property. Chapter 10 delves into basic aspects of property law, the nature of personal property, and the transfer of property upon death. Chapter 11 is devoted to real property. The last chapter in Part II, Chapter 12, explores the fascinating topic of intellectual property, with particular attention paid to cyberlaw.

Part III, dealing with *contract law,* is designed to give students an understanding of the basic and traditional concepts of contracts, as well as of recent developments from the closely related topic of sales under the Uniform Commercial Code. Pertinent parts of the Code are included as an appendix, and appropriate sections are referred to in brackets within the text. Also, the impact of the digital age on traditional notions of contract law is explored within Part III. After an introductory chapter that includes extensive coverage of contract remedies (13), the next four chapters (14 through 17) discuss the essential requirements for every valid contract.

Chapter 18 involves issues of form and interpretation of contracts, whereas issues created when third parties become involved in contracts are discussed in Chapter 19. Chapter 20 includes a discussion of contractual performance, along with a presentation of the methods of discharging or excusing the performance of promises.

Part IV consists of three chapters that present additional material on the *sale of goods*. Without repeating the details contained in the chapters on contracts, Chapters 21 and 22 emphasize the provisions of Article 2 of the Uniform Commercial Code, which is necessary to understand formational and operational aspects of sales and leases of goods. Chapter 23 is an in-depth examination of the law of warranties. Domestic and global aspects are presented in each of these three chapters.

Part V consists of four chapters devoted to *negotiable instruments*. Chapter 24 serves as an introduction to terminology and to an understanding of the scope of Articles 3 and 4 of the Uniform Commercial Code. Chapters 25 and 26 discuss the basic elements and advantages of negotiable instruments. Chapter 27 concentrates on potential liability of the parties involved in the commercial paper transaction.

Part VI contains three chapters dealing with the law as it relates to *creditors* and *debtors*. The first, Chapter 28, examines Article 9 of the Uniform Commercial Code on secured credit transactions. Chapter 29 presents additional laws assisting creditors, emphasizing the complex area of suretyship. Finally, Chapter 30 discusses bankruptcy

Part VII contains four chapters on legal principles directed at dealing with people within a business environment. Chapter 31 covers the creation, termination, and general principles of the agency relationship. Chapter 32 discusses liability principles associated with an agency relationship from the perspectives of the law of contracts and the law of torts. Employment-related concepts follow in the next two chapters, with Chapter 33 examining general employment and labor law subjects and Chapter 34 focusing on discrimination.

Part VIII surveys laws relating to *business organizations*. We begin with Chapter 35, offering a unique and dynamic presentation comparing various forms of conducting business. Then we move on to a discussion of selected forms of business organizations using a three-stage model: (1) the methods of creating the various forms of organizations, (2) the legal aspects of operating the various forms of organizations, and (3) the law as it relates to dissolution of business organizations. This material is covered in Chapters 36 through 38. Recognizing the explosion in the use of limited liability companies, most of Chapter 39 is devoted to this exciting mechanism for conducting business.

Part IX contains four chapters on the subject of *government regulation of business*. Chapter 40 covers administrative law, with an emphasis on the operation and impact of administrative agencies. Chapter 41 deals with the regulation of corporate securities. The subject of antitrust law is dealt with in Chapter 42. Two areas of comparatively recent vintage, consumer law (Chapter 43) and environmental law (Chapter 44), conclude Part IX.

Part X presents two subject areas that are more and more relevant to doing business today. Chapter 45 examines legal aspects of *international business,* while Chapter 46 presents important legal subjects that an *entrepreneur* may wish to consider.

Supplements and Resources

➢ *Instructor Supplements*

A complete teaching package is available for instructors who adopt this book. This package includes an **online lab**, **instructor's manual**, **exam bank**, **PowerPoint™ slides, LMS integration**, and **LMS exam bank files**.

Online Lab	BVT's online lab is available for this textbook on two different platforms—BVT*Lab* (at www.BVTLab.com) and LAB BOOK™ (at www.BVTLabBook.com). These are described in more detail in the corresponding sections below. Both platforms allow instructors to set up graded homework, quizzes, and exams.
Instructor's Manual	The Instructor's Manual helps first-time instructors develop the course, while also offering seasoned instructors a new perspective on the materials. Each section of the Instructor's Manual coincides with a chapter in the textbook. The user-friendly format begins by providing learning objectives and detailed outlines for each chapter. Then, the manual presents lecture discussions, class activities, and/or sample answers to the end-of-chapter review questions, along with citations that provide the rationale for the answers. Lastly, additional resources—books, articles, websites—are listed to help instructors review the materials covered in each chapter.
Exam Bank	An extensive exam bank is available to instructors in both hard-copy and electronic form. Each chapter has approximately fifty multiple-choice, thirty true/false, ten short-answer, and five essay questions ranked by difficulty and style, as well as twenty written-answer questions. Each question is referenced to the appropriate section of the text to make test creation quick and easy.
PowerPoint Slides	A set of PowerPoint slides includes about thirty slides per chapter, including a chapter overview, learning objectives, slides covering all key topics and key figures and charts, and summary and conclusion slides.
LMS Integration	BVT offers basic integration with Learning Management Systems (LMSs), providing single-sign-on links (often called LTI links) from Blackboard, Canvas, Moodle, or any other LMS directly into BVT*Lab*, eBOOK^{Plus}, or the LAB BOOK platform. Gradebooks from BVT*Lab* and the LAB BOOK can be imported into most LMSs.
LMS Exam Bank Files	Exam banks are available as Blackboard files, QTI files (for Canvas), and Respondus files (for other LMSs) so they can easily be imported into a wide variety of course management systems.

➢ *Student Resources*

Student resources are available for this textbook on both the BVT*Lab* platform and the LAB BOOK platform, as described below. These resources are geared toward students needing additional assistance, as well as those seeking complete mastery of the content. The following resources are available:

Practice Questions	Students can work through hundreds of practice questions online. Questions are multiple choice or true/false in format and are graded instantly for immediate feedback.
Flashcards	**BVT***Lab* includes sets of flashcards that reinforce the key terms and concepts from each chapter.
Chapter Summaries	A convenient and concise chapter summary is available as a study aid.
PowerPoint	For a study recap, students can view all instructor PowerPoint slides online.
Additional LAB BOOK Resources	On the LAB BOOK platform, comprehension questions are sprinkled throughout each chapter of the eBook, and detailed section summaries (and case summaries) are included in the lab. Study tools such as text highlighting and margin notes are also available. These resources are not available in BVT*Lab*.

➢ BVT*Lab*

BVT*Lab* is an affordable online lab for instructors and their students. It includes an online classroom with grade book and class forum, a homework grading system, extensive test banks for quizzes and exams, and a host of student study resources.

Course Setup	**BVT***Lab* has an easy-to-use, intuitive interface that allows instructors to quickly set up their courses and grade books and to replicate them from section to section and semester to semester.
Grade Book	Using an assigned passcode, students register into their section's grade book, which automatically grades and records all homework, quizzes, and tests.
Class Forum	Instructors can post discussion threads to a class forum and then monitor and moderate student replies.
Student Resources	All student resources for this textbook are available in digital form within **BVT***Lab*. Even if a class is not taught in the lab, students who have purchased lab access can use the student resources in the lab.
eBook	BVT*Lab* includes both a webBook™ and a downloadable eBook (on the VitalSource® platform). For some product bundles, BVT's LAB BOOK can also be accessed from within BVT*Lab*, offering enhanced eBook features and study tools for students, as described below.

➢ *LAB BOOK*

LAB BOOK is a web-based eBook platform with an integrated lab providing comprehension tools and interactive student resources. Instructors can build homework and quizzes right into the eBook. LAB BOOK is either included with eBOOK^{Plus} or offered as a stand-alone product.

Course Setup	LAB BOOK uses the BVT*Lab* interface to allow instructors to set up their courses and grade books and to replicate them from section to section and semester to semester.
Grade Book	Using an assigned passcode, students register into their section's grade book, which automatically grades and records all homework, quizzes, and tests.
Advanced eBook	LAB BOOK is a mobile-friendly, web-based eBook platform designed for PCs, MACs, tablets, and smartphones. LAB BOOK allows highlighting, margin notes, and a host of other study tools.
Student Resources	All student resources for this textbook are available in the LAB BOOK, as described in the Student Resources section above.

➢ *Customization*

BVT's Custom Publishing Division can help you modify this book's content to satisfy your specific instructional needs. The following are examples of customization:

- Rearrangement of chapters to follow the order of your syllabus
- Deletion of chapters not covered in your course
- Addition of paragraphs, sections, or chapters you or your colleagues have written for this course
- Editing of the existing content, down to the word level
- Customization of the accompanying student resources and online lab
- Addition of handouts, lecture notes, syllabus, and so forth
- Incorporation of student worksheets into the textbook

All of these customizations will be professionally typeset to produce a seamless textbook of the highest quality, with an updated table of contents and index to reflect the customized content.

