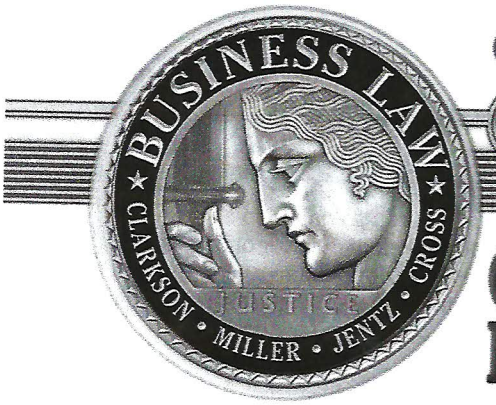


CHAPTER 2

Courts and Alternative Dispute Resolution

Today in the United States there are fifty-two court systems—one for each of the fifty states, one for the District of Columbia, and a federal system. Keep in mind that the federal courts are not superior to the state courts; they are simply an independent system of courts, which derives its authority from Article III, Section 2, of the U.S. Constitution. By the power given to it under Article I of the U.S. Constitution, Congress has extended the federal court system beyond the boundaries of the United States to U.S. territories such as Guam, Puerto Rico, and the Virgin Islands.[1] As we shall see, the United States Supreme Court is the final controlling voice over all of these fifty-two systems, at least when questions of federal law are involved.

Every businessperson will likely face a lawsuit at some time in his or her career. Thus, anyone involved in business needs to have an understanding of the American court systems, as well as the various methods of dispute resolution that can be pursued outside the courts. In this chapter, after examining the judiciary's role in the American governmental system, we discuss some basic requirements that must be met before a party may bring a lawsuit before a particular court. We then look at the court systems of the United States in some detail. We conclude the chapter with an overview of some alternative methods of settling disputes, including online dispute resolution.

1. In Guam and the Virgin Islands, territorial courts serve as both federal courts and state courts; in Puerto Rico, they serve only as federal courts.

The Judiciary's Role in American Government

As you learned in Chapter 1, the body of American law includes the federal and state constitutions, statutes passed by legislative bodies, administrative law, and the case decisions and legal principles that form the common law. These laws would be meaningless, however, without the courts to interpret and apply them. This is the essential role of the judiciary—the courts—in the American governmental system: to interpret the laws and apply them to specific situations.

As the branch of government entrusted with interpreting the laws, the judiciary can decide, among other things, whether the laws or actions of the other two branches are constitutional. The process for making such a determination is known as **judicial review.** The power of judicial review enables the judicial branch to act as a check on the other two branches of government, in line with the system of checks and balances established by the U.S. Constitution.[2]

The power of judicial review is not mentioned in the Constitution (although many constitutional scholars conclude that the founders intended the judiciary to have this power). Rather, this power was explicitly established by the United States Supreme Court in 1803 by its decision in *Marbury v. Madison,*[3] in which the Supreme Court stated, "It is emphatically the province and duty of the Judicial Department to say

2. In a broad sense, judicial review occurs whenever a court "reviews" a case or legal proceeding—as when an appellate court reviews a lower court's decision. When referring to the judiciary's role in American government, however, the term *judicial review* is used to indicate the power of the judiciary to decide whether the actions of the other two branches of government do or do not violate the U.S. Constitution.

3. 5 U.S. (1 Cranch) 137, 2 L.Ed. 60 (1803).

what the law is. . . . If two laws conflict with each other, the courts must decide on the operation of each. . . . So if the law be in opposition to the Constitution . . . [t]he Court must determine which of these conflicting rules governs the case. This is the very essence of judicial duty." Since the *Marbury v. Madison* decision, the power of judicial review has remained unchallenged. Today, this power is exercised by both federal and state courts.

Basic Judicial Requirements

Before a lawsuit can be brought before a court, certain requirements must be met. These requirements relate to jurisdiction, venue, and standing to sue. We examine each of these important concepts here.