Acknowledgments

A considerable debt of gratitude is owed to the dedicated staff at BVT Publishing, including Jason James, Richard Schofield, Janai Escobedo, Tara Joffe, Jade Elk, Teresa Daly, Stephanie Elliott, Rhonda Minnema, and Esther Scannell. These named individuals are responsible for creating the concept for this book and working tirelessly to make that concept the reality you hold in your hands today. Their professionalism is truly peerless.

While writing a textbook is a solitary endeavor, the content explored and the approach adopted throughout this book are influenced by the valuable perspectives of former students, friends, campus colleagues, business owners and managers, attorneys, law school professors, legislators, and judges who have shared with the author over the past thirty years. In that sense, this project is most certainly a "team" effort.

That said, all omissions and errors are mine and mine alone.

Dedication

To colleagues at various stages of my career who provided needed guidance and whose sage advice I continue to treasure—Associate Vice President Sara Armstrong, Associate Vice President Herman Ellis, and Professors James Dunlavey, Susan Gardner, James Owens, Glenn Gomes, and Suzanne Zivnuska

To my wife, Sheryl, and our boys, Chris (and his wife, Rachel, and our grandchild, Taylor) and Matt—your support was crucial to the completion of this book and I am forever in your debt.

Wisdom for selected aspects of this project came from friends and family—of particular note, my sister, Janet, and my in-laws, Al and Jean Lewis.

To my mother and my father—your unwavering confidence in my abilities, regardless of whether grounded in reality, is greatly appreciated.

Welcome to *Business Law,* sixth edition!

James F. Morgan

CHAPTER 3

Court Systems

Chapter Outline

Chapter Preview

In our system of government, courts are the primary means to resolve controversies that cannot be settled by agreement of the parties involved. Litigation is the ultimate method for resolving conflict and disagreements in our society. Whether the issue is the busing of schoolchildren, the legality of abortions, the enforceability of a contract, or the liability of a wrongdoer, the dispute—if not otherwise resolved—goes to the court system for a final decision.

The basic function of the judge is to apply the law to the facts, and a jury often determines the facts. If a jury is not used, the judge is also the finder of the facts. The rule of law applied to the facts produces a decision that settles the controversy.

Three great powers of the judiciary come into play as it performs its functions of deciding cases and controversies: (1) the power of judicial review, (2) the power to interpret and apply statutes, and (3) the power to create law through precedent. The extent to which these powers are exercised varies from case to case, but all three are frequently involved.

Business Management Decision

You are president of a small business that has seven employees. One of these employees—your bookkeeper—has been called for jury duty. There is a possibility that this employee will be asked to serve on a jury that will hear a three-month-long trial.

Should you require that this employee attempt to be excused from jury service?

3.1 Operating the Court System

Numerous persons with special training and skills must operate the court system, which is highly technical. Trial court judges, reviewing court judges (or justices), and attorneys provide necessary professional expertise. Responsible citizens are required to serve as jurors if justice is to be achieved.

3.1a Trial Judges

The trial judge conducts the lawsuit. It is in the trial courts that the law is made alive and its words are given meaning. Since a trial judge is the only contact that most people have with the law, the ability of such judges is largely responsible for the effective function of the law.

The trial judge should be temperate, attentive, patient, impartial, studious, diligent, and prompt in ascertaining the facts and applying the law. This judge is the protector of constitutional limitations and guarantees of the litigants. Judges should be courteous and considerate of jurors, witnesses, and others in attendance on the court, but they should also criticize and correct unprofessional conduct of attorneys.

Judges must avoid any appearance of impropriety and should not act on a controversy in which they or their near relatives have an interest. They should not be swayed by public clamor or consideration of personal popularity, nor should they be apprehensive of unjust criticism.

3.1b Reviewing Court Judges and Justices

Members of reviewing (or appellate) courts are also called *judges*. Persons serving on final reviewing courts, such as the Supreme Court of the United States, are called *justices*. The reviewing judges and justices must be distinguished from trial court judges because their roles are substantially different. For example, a reviewing court judge or justice rarely has any contact with litigants. These judges or justices must do much more than simply decide cases—they usually give written reasons for their decisions, so that anyone may examine those decisions and comment on their merits. Each decision becomes precedent to some degree, a part of our body of law. Thus, the legal opinion of a reviewing judge or justice—unlike that of the trial judge, whose decision has direct effect only on the litigants—affects society as a whole. Reviewing judges or justices, in deciding a case, must consider not only the result between the parties involved but also the total effect of the decision on the law. In this sense, they may assume a role similar to that of a legislator.

Because of this difference in roles, the personal qualities required for a reviewing judge or justice are somewhat different from those for a trial judge. The duties of a reviewing judge or justice are in the area of legal scholarship. These individuals are required to be articulate in presenting ideas in writing and to use the written word to convey their decisions. Whereas trial judges, as a part of the trial arena, observe the witnesses and essentially use knowledge gained from their participation for their decisions, reviewing judges or justices spend hours studying briefs, the record of proceedings, and the law before preparing and handing down their decisions.

Touchstone

The Justices on the United States Supreme Court

	Position	Name	Date of Birth	Law School Attended	Appointment to Supreme Court			Prior Legal Experience (Position Held When Appointed in Bold)
					Year	President	Party of President	
1	Chief Justice	John Roberts	1955	Harvard	2005	George W. Bush	Republican	**Federal Circuit Court Judge,** Government Lawyer, Private Practice
2	Associate Justice	Anthony Kennedy	1936	Harvard	1988	Ronald Reagan	Republican	**Federal Circuit Court Judge,** Law School Professor, Private Practice
3	Associate Justice	Clarence Thomas	1948	Yale	1991	George H. W. Bush	Republican	**Federal Circuit Court Judge,** Government Lawyer, Private Practice
4	Associate Justice	Ruth Bader Ginsburg	1933	Columbia	1993	William Clinton	Democrat	**Federal Circuit Court Judge,** Law School Professor, Lawyer for Nonprofit Organization
5	Associate Justice	Steven Breyer	1938	Harvard	1994	William Clinton	Democrat	**Federal Circuit Court Judge,** Government Lawyer, Law School Professor
6	Associate Justice	Samuel Alito	1950	Yale	2006	George W. Bush	Republican	**Federal Circuit Court Judge,** Government Lawyer
7	Associate Justice	Sonia Sotomayor	1954	Yale	2009	Barack Obama	Democrat	**Federal Circuit Court Judge,** Federal Trial Court Judge, Government Attorney, Private Practice
8	Associate Justice	Elena Kagan	1960	Harvard	2010	Barack Obama	Democrat	**Government Lawyer,** Private Practice, Law School Professor and Dean
9	Associate Justice	Neil Gorsuch	1967	Harvard	2017	Donald Trump	Republican	**Federal Circuit Court Judge,** Government Attorney, Private Practice

Source: *Biographies of Current Justices of the Supreme Court,* available at https://www.supremecourt.gov/about/biographies.aspx

This table lists the nine justices sitting on the U.S. Supreme Court as of August 2017. Consider the following questions:

- What attributes or aspects of the information presented strike you as particularly interesting?
- Does it surprise you that eight of the nine were judges on a federal circuit court at the time of their elevation to the U.S. Supreme Court?
- Are you concerned that only one of the justices has ever been a trial court judge?
- Do you find it interesting that three of the nine have never practiced law with a private firm?
- Each of the nine justices graduated from one of only three law schools (Harvard, Yale, or Columbia). Moreover, the majority have their degree in law from Harvard. Would the court be better if more law schools were represented?
- Justices of the U.S. Supreme Court are appointed for life. Four of the justices currently have served at least twenty years on the Court. Does having individuals serve for such a long time strengthen the court and its image among the public?

3.1c The Jury

In Anglo-American law, the right of trial by jury, particularly in criminal cases, is traced to the famous Magna Carta issued by King John of England in 1215, which stated, "No freeman shall be taken or imprisoned or disseised or outlawed or exiled … without the judgment of his peers or by the law of the land."

In early English legal history, the juror was a witness—that is, he was called to tell what he knew, not to listen to others testify. The word *jury* comes from the French word *juré,* which means "sworn." The jury gradually developed into an institution to determine facts. The function of the jury today is to ascertain facts, just as the function of the court is to ascertain the law.

The Sixth and Seventh Amendments to the U.S. Constitution guarantee the right of trial by jury in both criminal and civil cases. The Fifth Amendment provides for indictment by a grand jury for capital offenses and infamous crimes. **Indictment** is a word used to describe the decision of the grand jury. A grand jury differs from a petit jury in that the grand jury determines whether the evidence of guilt is sufficient to warrant a trial; the petit jury determines guilt or innocence in criminal cases and decides the winner in civil cases. In civil cases, the right to trial by a jury is preserved in suits at common law when the amount in controversy exceeds $20. State constitutions have similar provisions guaranteeing the right of trial by jury in state courts.