Jurisdiction

In Latin, *juris* means "law," and *diction* means "to speak." Thus, "the power to speak the law" is the literal meaning of the term **jurisdiction.** Before any court can hear a case, it must have jurisdiction over the person (or company) against whom the suit is brought (the defendant) or over the property involved in the suit. The court must also have jurisdiction over the subject matter of the dispute.

Jurisdiction over Persons or Property Generally, a particular court can exercise ***in personam* jurisdiction** (personal jurisdiction) over any person or business that resides in a certain geographic area. A state trial court, for example, normally has jurisdictional authority over residents (including businesses) of a particular area of the state, such as a county or district. A state's highest court (often called the state supreme court)[4] has jurisdictional authority over all residents within the state.

A court can also exercise jurisdiction over property that is located within its boundaries. This kind of jurisdiction is known as ***in rem* jurisdiction,** or "jurisdiction over the thing." For example, suppose that a dispute arises over the ownership of a boat in dry dock in Fort Lauderdale, Florida. The boat is owned by an Ohio resident, over whom a Florida court normally cannot exercise personal jurisdiction. The other party to the dispute is a resident of Nebraska. In this situation, a lawsuit concerning the boat could be brought in a Florida state court on the basis of the court's *in rem* jurisdiction.

Long Arm Statutes. Under the authority of a state **long arm statute,** a court can exercise personal jurisdiction over certain out-of-state defendants based on activities that took place within the state. Before a court can exercise jurisdiction over an out-of-state defendant under a long arm statute, though, it must be demonstrated that the defendant had sufficient contacts, or *minimum contacts*, with the state to justify the jurisdiction.[5] Generally, this means that the defendant must have enough of a connection to the state for the judge to conclude that it is fair for the state to exercise power over the defendant. For example, if an out-of-state defendant caused an automobile accident or sold defective goods within the state, a court will usually find that minimum contacts exist to exercise jurisdiction over that defendant. Similarly, a state may exercise personal jurisdiction over a nonresident defendant who is sued for breaching a contract that was formed within the state.

Corporate Contacts. Because corporations are considered legal persons, courts use the same principles to determine whether it is fair to exercise jurisdiction over a corporation.[6] A corporation normally is subject to personal jurisdiction in the state in which it is incorporated, has its principal office, and is doing business. Courts apply the minimum-contacts test to determine if they can exercise jurisdiction over out-of-state corporations.

The minimum-contacts requirement is usually met if the corporation advertises or sells its products within the state, or places its goods into the "stream of commerce" with the intent that the goods be sold in the state. For example, suppose that a business is incorporated under the laws of Maine but has a branch office and manufacturing plant in Georgia. The corporation also advertises and sells its products in Georgia. These activities would likely constitute sufficient contacts

4. As will be discussed shortly, a state's highest court is often referred to as the state supreme court, but there are exceptions. For example, in New York the supreme court is a trial court.

5. The minimum-contacts standard was first established in *International Shoe Co. v. State of Washington*, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945).

6. In the eyes of the law, corporations are "legal persons"—entities that can sue and be sued. See Chapter 38.

with the state of Georgia to allow a Georgia court to exercise jurisdiction over the corporation.

Some corporations, however, do not sell or advertise products or place any goods in the stream of commerce. Determining what constitutes minimum contacts in these situations can be more difficult, as the following case—involving a resort hotel in Mexico and a hotel guest from New Jersey—illustrates.

CASE 2.1 Mastondrea v. Occidental Hotels Management S.A.

Superior Court of New Jersey, Appellate Division, 2007. 391 N.J.Super. 261, 918 A.2d 27.
lawlibrary.rutgers.edu/search.shtml[a]

Background and Facts Libgo Travel, Inc., in Ramsey, New Jersey, with Allegro Resorts Management Corporation (ARMC), a marketing agency in Miami, Florida, placed an ad in the *Newark Star Ledger,* a newspaper in Newark, New Jersey, to tout vacation packages for accommodations at the Royal Hideaway Playacar, an all-inclusive resort hotel in Quintana Roo, Mexico. ARMC is part of Occidental Hotels Management, B.V., a Netherlands corporation that owns the hotel with Occidental Hoteles Management S.A., a Spanish company. In response to the ad, Amanda Mastondrea, a New Jersey resident, bought one of the packages through Liberty Travel, a chain of travel agencies in the eastern United States that Libgo owns and operates. On June 16, 2003, at the resort, Mastondrea slipped and fell on a wet staircase, breaking her ankle. She filed a suit in a New Jersey state court against the hotel, its owners, and others, alleging negligence. The defendants asked the court to dismiss the suit on the ground that it did not have personal jurisdiction over them. The court ruled in part that it had jurisdiction over the hotel. The hotel appealed this ruling to a state intermediate appellate court.

IN THE LANGUAGE OF THE COURT

***PAYNE,* J.A.D. [Judge, Appellate Division]**

* * * *

It is unquestionably true that the Hotel has no direct presence in New Jersey. * * * [T]he Hotel's operations are located in Quintana Roo, Mexico. The Hotel is not registered, licensed or otherwise authorized to do business in New Jersey. It has no registered agent in this state for service of process, and it pays no state taxes. The Hotel maintains no business address here, it has never owned property or maintained any bank accounts in this state, and it has no employees in New Jersey.

However, * * * "Tour Operator Agreements" between the Hotel and Libgo * * * provide that the Hotel will allot a specific number of rooms at its resort to Libgo at agreed-upon rates. Libgo, as "tour operator," is then authorized by the Hotel to book those rooms on behalf of Libgo's customers. Pursuant to the contract, Libgo is required to provide the Hotel with weekly sales reports listing the number of rooms booked by Libgo and the rates at which those rooms were booked. It must also confirm all reservations in a writing sent to the Hotel.

Courts have generally sustained the exercise of personal jurisdiction over a defendant who, as a party to a contract, has had some connection with the forum state [the state in which the lawsuit is filed] or who should have anticipated that his conduct would have significant effects in that state. Here, the Hotel entered into a contract with a New Jersey entity, Libgo, which agreed to solicit business for the Hotel and derived a profit from that solicitation through sales of vacation packages. Although Libgo's business extends beyond New Jersey and throughout much of the East Coast, at least part of its customer base resides in this state. Likewise, as a result of this contract, the Hotel purposefully and successfully sought vacationers from New Jersey, and it derived a profit from them. Therefore, the Hotel should have reasonably anticipated that its conduct would have significant effects in New Jersey. [Emphasis added.]

* * * *

a. In the "SEARCH THE N.J. COURTS DECISIONS" section, type "Mastondrea" in the box, and click on "Search!" In the result, click on the case name to access the opinion. Rutgers University Law School in Camden, New Jersey, maintains this Web site.

CASE 2.1 CONTINUED

* * * [A]dditional evidence of purposeful acts in New Jersey exists that fairly can be attributed to the Hotel and that are causally connected to plaintiff's decision to purchase the Hotel's vacation package * * *, [including] an ongoing, but undefined, relationship between the Hotel and * * * ARMC * * *. ARMC is a marketing organization that solicits business in the United States for the "Occidental Hotels & Resorts," a group of which the defendant Hotel is a part. ARMC does not have any direct contact with any of the potential customers of the various hotels that it promotes, and it does not itself sell travel or vacation packages. However, [ARMC] * * * works closely with Libgo in developing marketing strategies for the Occidental Hotels & Resorts in the New Jersey area pursuant to cooperative marketing agreements between ARMC and Libgo.

* * * *

* * * [T]he defendant Hotel was featured, singly, [in 2003] in advertisements in the *Newark Star Ledger* on four occasions, including one in January * * *, prior to plaintiff's decision to book a vacation there.