Historically, the jury consisted of twelve persons; now, many states and some federal courts have rules of procedure that provide for smaller juries in both criminal and civil cases. As established in Case 3.1, juries consisting of as few as six persons are constitutional.

Historically, too, a jury's verdict was required to be unanimous. Today, some states authorize less-than-unanimous verdicts. If fewer than twelve persons serve on the jury, however, the verdict in criminal cases must be unanimous.

The jury system is much criticized by those who contend that many jurors are prejudiced, unqualified to distinguish fact from fiction, and easily swayed by skillful trial lawyers. However, most members of the bench and bar feel that the Sixth Amendment's "right to be tried by a jury of his peers" in criminal cases is as fair and effective a method as has been devised for ascertaining the truth and giving the accused his/her day in court.

People who are selected to serve on trial juries are drawn at random from lists of qualified voters in the county or city where the trial court sits. Most states, by statute, exempt from jury duty those who are in certain occupations and professions; however, such exemptions have been reduced or eliminated in recent years in an effort to make jury duty a responsibility of all citizens. Many persons called for jury duty attempt to avoid serving because it involves a loss of money or time away from a job; but because of the importance of jury duty, most judges are reluctant to excuse citizens who are able to serve. Indeed, citizens are encouraged to view the opportunity to serve on a jury as a privilege and obligation of being a part of our constitutional democracy.

Indictment
A grand jury's finding that it has probable cause to believe there is sufficient evidence to require that the accused be tried and that informs the accused of the offense with which he/she is charged so the accused may prepare a defense

CASE 3.1

Colgrove v. Battin

413 U.S. 149

Supreme Court of the United States (1973)

Justice Brennan Delivered the Opinion of the Court.

Local Rule 13(d)(1) of the District Court for the District of Montana provides that a jury for the trial of civil cases shall consist of six persons. When respondent District Court Judge set this diversity case for trial before a jury of six in compliance with the Rule, petitioner sought mandamus from the Court of Appeals for the Ninth Circuit to direct respondent to impanel a twelve-member jury. Petitioner contended that the local Rule (1) violated the Seventh Amendment. The Court of Appeals found no merit in these contentions, sustained the validity of Local Rule 13(d)(1).

The pertinent words of the Seventh Amendment are: "In suits at common law … the right of trial by jury shall be preserved." On its face, this language is not directed to jury characteristics, such as size, but rather

(continues)

(Case 3.1 continued)

defines the kind of cases for which jury trial is preserved, namely, "suits at common law." While it is true that "[w]e have almost no direct evidence concerning the intention of the framers of the seventh amendment itself," the historical setting in which the Seventh Amendment was adopted highlighted a controversy that was generated not by concern for preservation of jury characteristics at common law but by fear that the civil jury itself would be abolished unless protected in express words. Almost a century and a half ago, this Court recognized that "one of the strongest objections originally taken against the Constitution of the United States was the want of an express provision securing the right of trial by jury in civil cases"; but the omission of a protective clause from the Constitution was not because an effort was not made to include one. On the contrary, a proposal was made to include a provision in the Constitution to guarantee the right to trial by jury in civil cases, but the proposal failed because the States varied widely as to the cases in which civil jury trial was provided; and the proponents of a civil jury guarantee found too difficult the task of fashioning words appropriate to cover the different state practices. The strong pressures for a civil jury provision in the Bill of Rights encountered the same difficulty. Thus, it was agreed that, with no federal practice to draw on and since state practices varied so widely, any compromising language would necessarily have to be general. As a result, although the Seventh Amendment achieved the primary goal of jury trial adherents to incorporate an explicit constitutional protection of the right of trial by jury in civil cases, the right was limited in general words to "suits at common law." We can only conclude, therefore, that by referring to the "common law," the Framers of the Seventh Amendment were concerned with preserving the right of trial by jury in civil cases where it existed at common law, rather than the various incidents of trial by jury. In short, constitutional history reveals no intention on the part of the Framers "to equate the constitutional and common-law characteristics of the jury."

Consistent with the historical objective of the Seventh Amendment, our decisions have defined the jury right preserved in cases covered by the Amendment as "the substance of the common-law right of trial by jury, as distinguished from mere matters of form or procedure." The Amendment therefore does not "bind the federal courts to the exact procedural incidents or details of jury trial according to the common law in 1791" and "new devices may be used to adapt the ancient institution to present needs and to make of it an efficient instrument in the administration of justice."

Our inquiry turns then to whether a jury of 12 is of the substance of the common law right of trial by jury. Keeping in mind the purpose of the jury trial in criminal cases to prevent government oppression, and, in criminal and civil cases, to assure a fair and equitable resolution of factual issues, the question comes down to whether jury performance is a function of jury size. In *Williams,* we rejected the notion that "the reliability of the jury as a fact finder … is a function of its size," and nothing has been suggested to lead us to alter that conclusion. Accordingly, we think it can not be said that 12 members is a substantive aspect of the right of trial by jury.

There remains, however, the question of whether a jury of six satisfies the Seventh Amendment guarantee of "trial by jury." We had no difficulty reaching the conclusion in *Williams* that a jury of six would guarantee an accused the trial by jury secured by Art. III and the Sixth Amendment. Significantly, our determination that there was "no discernible difference between the results reached by the two different-sized juries," drew largely upon the results of studies of the operations of juries of six in civil cases. Since then, much has been written about the six-member jury, but nothing that persuades us to depart from the conclusion reached in *Williams*. Thus, while we express no view as to whether any number less than six would suffice, we can conclude that a jury of six satisfies the Seventh Amendment's guarantee of trial by jury in civil cases.

Affirmed.

Case Concepts for Discussion

1. What type of civil case must be tried before a jury under the language of the Seventh Amendment?
2. Why does the Supreme Court conclude that a six-person jury is as reliable as a twelve-person jury?
3. Do you think the same result would occur if the proposed jury consisted of fewer than six members?

3.2 Court Systems

3.2a The State Structure

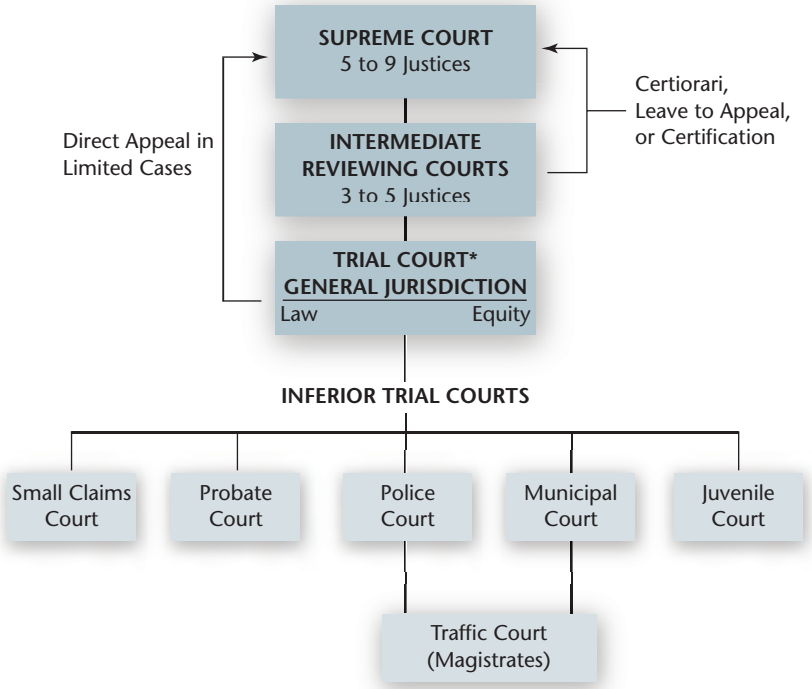
The judicial system of the United States is a dual system consisting of state courts and federal courts. Most states have three levels of court systems: *trial courts,* where litigation is begun; *intermediate reviewing courts;* and a *final reviewing court.* States use different names to describe these three levels of courts. For example, some states call their trial courts the *circuit court,* because in early times a judge rode the circuit from town to town, holding court. Other states call the trial court the *superior court* or the *district court*. New York has labeled it the *supreme court*.

Before examining these courts, it is necessary to define **jurisdiction** as it is used in the study of courts. *Jurisdiction* means the power to hear a case. Every state has courts of *general jurisdiction*; these courts have the power to hear almost any type of case. In contrast, many courts have limited powers, which means they can hear only certain types of cases and thus are said to have *limited jurisdiction*. They may be limited to the area in which the parties live, the subject matter involved, or the dollar amount in the controversy. For example, courts with jurisdiction limited to a city's residents often are called *municipal courts*.