We are satisfied * * * that * * * ARMC was operating [on behalf] of the Hotel when ARMC entered into cooperative marketing agreements with Libgo, and that ARMC's extensive contacts with Libgo in New Jersey regarding the marketing plan, together with the New Jersey fruits of that plan, can be attributed to the Hotel for jurisdictional purposes.

We are further persuaded that the *targeted advertising conducted pursuant to the cooperative marketing agreement on behalf of the Hotel provided the minimum contacts necessary to support* * * * *jurisdiction in this case.* [Emphasis added.]

- **Decision and Remedy** *The state intermediate appellate court affirmed the lower court's ruling. The appellate court concluded that the hotel had contacts with New Jersey, consisting of a tour operator contract and marketing activities through ARMC and Libgo, during the relevant time period and that, in response to the marketing, Mastondrea booked a vacation at the hotel. "[T]his evidence was sufficient to support the assertion of . . . personal jurisdiction over the Hotel in this State."*

- **What If the Facts Were Different?** *If Mastondrea had not seen Libgo and Allegro's ad, but had bought a Royal Hideaway vacation package on the recommendation of a Liberty Travel agent, is it likely that the result in this case would have been different? Why or why not?*

- **The Global Dimension** *What do the circumstances and the holding in this case suggest to a business firm that actively attempts to attract customers in a variety of jurisdictions?*

Jurisdiction over Subject Matter Subject-matter jurisdiction refers to the limitations on the types of cases a court can hear. Certain courts are empowered to hear certain kinds of disputes.

General and Limited Jurisdiction. In both the federal and the state court systems, there are courts of *general* (unlimited) *jurisdiction* and courts of *limited jurisdiction.* A court of general jurisdiction can decide cases involving a broad array of issues. An example of a court of general jurisdiction is a state trial court or a federal district court. An example of a state court of limited jurisdiction is a probate court. **Probate courts** are state courts that handle only matters relating to the transfer of a person's assets and obligations after that person's death, including issues relating to the custody and guardianship of children. An example of a federal court of limited subject-matter jurisdiction is a bankruptcy court. **Bankruptcy courts** handle only bankruptcy proceedings, which are governed by federal bankruptcy law (discussed in Chapter 30).

A court's jurisdiction over subject matter is usually defined in the statute or constitution creating the court. In both the federal and the state court systems, a court's subject-matter jurisdiction can be limited not only by the subject of the lawsuit but also by the sum in controversy, whether the case is a felony (a more serious type of crime) or a misdemeanor (a less serious type of crime), or whether the proceeding is a trial or an appeal.

Original and Appellate Jurisdiction. A court's subject-matter jurisdiction is also frequently limited to hearing cases at a particular stage of the dispute. Courts in which lawsuits begin, trials take place, and evidence is presented are referred to as *courts of*

original jurisdiction. Courts having original jurisdiction are courts of the first instance, or trial courts. In the federal court system, the *district courts* are trial courts. In the various state court systems, the trial courts are known by different names, as will be discussed shortly.

Courts having appellate jurisdiction act as reviewing courts, or appellate courts. In general, cases can be brought before appellate courts only on appeal from an order or a judgment of a trial court or other lower court. In other words, the distinction between courts of original jurisdiction and courts of appellate jurisdiction normally lies in whether the case is being heard for the first time.

Jurisdiction of the Federal Courts Because the federal government is a government of limited powers, the jurisdiction of the federal courts is limited. Federal courts have subject-matter jurisdiction in two situations.

Federal Questions. Article III of the U.S. Constitution establishes the boundaries of federal judicial power. Section 2 of Article III states that "[t]he judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority." In effect, this clause means that whenever a plaintiff's cause of action is based, at least in part, on the U.S. Constitution, a treaty, or a federal law, a **federal question** arises. Any lawsuit involving a federal question comes under the judicial authority of the federal courts and can originate in a federal court. People who claim that their constitutional rights have been violated, for example, can begin their suits in a federal court. Note that in a case based on a federal question, a federal court will apply federal law.

Diversity of Citizenship. Federal district courts can also exercise original jurisdiction over cases involving **diversity of citizenship.** This term applies whenever a federal court has jurisdiction over a case that does not involve a question of federal law. The most common type of diversity jurisdiction has two requirements:[7] (1) the plaintiff and defendant must be residents of different states, and (2) the dollar amount in controversy must exceed $75,000. For purposes of diversity jurisdiction, a corporation is a citizen of both the state in which it is incorporated and the state in which its principal place of business is located. A case involving diversity of citizenship can be filed in the appropriate federal district court. If the case starts in a state court, it can sometimes be transferred, or "removed," to a federal court. A large percentage of the cases filed in federal courts each year are based on diversity of citizenship.

As noted, a federal court will apply federal law in cases involving federal questions. In a case based on diversity of citizenship, in contrast, a federal court will apply the relevant state law (which is often the law of the state in which the court sits).

Exclusive versus Concurrent Jurisdiction When both federal and state courts have the power to hear a case, as is true in suits involving diversity of citizenship, **concurrent jurisdiction** exists. When cases can be tried only in federal courts or only in state courts, **exclusive jurisdiction** exists. Federal courts have exclusive jurisdiction in cases involving federal crimes, bankruptcy, and most patent and copyright claims; in suits against the United States; and in some areas of admiralty law (law governing transportation on the seas and ocean waters). State courts also have exclusive jurisdiction over certain subjects—for example, divorce and adoption. When concurrent jurisdiction exists, a party may choose to bring a suit in either a federal court or a state court.

Jurisdiction in Cyberspace

The Internet's capacity to bypass political and geographic boundaries undercuts the traditional basis on which courts assert personal jurisdiction. This basis includes a party's contacts with a court's geographic jurisdiction. As already discussed, for a court to compel a defendant to come before it, there must be at least minimum contacts—the presence of a salesperson within the state, for example. Are there sufficient minimum contacts if the only connection to a jurisdiction is an ad on a Web site originating from a remote location?

The "Sliding-Scale" Standard Gradually, the courts are developing a standard—called a "sliding-scale" standard—for determining when the exercise of personal jurisdiction over an out-of-state Internet-based defendant is proper. In developing this standard, the courts have identified three types of Internet

7. Diversity jurisdiction also exists in cases between (1) a foreign country and citizens of a state or of different states and (2) citizens of a state and citizens or subjects of a foreign country. These bases for diversity jurisdiction are less commonly used.

business contacts: (1) substantial business conducted over the Internet (with contracts and sales, for example); (2) some interactivity through a Web site; and (3) passive advertising. Jurisdiction is proper for the first category, is improper for the third, and may or may not be appropriate for the second.[8] An Internet communication is typically considered passive if people have to voluntarily access it to read the message and active if it is sent to specific individuals.

In certain situations, even a single contact can satisfy the minimum-contacts requirement. In one case, for example, a Texas resident, Connie Davis, sent an unsolicited e-mail message to numerous Mississippi residents advertising a pornographic Web site. Davis falsified the "from" header in the e-mail so that Internet Doorway appeared to be the sender. Internet Doorway filed a lawsuit against Davis in Mississippi, claiming that its reputation and goodwill in the community had been harmed. The federal court in Mississippi held that Davis's single e-mail to Mississippi residents satisfied the minimum-contacts requirement for jurisdiction. The court concluded that Davis, by sending the e-mail solicitation, should reasonably have expected that she could be "haled into court in a distant jurisdiction to answer for the ramifications."[9]

International Jurisdictional Issues

Because the Internet is international in scope, international jurisdictional issues have understandingly come to the fore. The world's courts seem to be developing a standard that echoes the requirement of "minimum contacts" applied by the U.S. courts. Most courts are indicating that minimum contacts—doing business within the jurisdiction, for example—are enough to exercise jurisdiction over a defendant. The effect of this standard is that a business firm may have to comply with the laws in any jurisdiction in which it actively targets customers for its products.