Courts may also be named according to the subject matter with which they deal. *Probate courts* deal with wills and the estates of deceased persons; *juvenile courts,* with juvenile crime and dependent children; *municipal* and *police courts*, with violators of local ordinances; and *traffic courts*, with traffic violations. For an accurate classification of the courts of any state, the statutes of that state should be examined. Exhibit 3–1 illustrates the jurisdiction and organization of reviewing and trial courts in a typical state.

The small claims court has a limited jurisdiction based on the amount in controversy. The amount of $5,000 is a typical limit. (Shutterstock)

EXHIBIT 3–1
Typical State Court System



*Commonly called circuit court, district court, or superior court in many states

The jurisdiction of a *small claims court* is limited by the monetary amount in controversy. In recent years, these courts have assumed growing importance. In fact, popular television programs have been created out of this concept. The small claims court represents an attempt to provide a prompt and inexpensive means of settling thousands of minor disputes that often include suits by consumers against merchants for lost or damaged goods or for services poorly performed. Landlord-tenant disputes and collection suits are also quite common in small claims courts. In these courts, the usual court costs are greatly reduced. The procedures are simplified, so the services of a lawyer usually are not required.

Most of the states have authorized small claims courts and have imposed a limit on their jurisdiction. Some states keep the amount as low as $2,500 (e.g., Kentucky, Rhode Island); others are as high as $15,000 (e.g., Delaware, Georgia) or even $25,000 (Tennessee). Common limits are $5,000 (e.g., Connecticut, District of Columbia, Florida, Hawaii, Idaho, Iowa, Maryland, Missouri, New York, Vermont, Virginia, Washington, West Virginia) and $10,000 (e.g., Alaska, California, Illinois, Nevada, New Hampshire, New Mexico, North Carolina, Oregon, Texas, Utah, Wisconsin).

Jurisdiction
The court's power or authority to conduct trials and decide cases

Touchstone

Advice for Appearing as a Party in Small Claims Court

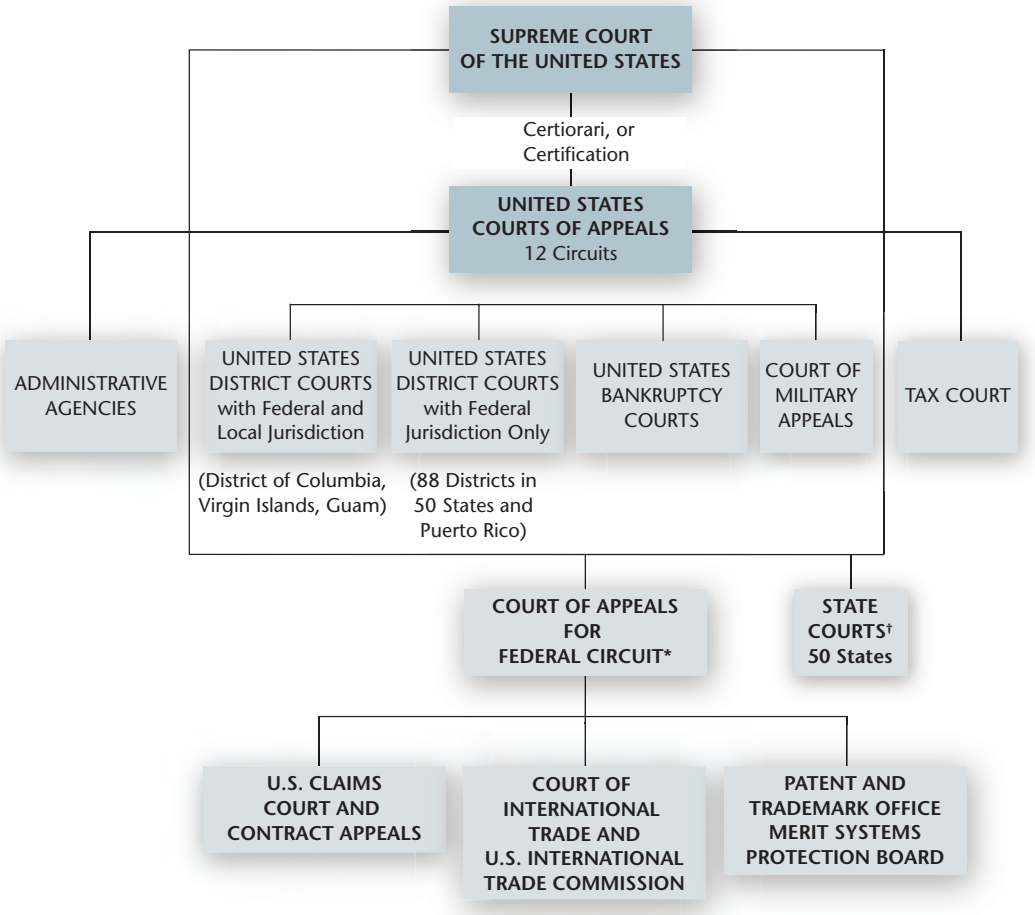
Whether it is to recover the cleaning deposit on an apartment lease or to defend oneself from a lawsuit involving damage to a car, there are many instances where we may either use the small claims court process or be drawn into that court. Businesses often use small claims court because it provides a means to litigate relatively small disputes without having to hire an attorney to represent them in court. Steve Averett, a small claims judge pro tem and law school faculty member, offers the following eight items to keep in mind if you are a party in a small claims court action:

1. You should try mediation before bringing a case to the small claims court. You need to recognize, from the start, that there are probably two sides to your case. You will remember the facts one way, and the opposing party may remember them another way. The judge will have to resolve any differences in the facts. The resolution could benefit your cause, or act to your detriment. This means there is a risk that you will not prevail in court. Mediation can help you reach a compromise that would give you something, even if it is not everything you want. It may also save court filing fees, service of process fees, and attorney fees. Most importantly, it will be a solution that you and the opposing party have made together, and, consequently, you will both have an interest in seeing it carried out.
2. Be familiar with and follow the simplified rules of procedure and evidence. These rules will let you know how to proceed with your case. They will let you know how to file, how to serve notice on the other side, what deadlines apply, how to obtain a continuance, how to present evidence, how to deal with a default judgment or dismissal, how to appeal a decision, and how to enforce a judgment.
3. Be punctual. Small claims judges usually call each case at the beginning of court to make sure all the parties are there. They will dismiss a case, usually with prejudice, if plaintiff is not there. They will rule in favor of plaintiff, by default, if defendant is not there.
4. Bring to court the witnesses and documents that will prove your case and make sure they accurately tell the facts of the case. You need these to show that you should prevail. Remember that plaintiff has the burden of proving plaintiff's case. Unless it is a default case, the judge must rule in favor of defendant unless plaintiff proves that he/she would prevail.
5. Share relevant documents with the opposing party before trial. This allows all parties to be fully prepared for court.
6. Be courteous in court. Wait until it is your turn to speak. Be polite to the other party, and avoid making gestures, sounds, and comments, while the other party is presenting his/her case. This can interrupt the other party's ability to present his/her case. It may also distract or annoy the judge. Each side should have an opportunity to present his/her evidence without interruption.
7. Present your case as concisely as possible. The court may have many trials to hear that day, so avoid sharing information that is not relevant to your case. Limit the evidence you present to things that prove (or disprove) the alleged injury or agreement and prove what is owed.
8. Accept the judgment gracefully. Avoid becoming angry when the judgment is announced. Both sides have presented their evidence, and two points of view were offered. The judge has done his/her best to analyze the evidence and the law and has made an effort to reach the right decision. If you disagree with the judgment, you have the right to appeal. If you are dissatisfied with the judgment and choose not to appeal, pay what you owe quickly and put the matter behind you.

Source: Steve Averett, "Small Claims Courts," 16 *BYU J. Pub.* L. 179 (2002). Available at http://digitalcommons.law.byu.edu/jpl/vol16/iss2/3

3.2b The Federal Structure

The U.S. Constitution created the Supreme Court and authorizes Congress to establish inferior courts from time to time. Congress has created the U.S. district courts (at least one in each state) to serve as trial courts in the federal system and to handle special subject matter, such as the Court of Appeals for the Armed Forces. Congress also has created twelve intermediate U.S. courts of appeal, plus a special U.S. Court of Appeals for the Federal Circuit. Intermediate reviewing courts are not trial courts, and their jurisdiction is limited to reviewing cases. Exhibit 3–2 illustrates the federal court system and shows the relationship of the state courts for review purposes.



*Same as other United States courts of appeal
†Certiorari

EXHIBIT 3–2
The Federal Court System

3.2c Federal District Courts

The district courts are the trial courts of the federal judicial system. They have original jurisdiction, exclusive of the courts of the states, over all federal crimes—that is, all criminal offenses against the United States. The accused is entitled to a trial by jury in the state and federal district within that state where the crime was allegedly committed.

In civil actions, the district courts have jurisdiction only when the matter in controversy is based on either *diversity of citizenship* or a *federal question*—that is, special requirements must be met to have a federal court hear a dispute. Each method of achieving federal jurisdiction is addressed in this section. As a matter of government policy, making the federal court system available only to those whose cases fit within one of these two categories means that the U.S. court structure favors disputes being brought in state—not federal—courts.