To understand some of the problems created by Internet commerce, consider a French court's judgment against the U.S.-based Internet company Yahoo!, Inc. Yahoo operates an online auction site on which Nazi memorabilia have been offered for sale. In France, the display of any objects depicting symbols of Nazi ideology is illegal and leads to both criminal and civil liability. The International League against Racism and Anti-Semitism filed a suit in Paris against Yahoo for displaying Nazi memorabilia and offering them for sale via its Web site.

The French court asserted jurisdiction over Yahoo on the ground that the materials on the company's U.S.-based servers could be viewed on a Web site accessible in France. The French court ordered Yahoo to eliminate all Internet access in France to the Nazi memorabilia offered for sale through its online auctions. Yahoo then took the case to a federal district court in the United States, claiming that the French court's order violated the First Amendment to the U.S. Constitution. Although the federal district court ruled in favor of Yahoo, the U.S. Court of Appeals for the Ninth Circuit reversed. According to the appellate court, U.S. courts lacked personal jurisdiction over the French groups involved.[10] The *Yahoo* case represents the first time a U.S. court was asked to decide whether to honor a foreign judgment involving business conducted over the Internet. The federal appeals court's ruling leaves open the possibility that Yahoo, and anyone else who posts anything on the Internet, could be held answerable to the laws of any country in which the message might be received. *Concept Summary 2.1* on the next page reviews the various types of jurisdiction, including jurisdiction in cyberspace.

Venue

Jurisdiction has to do with whether a court has authority to hear a case involving specific persons, property, or subject matter. **Venue**[11] is concerned with the most appropriate location for a trial. For example, two state courts (or two federal courts) may have the authority to exercise jurisdiction over a case, but it may be more appropriate or convenient to hear the case in one court than in the other.

Basically, the concept of venue reflects the policy that a court trying a suit should be in the geographic neighborhood (usually the county) where the incident leading to the lawsuit occurred or where the parties involved in the lawsuit reside. Venue in a civil case typically is where the defendant resides, whereas venue in a criminal case is normally where the crime occurred. Pretrial publicity or other factors, though, may require a change of venue to another community, especially in criminal cases in which the defendant's right to a fair and impartial jury has been impaired.

8. For a leading case on this issue, see *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.*, 952 F.Supp. 1119 (W.D.Pa. 1997).
9. *Internet Doorway, Inc. v. Parks*, 138 F.Supp.2d 773 (S.D.Miss. 2001).
10. *Yahoo! Inc. v. La Ligue Contre le Racisme et l'Antisemitisme*, 379 F.3d 1120 (9th Cir. 2004), *cert.* denied, __ U.S. __, 126 S.Ct. 2332, 164 L.Ed.2d 841 (2006).
11. Pronounced *ven*-yoo.

CONCEPT SUMMARY 2.1
Jurisdiction

Type of Jurisdiction	Description
PERSONAL	Exists when a defendant is located within the territorial boundaries within which a court has the right and power to decide cases. Jurisdiction may be exercised over out-of-state defendants under state long arm statutes. Courts have jurisdiction over corporate defendants that do business within the state, as well as corporations that advertise, sell, or place goods into the stream of commerce in the state.
PROPERTY	Exists when the property that is subject to a lawsuit is located within the territorial boundaries within which a court has the right and power to decide cases.
SUBJECT MATTER	Limits the court's jurisdictional authority to particular types of cases. 1. *Limited jurisdiction*—Exists when a court is limited to a specific subject matter, such as probate or divorce. 2. *General jurisdiction*—Exists when a court can hear cases involving a broad array of issues.
ORIGINAL	Exists with courts that have the authority to hear a case for the first time (trial courts).
APPELLATE	Exists with courts of appeal and review. Generally, appellate courts do not have original jurisdiction.
FEDERAL	1. *Federal questions*—When the plaintiff's cause of action is based at least in part on the U.S. Constitution, a treaty, or a federal law, a federal court can exercise jurisdiction. 2. *Diversity of citizenship*—In cases between citizens of different states when the amount in controversy exceeds $75,000 (or in cases between a foreign country and citizens of a state or of different states and in cases between citizens of a state and citizens or subjects of a foreign country), a federal court can exercise jurisdiction.
CONCURRENT	Exists when both federal and state courts have authority to hear the same case.
EXCLUSIVE	Exists when only state courts or only federal courts have authority to hear a case.
JURISDICTION IN CYBERSPACE	Because the Internet does not have physical boundaries, traditional jurisdictional concepts have been difficult to apply in cases involving activities conducted via the Web. Gradually, the courts are developing standards to use in determining when jurisdiction over a Web site owner or operator in another state is proper. A significant legal challenge with respect to cyberspace transactions has to do with resolving jurisdictional disputes in the international context.

Standing to Sue

In order to bring a lawsuit before a court, a party must have **standing to sue,** or a sufficient "stake" in a matter to justify seeking relief through the court system. In other words, to have standing, a party must have a legally protected and tangible interest at stake in the litigation. The party bringing the lawsuit must have suffered a harm or been threatened with a harm by the action about which she or he has complained. At times, a person can have standing to sue on behalf of another person. For example, suppose that a child suffers serious injuries as a result of a defectively manufactured toy. Because the child is a minor, another person, such as a parent or a legal guardian, can bring a lawsuit on the child's behalf.

Standing to sue also requires that the controversy at issue be a **justiciable**[12] **controversy**—a controversy that is real and substantial, as opposed to hypothetical or academic. For example, to entice DaimlerChrysler Corporation to build a $1.2 billion Jeep assembly plant in the area, the city of Toledo, Ohio, gave the company a ten-year local property tax exemption as well as a state franchise tax credit. Toledo taxpayers filed a lawsuit in state court, claiming that the tax breaks violated the commerce clause in the U.S. Constitution. The taxpayers alleged that the tax exemption and credit injured them because they would have to pay higher taxes to cover the shortfall in tax revenues. In 2006, the United States Supreme Court ruled that the taxpayers lacked standing to sue over the incentive program because their alleged injury was "conjectural or hypothetical"—that is, there was no justiciable controversy.[13]

The State and Federal Court Systems

As mentioned earlier in this chapter, each state has its own court system. Additionally, there is a system of federal courts. Although no two state court systems are exactly the same, the right-hand side of Exhibit 2–1 illustrates the basic organizational framework characteristic of the court systems in many states. The exhibit also shows how the federal court system is structured. We turn now to an examination of these court systems, beginning with the state courts. (See this chapter's *Insight into Ethics* feature on pages 38–39 for a discussion of the impact that the use of private judges and out-of-court settlements is having on the nation's court systems and our notions of justice.)