➢ *Diversity of Citizenship*

Diversity of citizenship exists in suits between citizens of different states, a citizen of a state and a citizen of a foreign country, and a state and citizens of another state. For diversity of citizenship to exist, all plaintiffs must be citizens of a state different from the state in which any one of the defendants is a citizen. This concept is known as *complete diversity* or *absolute diversity*.

Diversity of citizenship does not prevent a plaintiff from bringing suit in a state court; however, if diversity of citizenship exists, the defendant has the right to have the case *removed* to a federal court. A defendant, by having the case removed to the federal court, has an opportunity to have a jury selected from an area larger than the county where the cause arose, thus perhaps reducing the possibility of jurors tending to favor the plaintiff.

Touchstone

In Diversity of Citizenship, Which Party Has the Burden of Determining Relevant Parties?

Consider this case, decided by the U.S. Supreme Court, regarding the question of who has the burden of determining the parties to litigation for purposes of diversity of citizenship. Federal law authorizes the removal of civil actions from state court to federal court when the action initiated in state court could have been brought, originally, in federal district court. Christophe and Juanita Roche leased an apartment in Virginia managed by Lincoln Property Company. Believing that certain health problems they were experiencing were caused by exposure to toxic mold in their apartment, the Roches sued Lincoln Property, which they identified as a Texas company, and other defendants located in other states. The Roches brought the suit in Virginia state court, largely because Virginia does not permit summary judgment based solely on affidavits or deposition testimony—and because Virginia has more favorable treatment of expert witness testimony.

Lincoln Property removed the case to federal district court, citing diversity of citizenship because the parties named by the Roches were from different states. The Roches, however, stated that they had conducted further investigation and now asserted there was not diversity because Lincoln is not a Texas corporation; rather, it is a partnership with one of its partners residing in Virginia. The federal district court denied the Roches' request to send the case back to state court, finding that Lincoln was, in fact, a Texas corporation and was a party to the action. On appeal to the Fourth Circuit Court of Appeal, the court reversed the district court. Agreeing with the Roches, the court stated that Lincoln failed to show complete diversity of citizenship because it did not disprove what the Roches asserted: the existence of an affiliated Virginia entity that was a party.

The Supreme Court, however, agreed with the district court and reversed the court of appeals. Quite simply, to achieve diversity, Lincoln need only show complete diversity between named plaintiffs and named defendants in the case. Lincoln did not need to negate the existence of a potential defendant whose presence in the litigation would destroy the required diversity of citizenship. The potential liability of other parties was a matter the plaintiff's counsel could explore through discovery devices; rather, the Roches were "masters of their complaint," and therefore complete diversity existed based on the parties named in their complaint.

Source: *Lincoln Property Company, et al. v. Roche,* 546 U.S. 81 (2005).

➢ *Corporate Citizenship for Diversity Purposes*

For the purpose of suit in a federal court based on diversity of citizenship, a corporation is considered a "citizen" both of the state where it is incorporated and of the state in which it has its principal place of business. As a result, there is no federal jurisdiction in many cases in which one of the parties is a corporation. If any one of the parties on the other side of the case is a citizen of the state in which the corporation is either chartered or doing its principal business, there is no diversity of citizenship and thus no federal jurisdiction.

CASE 3.2

Hertz Corporation v. Friend

559 U.S. 77

Supreme Court of the United States (2010)

Justice Breyer Delivered the Opinion of the Court.

The federal diversity jurisdiction statute provides that "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." We seek here to resolve different interpretations that the Circuits have given this phrase. In doing so, we place primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible. And we conclude that the phrase "principal place of business" refers to the place where the corporation's high level officers direct, control, and coordinate the corporation's activities. Lower federal courts have often metaphorically called that place the corporation's "nerve center." We believe that the "nerve center" will typically be found at a corporation's headquarters.

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(Case 3.2 continued)

In September 2007, respondents Melinda Friend and John Nhieu, two California citizens, sued petitioner, the Hertz Corporation, in a California state court. They sought damages for what they claimed were violations of California's wage and hour laws. And they requested relief on behalf of a potential class composed of California citizens who had allegedly suffered similar harms.

Hertz filed a notice seeking removal to a federal court. Hertz claimed that plaintiffs and defendant were citizens of different States. Hence, the federal court possessed diversity-of-citizenship jurisdiction. Friend and Nhieu, however, claimed that the Hertz Corporation was a California citizen, like themselves, and that, hence, diversity jurisdiction was lacking. Therefore, the suit must remain in state court, not be removed to federal court.

To support its position, Hertz submitted a declaration by an employee relations manager that sought to show that Hertz's "principal place of business" was in New Jersey, not in California. The declaration stated, among other things, that Hertz operated facilities in 44 States; and that California—which had about 12 percent of the Nation's population, accounted for 273 of Hertz's 1,606 car rental locations; about 2,300 of its 11,230 full-time employees; about $811 million of its $4.371 billion in annual revenue; and about 3.8 million of its approximately 21 million annual transactions, i.e., rentals. The declaration also stated that the "leadership of Hertz and its domestic subsidiaries" is located at Hertz's "corporate headquarters" in Park Ridge, New Jersey; that its "core executive and administrative functions … are carried out" there and "to a lesser extent" in Oklahoma City, Oklahoma; and that its "major administrative operations … are found" at those two locations.

The District Court of the Northern District of California accepted Hertz's statement of the facts as undisputed. But it concluded that, given those facts, Hertz was a citizen of California. In reaching this conclusion, the court applied Ninth Circuit precedent, which instructs courts to identify a corporation's "principal place of business" by first determining the amount of a corporation's business activity State by State. If the amount of activity is "significantly larger" or "substantially predominates" in one State, then that State is the corporation's "principal place of business." If there is no such State, then the "principal place of business" is the corporation's "'nerve center,'" i.e., the place where "'the majority of its executive and administrative functions are performed.'"

Applying this test, the District Court found that the "plurality of each of the relevant business activities" was in California, and that "the differential between the amount of those activities" in California and the amount in "the next closest state" was "significant." Hence, Hertz's "principal place of business" was California, and diversity jurisdiction was thus lacking. The District Court consequently remanded the case to the state courts.

Hertz appealed the District Court's remand order. The Ninth Circuit affirmed in a brief memorandum opinion. Hertz filed a petition for certiorari. And, in light of differences among the Circuits in the application of the test for corporate citizenship, we granted the writ.

We begin our "principal place of business" discussion with a brief review of relevant history. The Constitution provides that the "judicial Power shall extend" to "Controversies … between Citizens of different States." Art. III, § 2. This language, however, does not automatically confer diversity jurisdiction upon the federal courts. Rather, it authorizes Congress to do so, and in doing so, to determine the scope of the federal courts' jurisdiction within constitutional limits.

Congress first authorized federal courts to exercise diversity jurisdiction in 1789 when, in the First Judiciary Act, Congress granted federal courts authority to hear suits "between a citizen of the State where the suit is brought, and a citizen of another State." § 11, 1 Stat. 78. The statute said nothing about corporations. In 1809, Chief Justice Marshall, writing for a unanimous Court, described a corporation as an "invisible, intangible, and artificial being" which was "certainly not a citizen." But the Court held that a corporation could invoke the federal courts' diversity jurisdiction based on a pleading that the corporation's shareholders were all citizens of a different State from the defendants, as "the term 'citizen' ought to be understood as it is used in the constitution, and as it is used in other laws. That is, to describe the real persons who come into court, in this case, under their corporate name."

In *Louisville, C. & C. R. Co. v. Letson* (1844), the Court modified this initial approach. It held that a corporation was to be deemed an artificial person of the State by which it had been created, and its citizenship for jurisdictional purposes determined accordingly. Ten years later, the Court in *Marshall v. Baltimore & Ohio R. Co.* (1854), held that the reason a corporation was a citizen of its State of incorporation was that, for the limited purpose of determining corporate citizenship, courts could conclusively (and artificially) presume that a corporation's *shareholders* were citizens of the State of incorporation. In 1928 this Court made clear that the "state of incorporation" rule was virtually absolute. It held that a corporation closely identified with State A could proceed in a federal court located in that State as long as the corporation had filed its incorporation papers in State B, perhaps a State where the corporation did no business at all.

At the same time as federal dockets increased in size, many judges began to believe those dockets contained too many diversity cases. Jurisdictions began to apply a "principal place of business" standard as a means to curtail the use of diversity jurisdiction to access the federal courts. Subsequently, in 1958, Congress both codified the courts' traditional place of incorporation test and also enacted into law a slightly modified version of the Conference Committee's proposed "principal place of business" language. A corporation was to "be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." § 2, 72 Stat. 415.

(continues)

(Case 3.2 continued)

The phrase "principal place of business" has proved more difficult to apply than its originators likely expected. If a corporation's headquarters and executive offices were in the same State in which it did most of its business, the test seemed straightforward. The "principal place of business" was located in that State.

However, suppose those corporate headquarters, including executive offices, are in one State while the corporation's plants or other centers of business activity are located in other States?

Or, consider this alternative: A corporation is a citizen both of the State of its incorporation and any State from which it received more than half of its gross income. If, for example, a citizen of California sued (under state law in state court) a corporation that received half or more of its gross income from California, that corporation would not be able to remove the case to federal court, even if Delaware was its State of incorporation.

Perhaps because corporations come in many different forms, involve many different kinds of business activities, and locate offices and plants for different reasons in different ways in different regions, a general "business activities" approach has proved unusually difficult to apply. Courts must decide which factors are more important than others—for example, plant location, sales or servicing centers, transactions, payrolls, or revenue generation.

In an effort to find a single, more uniform interpretation of the statutory phrase, we have reviewed the Courts of Appeals' divergent and increasingly complex interpretations. We conclude that "principal place of business" is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's activities. It is the place that Courts of Appeals have called the corporation's "nerve center." In practice it should normally be the place where the corporation maintains its headquarters—provided that the headquarters is the actual center of direction, control, and coordination, *i.e.,* the "nerve center," and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion).

Three sets of considerations, taken together, convince us that this approach, while imperfect, is superior to other possibilities. First, the statute's language supports the approach. The statute's text deems a corporation a citizen of the "State where it has its principal place of business." 28 U.S.C. § 1332(c)(1). The word "place" is in the singular, not the plural. The word "principal" requires us to pick out the "main, prominent" or "leading" place. And the fact that the word "place" follows the words "State where" means that the "place" is a place *within* a State. It is not the State itself.

A corporation's "nerve center," usually its main headquarters, is a single place. The public often (although not always) considers it the corporation's main place of business, and it is a place within a State. By contrast, the application of a more general business activities test has led some courts, as in the present case, to look, not at a particular place within a State, but incorrectly at the State itself—measuring the total amount of business activities that the corporation conducts there and determining whether they are "significantly larger" than in the next-ranking State. This approach invites greater litigation and can lead to strange results, as the Ninth Circuit has since recognized. Namely, if a "corporation may be deemed a citizen of California on th[e] basis" of "activities [that] roughly reflect California's larger population … nearly every national retailer—no matter how far flung its operations—will be deemed a citizen of California for diversity purposes." But why award or decline diversity jurisdiction on the basis of a State's population—whether measured directly, indirectly (say proportionately), or with modifications?

Second, administrative simplicity is a major virtue in a jurisdictional statute. Complex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but rather which court is the right court to decide those claims. Complex tests produce appeals and reversals, encourage gamesmanship, and diminish, again, the likelihood that results and settlements will reflect a claim's legal and factual merits. Judicial resources, also, are at stake. Thus, courts benefit from straightforward rules under which they can readily assure themselves of their power to hear a case.

Simple jurisdictional rules also promote greater predictability. Predictability is valuable to corporations making business and investment decisions. Predictability also benefits plaintiffs in deciding whether to file suit in a state or federal court. A "nerve center" approach, which ordinarily equates that "center" with a corporation's headquarters, is simple to apply *comparatively speaking*. The metaphor of a corporate "brain," while not precise, suggests a single location. By contrast, a corporation's general business activities more often lack a single principal place where they take place. That is to say, the corporation may have several plants, many sales locations, and employees located in many different places. If so, it will not be as easy to determine which of these different business locales is the "principal" or most important "place."

We recognize that there may be no perfect test that satisfies all administrative and purposive criteria. We recognize as well that, under the "nerve center" test we adopt today, there will be hard cases. For example, in this era of telecommuting, some corporations may divide their command and coordinating functions among officers who work at several different locations, perhaps communicating over the Internet. That said, our test points courts in a single direction, nonetheless, toward the center of overall direction, control, and coordination. Courts do not have to try to weigh corporate functions, assets, or revenues different in kind, one from the other. Our approach provides a sensible test that is relatively easier to apply, not a test that will, in all instances, automatically generate a result.

(continues)

(Case 3.2 continued)

We also recognize that the use of a "nerve center" test may in some cases produce results that seem to cut against the basic rationale for the statute. For example, if the bulk of a company's business activities visible to the public take place in New Jersey, while its top officers direct those activities just across the river in New York, the "principal place of business" is New York. One could argue that members of the public in New Jersey would be *less* likely to be prejudiced against the corporation than persons in New York—yet the corporation will still be entitled to remove a New Jersey state case to federal court. Note, also, that the same corporation would be unable to remove a New York state case to federal court, despite the New York public's presumed prejudice against the corporation.

We understand that such seeming anomalies will arise. However, in view of the necessity of having a clearer rule, we must accept them. Accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex, jurisdictional administration while producing the benefits that accompany a more uniform legal system.

Petitioner's unchallenged declaration suggests that Hertz's center of direction, control, and coordination, its "nerve center," and its corporate headquarters are one and the same—and they are located in New Jersey, not in California. Because respondents should have a fair opportunity to litigate their case in light of our holding, however, we vacate the Ninth Circuit's judgment and remand the case for further proceedings consistent with this opinion.

Case Concepts for Discussion

1. Corporations defending employment-related lawsuits in state courts often view the state courts as "home" venues to employees and former employees who sue. Does this case make it easier or harder for corporate employers to avoid defending such lawsuits in state court and remove them to the federal court system? Why?
2. In determining "principal place of business," what does the Court indicate a lower federal court judge should consider?
3. Explain the two rationales the Court offered to support its explanation of "principal place of business."

Jurisdictional Amount for Diversity Purposes

If diversity of citizenship is the basis of federal jurisdiction, the parties must satisfy a *jurisdictional amount,* which is $75,000. If a case involves multiple plaintiffs with separate and distinct claims, each claim must satisfy the jurisdictional amount. Thus, in a class-action suit, the claim of each plaintiff must exceed the $75,000 minimum unless changed by statute.

➢ *Federal Question*

In addition to diversity of citizenship, where the U.S. Constitution, federal laws, or treaties of the United States are the basis for the litigation, the federal courts are available to resolve the dispute. There is *no jurisdictional amount.* These civil actions may involve matters such as antitrust, securities regulations, rights guaranteed by the Bill of Rights, and rights secured to individual citizens by the Fourteenth Amendment. In addition, the district courts have original jurisdiction, by statute, to try tort cases involving citizens who suffer damages caused by officers or agents of the federal government.

TABLE 3–1 Usage Requirements of the Federal Court System

Type of Federal Basis for Subject-Matter Jurisdiction	Essence	Minimum Dollar Requirement	Law Applicable
Diversity of citizenship	Cases brought between citizens of different states or between a citizen of one state and a citizen of a foreign country.	$75,000	For controversies involving citizens of different states, the law of one state will apply. If one party is from another country, then the law of that country or of a state will apply.
Federal question	Cases arising under the U.S. Constitution, treaties, federal statutes, and administrative regulations.	None	Federal law

3.2d The Law in Federal Courts

The dual system of federal and state courts in the United States creates a unique problem in the area of conflict of laws. Over time, certain rules have been developed to provide guidance. First, federal courts use their own body of procedural law; they will never employ procedural law of a specific state. Next, in federal question cases (i.e., cases brought to the federal courts system that involve the U.S. Constitution, treaties, and federal statutes) federal substantive law is used. There is no body of federal common law in suits based on diversity of citizenship. *Therefore, federal courts use the substantive law, including conflict of laws principles, of the state in which they are sitting.* Thus, just as the state courts are bound by federal precedent in cases involving federal law and federally protected rights, federal courts are bound by state precedent in diversity of citizenship cases. Thus, a federal judge sitting in a case brought under diversity of citizenship is bound to use the law of a state to reach a proper judgment. Therefore, if a party from New York sues a party from Florida in Florida *state court*, state law (not federal law) will apply. Similarly, if a party from New York sues a party from Florida in *federal court*, state law (not federal law) applies. In this way, the parties are assured that state law will apply, regardless of whether the federal court system is employed in diversity of citizenship cases. Case 3.3 established this very important principle.

CASE 3.3

Erie Railroad v. Tompkins

304 U.S. 64

Supreme Court of the United States (1938)

Justice Brandeis Delivered the Opinion of the Court.

Tompkins, a citizen of Pennsylvania, was injured on a dark night by a passing freight train of the Erie Railroad Company while walking along its right of way at Hughestown in that state. He claimed the accident occurred through negligence in the operation, or maintenance, of the train; that he was rightfully on the premises as a licensee because he was on a commonly used beaten footpath which ran for a short distance alongside the tracks; and that he was struck by something which looked like a door projecting from one of the moving cars. To enforce that claim he brought an action in the federal court for Southern New York, which has jurisdiction because the company is a corporation of that state. It denied liability; and the case was tried by a jury.

The Erie insisted that its duty to Tompkins was no greater than that owed to a trespasser. It contended, among other things, that its duty to Tompkins, and hence its liability, should be determined in accordance with the Pennsylvania law; that under the law of Pennsylvania, as declared by its highest court, persons who use pathways along the railroad right of way—that is, a longitudinal pathway as distinguished from a crossing—are to be deemed trespassers; and that the railroad is not liable for injuries to undiscovered trespassers resulting from its negligence, unless it be wanton or willful. Tompkins contended that railroad's duty and liability is to be determined in federal courts as a matter of general law … .

The trial judge refused to rule that the applicable law precluded recovery. The jury brought in a verdict of $30,000; and the judgment entered thereon was affirmed by the Circuit Court of Appeals, which held that the question was one not of local but of general law and that upon questions of general law the federal courts are free, in absence of a local statute, to exercise their independent judgment as to what the law is; and it is well settled that the question of the responsibility of a railroad for injuries caused by its servants is one of general law …

The Erie had contended that application of the Pennsylvania rule was required, among other things, by section 34 of the Federal Judiciary Act which provides: "The laws of the several States, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply."

Because of the importance of the question whether the federal court was free to disregard the alleged rule of the Pennsylvania common law, we granted certiorari.

First, *Swift v. Tyson* held that federal courts exercising jurisdiction on the ground of diversity of citizenship need not, in matters of general jurisprudence, apply the unwritten law of the state as declared by its highest court; and they are free to exercise an independent judgment as to what the common law of the state is—or should be.

Doubt was repeatedly expressed as to the correctness of the construction given section 34, and as to the soundness of the rule which it introduced. However, it was the more recent research of a competent scholar, who examined the original document, which established that the construction given to it by the Court was erroneous.

(continues)

(Case 3.3 continued)

Second, experience in applying the doctrine of *Swift v. Tyson* had revealed its defects, political and social; and the benefits expected to flow from the rule did not accrue.

On the other hand, the mischievous results of the doctrine had become apparent. Diversity of citizenship jurisdiction was conferred in order to prevent apprehended discrimination in state courts against those not citizens of the state. *Swift v. Tyson* introduced grave discrimination by noncitizens against citizens. It made rights enjoyed under the unwritten "general law" vary according to whether enforcement was sought in the state or in the federal court; and the privilege of selecting the court in which the right should be determined was conferred upon the noncitizen. Thus, the doctrine rendered impossible equal protection of the law. In attempting to promote uniformity of law throughout the United States, the doctrine had prevented uniformity in the administration of the law of the state.

Thirdly, except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state, and whether the law of the state shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they are local in their nature or "general," whether they are commercial law or a part of the law of torts. There is no clause in the Constitution that purports to confer such a power upon the federal courts.

Thus the doctrine of *Swift v. Tyson* is, as Mr. Justice Holmes said, "an unconstitutional assumption of powers by the Courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct." In disapproving that doctrine we do not hold unconstitutional section 34 of the Federal Judiciary Act of 1789 or any other act of Congress. We merely declare that in applying the doctrine this Court and the lower courts have invaded rights that, in our opinion, are reserved by the Constitution to the several states.

Reversed and remanded.

Case Concepts for Discussion

1. Why was Tompkins able to file this lawsuit in a federal district court?
2. Why did Tompkins argue that the federal common law should apply in this case?
3. How does the Supreme Court's decision provide for the same outcome of the litigation, regardless of the court system in which the case is filed?

3.2e Federal Reviewing Courts

As previously noted, there generally are two levels of federal reviewing courts. Cases decided in the federal district courts are reviewed by the appropriate courts of appeals. In most cases, the decisions of the courts of appeals are final. There are thirteen federal courts of appeal. Eleven of these courts hear appeals from district courts located in individual states; the Court of Appeals for the D.C. Circuit hears appeals from the district court located in the District of Columbia. The final court of appeals has a unique purpose. The Court of Appeals for the Thirteenth Circuit, more commonly called the Federal Circuit, hears cases where the federal government is a defendant and in cases involving certain types of disputes (e.g., appeals involving patents). Exhibit 3–3 depicts the geographic boundaries of the U.S. Courts of Appeals and district courts.

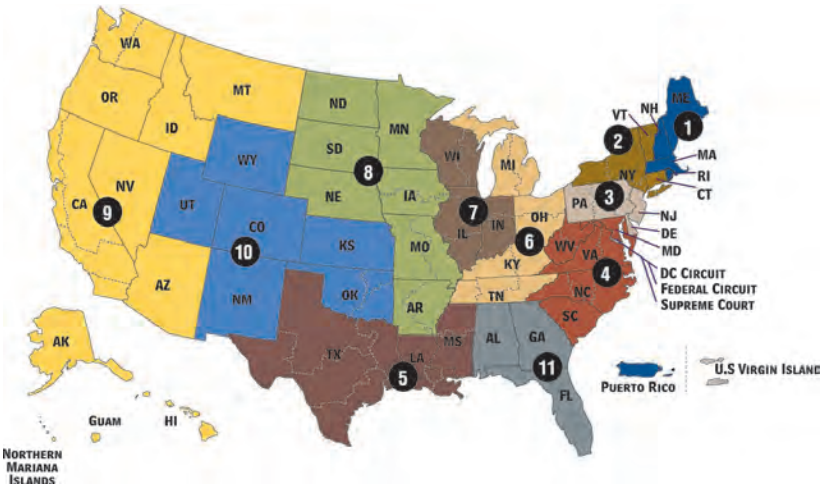

EXHIBIT 3–3
Geographic Boundaries of U.S. Courts of Appeals and U.S. District Courts

Source: http://www.uscourts.gov/uscourts/images/CircuitMap.pdf

The U.S. Supreme Court *may* review cases from the courts of appeals if the Supreme Court, upon a petition of any party, grants a **writ of certiorari** before or after a decision in the courts of appeals. The Supreme Court also has the ability to hear a case decided by the highest state court as long as the case involves a federal question. The granting of a writ of certiorari to review is within the discretion of the Supreme Court. Only four of the nine justices need to vote in favor of granting a writ of certiorari for the Court to review the merits of a case. This is called the Rule of Four. Generally, the writ will be granted only to bring cases of significant public concern to the court of last resort for decision.

The justices of the U.S. Supreme Court decide which issues are brought before the Court. (Wikimedia/Franz Jantzen, Collection of the Supreme Court of the United States)

Prior to 1988, the Supreme Court was required to review certain cases. This mandatory or obligatory jurisdiction extended to certain cases heard by three judges at the district court level and to certain state supreme court decisions involving constitutional issues. This mandatory jurisdiction was eliminated almost entirely in 1988 to grant the U.S. Supreme Court the total power to control its docket. Today, the justices of the U.S. Supreme Court themselves determine which issues they will allow to be brought before the Court.

Decisions of state courts that could formerly be appealed as a matter of right are now subject to the discretion of the certiorari process. This relieves the Supreme Court of any obligation to review the merits of inconsequential federal challenges to state laws. If there is a significant federal issue of paramount importance, the court may, of course, hear the case.

The 1988 law also transferred most appeals from the Supreme Court to the courts of appeals. However, federal statutes still do authorize a few direct appeals to the Supreme Court. For example, the Antitrust Procedures and Penalties Act of 1974 authorizes a direct appeal to the Supreme Court in civil antitrust cases brought by the government seeking equitable relief where immediate Supreme Court review is found by the trial judge to be "of general public importance in the administration of justice." However, the Supreme Court may decide in its discretion to "deny the direct appeal and remand the case to the court of appeals." These few statutory kinds of Supreme Court obligatory jurisdiction contribute very little to the Court's workload.

Writ of certiorari
The legal document used within the discretion of a reviewing court to decide whether to hear a case, thereby agreeing to review a lower court's decision

As a virtually all-certiorari court, the Supreme Court will review annually more than five thousand petitions for a writ of certiorari. It can be expected to grant fewer than 150 each year. As Table 3–2 reveals, for the October term of 2016, the Supreme Court granted certiorari in seventy-one cases, with fifty-one of those coming from the courts of appeals. The presentation also depicts, among other items, the percentage of cases reversed based on the originating circuit court.

TABLE 3–2 Certiorari Petitions Granted and Resolution by Supreme Court, 2016 October Term

Court	Number of Granted Certiorari	% Total	Number affirmed	Number Reversed	% Affirmed	% Reversed
State Court	17	24%	3	14	18%	82%
Ninth Circuit	8	11%	1	7	13%	87%
Federal Circuit	7	10%	1	6	14%	86%
Sixth Circuit	7	10%	1	6	14%	86%
Eleventh Circuit	5	7%	2	3	40%	60%
Second Circuit	5	7%	1	4	20%	80%
Fifth Circuit	4	6%	2	2	50%	50%
District Court	3	4%	1	2	33%	67%
District of Columbia	3	4%	1	2	33%	67%
Tenth Circuit	3	4%	0	3	0%	100%
Eighth Circuit	2	3%	0	2	0%	100%
Seventh Circuit	2	3%	0	2	0%	100%
Fourth Circuit	2	3%	1	1	50%	50%
Third Circuit	2	3%	0	2	0%	100%
First Circuit	1	1%	1	0	100%	0%
Total	71	100%	15	56	21%	79%

Data source: Kedar Bhatia, "Final Stat Pack for October Term 2016 and Key Takeaways," SCOTUSblog (June 28, 2017), http://www.scotusblog.com/wp-content/uploads/2017/06/SB_scorecard_20170628.pdf

3.3 Law and Equity

3.3a Basic Distinction

Historically, trial courts in the United States have been divided into two parts—a court of law and a court of equity or chancery. The term *equity* arose in England because the failure of **legal remedies** to provide adequate relief often made it impossible to obtain justice in the king's courts of law. *The only remedy at law was a suit for money damages.*

In order that justice might be done, the person sought **equitable remedies** from the king in person. Because the appeal was to the king's conscience, he referred such matters to his spiritual adviser, the chancellor, who was usually a church official, who, in giving a remedy, would usually favor the ecclesiastical law.

By such a method, there developed a separate system of procedure and different rules for deciding matters presented to the chancellor. Suits involving these rules were said to be brought *in chancery* or *in equity*, in contrast to suits *at law* in the king's courts. Courts of equity were courts of conscience, and they recognized many rights that were not recognized by common-law courts. For example, trusts in lands were recognized, rescission was allowed on contracts created through fraud, and injunction and specific performance were developed as remedies.

In a few states, courts of equity are still separate and distinct from courts of law. In most states, the equity and law courts are organized under a single court with two dockets—one at law, the other in equity. The remedy desired determines whether the case is in equity or at law. Modern civil-procedure laws usually have abolished the distinction between actions at law and in equity. However, pleadings usually must denote whether the action is legal or equitable because, as a general rule, there is no right to a jury trial of an equitable action. The constitutional guarantee to a trial by jury applies only to actions at law.

3.3b Equitable Procedures

By statute, in some states, a jury may hear the evidence in equity cases; however, the determination of the jury in these cases is usually advisory only and is not binding on the court. The judge passes on questions of both law and fact and may decide the case based on the pleadings without the introduction of oral testimony. If the facts are voluminous and complicated, the judge may refer the case to an attorney-at-law, usually called a *master in chancery,* to take the testimony. The master in chancery hears the evidence, makes findings of fact and conclusions of law, and reports back to the judge.

Courts of equity use maxims instead of strict rules of law to decide cases. There are no legal rights in equity, for the decision is based on moral rights and natural justice. Some of the typical maxims of equity are as follows:

- Equity will not suffer a right to exist without a remedy.
- Equity regards as done that which ought to be done.
- Where there is equal equity and law, the law must prevail.
- Those who come into equity must do so with clean hands.
- Those who seek equity must do equity.
- Equity aids the vigilant.
- Equality is equity.

These maxims guide the chancellor in exercising discretion. For example, the clean-hands doctrine prohibits a party who is guilty of misconduct in the matter in litigation from receiving the aid of a court. Likewise, a court of equity may protect one party if the other party does not act in good faith.

Legal remedies
Relief sought from a court, involving monetary damages

Equitable remedies
Any form of relief that does not involve a request for monetary damages

The decision of the court of equity is called a **decree**. A judgment in a court of law is measured in damages, whereas a decree of a court of equity is said to be *in personam*—that is, it is directed to the defendant personally, who is to do or not to do some specific thing.

Decrees are either final or interlocutory. A decree is final when it disposes of the issues of the case, reserving no question to be decided in the future. A decree establishing title to real estate, granting a divorce, or ordering specific performance is usually final. A decree is *interlocutory* when it reserves some question to be determined in the future. A decree granting a temporary injunction, appointing a receiver, or ordering property to be delivered to such a receiver would be interlocutory.

Decree
The decision of the chancellor (judge) in a suit in equity that, like a judgment at law, is the determination of the rights between the parties

Failure on the part of the defendant to obey a decree of a court of equity is contempt of court because the decree is directed not against his/her property but against his/her person. Any person in contempt of court may be placed in jail or fined by order of the court.

Equity jurisprudence plays an ever-increasing role in our legal system. The movement toward social justice requires more reliance on the equitable maxims and less reliance on rigid rules of law.

Chapter Summary: Court Systems

Operating the Court System

Trial Judges

1. Judges conduct the trial. They decide questions of procedure and instruct the jury on the law applicable to the issues to be decided by the jury.
2. Judges supply the law applicable to the facts.
3. Judges find the facts if there is no jury.

Reviewing Court Judges and Justices

1. Judges of intermediate reviewing courts and justices of final reviewing courts decide cases on appeal. The questions to be decided are questions of law.
2. Reviewing courts require more legal scholarship of the reviewing judges and justices than that typically required of the trial judges.

The Jury

1. The jury function is to decide disputed questions of fact.
2. A jury may consist of as few as six persons.
3. Less-than-unanimous verdicts are possible with twelve-person juries.
4. Excuses from jury duty are more difficult to obtain today.

Court Systems

The State Structure

1. Each state has a trial court of general jurisdiction and inferior courts of limited jurisdiction.
2. The small claims court is of growing importance because it provides a means of handling small cases without the need for a lawyer.
3. Historically, trial courts were divided into courts of law and courts of equity or chancery.

The Federal Structure

1. The U.S. Constitution created the U.S. Supreme Court.
2. Congress has created thirteen courts of appeals and at least one district court in each state.

Federal District Courts

1. Federal courts have limited jurisdiction. They hear cases based on federal laws (federal question cases) and cases involving diversity of citizenship.
2. Diversity of citizenship cases have a jurisdictional minimum of more than $75,000.
3. For diversity of citizenship purposes, a corporation is a citizen of two states—the state of incorporation and the state of its principal place of business.

The Law in Federal Courts

1. Federal courts use the rules of federal procedure.
2. Federal question cases are decided using federal substantive law.
3. A federal court in a diversity of citizenship case uses the substantive law of the state in which it sits to decide such a case.

Federal Reviewing Courts

1. The decisions of courts of appeals are usually final.
2. Most cases in the U.S. Supreme Court are there as the result of granting a petition for a writ of certiorari.

Law and Equity

Basic Distinction

1. Historically, courts of law handled cases involving claims for money damages.
2. Courts of equity or chancery were created where the remedy at law (money damages) was inadequate—for example, suits seeking an injunction or dissolution of a business.

Equitable Procedures

1. There is usually no right to a trial by jury.
2. Sometimes a special appointee, known as a master in chancery, assists with the fact-finding.
3. The decision of a court of equity is called a decree.
4. A person may be jailed for violating a decree.
5. Courts of equity use maxims instead of rules of law to decide cases.
6. Use of maxims allows courts to achieve justice.

Review Questions and Problems

1. Why are some controversies excluded from the court system? Give examples of such issues.
2. Why were small claims courts created? Give three examples of typical cases decided in such courts.
3. Jane deposited $400 with her landlord to secure a lease and to pay for any damages to an apartment that she had rented. At the end of the lease, she vacated the apartment and requested the return of the deposit. Although the landlord admitted that the apartment was in good shape, the landlord refused to return the deposit. What should Jane do? Explain.
4. Henry, a resident of Nevada, sued Adam, a resident of Utah, in the federal court in California. He sought $60,000 damages for personal injuries arising from an automobile accident that occurred in Los Angeles, California.
   a. Does the federal court have jurisdiction? Why or why not?
   b. What rules of procedure will the court use? Why?
   c. What rules of substantive law will the court use? Why?
5. For diversity of citizenship purposes, a corporation is a citizen of two states. How do you identify these states?
6. Paul, a citizen of Georgia, was crossing a street in New Orleans, Louisiana, when a car driven by David, a citizen of Texas, struck him. David's employer, a Delaware corporation that has its principal place of business in Atlanta, Georgia, owned the car. Paul sues both David and the corporation in the federal district court in New Orleans. Paul's complaint alleges damages in the amount of $100,000. Does this court have jurisdiction? Why?
7. What is the function of a petition for a writ of certiorari? Explain.
8. John sues Ivan in a state court, seeking damages for breach of contract to sell a tennis racquet. The trial court finds for Ivan. John announces that he will appeal "all the way to the Supreme Court of the United States, if necessary, to change the decision." Assuming that John has the money to do so, will he be able to obtain review by the U.S. Supreme Court? Explain.
9. Describe three controversies that would be decided in a court of equity or chancery in states that still distinguish between courts of law and courts of equity.
10. Mario agreed to sell his house to George, but he later changed his mind. George sued Mario for specific performance. Is either party entitled to a jury trial? Why or why not?