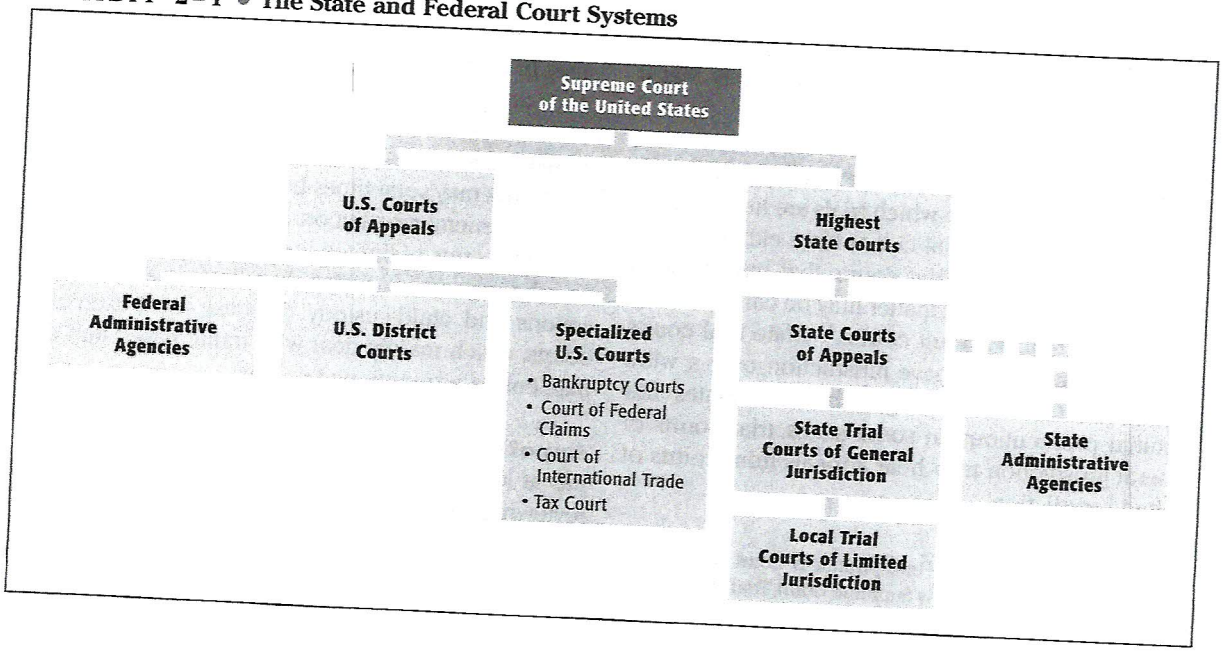
State Court Systems

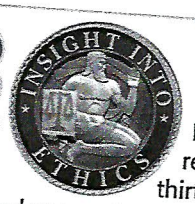
Typically, a state court system includes several levels, or tiers, of courts. As indicated in Exhibit 2–1, state courts may include (1) local trial courts of limited jurisdiction, (2) state trial courts of general jurisdiction, (3) state courts of appeals (intermediate appellate courts), and (4) the state's highest court (often called the state supreme court). Generally, any person who is a party to a lawsuit has the opportunity to plead the case before a trial court and then, if he or she loses, before at least one level of appellate court. Finally, if the case involves a federal statute or federal constitutional issue, the decision of a state supreme court on that issue may be further appealed to the United States Supreme Court.

The states use various methods to select judges for their courts. Usually, voters elect judges, but in some states judges are appointed. For example, in Iowa, the governor appoints judges, and then the general population decides whether to confirm their appointment

12. Pronounced jus-*tish*-a-bul.
13. *DaimlerChrysler v. Cuno*, __ U.S. __, 126 S.Ct. 1854, 164 L.Ed.2d 589 (2006).

EXHIBIT 2–1 • The State and Federal Court Systems





INSIGHT INTO ETHICS
Implications of an Increasingly Private Justice System

Downtown Houston boasts a relatively new courthouse with thirty-nine courtrooms, but more and more often, many of those courtrooms often stand empty. Has litigation in Texas slowed down? Indeed, it has not—the courtrooms are empty because fewer civil lawsuits are going to trial. A similar situation is occurring in the federal courts. In the northern district of Florida, for example, the four federal judges presided over only a dozen civil trials in 2007. In 1984, more than 12,000 civil trials were heard in our federal courts. Today, only about 3,500 federal civil trials take place annually. University of Wisconsin law professor Mark Galanter has labeled this trend the "vanishing trial." Two developments in particular are contributing to the disappearance of civil trials—arbitration and private judges.

Arbitration Is One Cause

Since the 1980s, corporations have been eschewing the public court system and taking cases to arbitration instead. Every day millions of Americans sign arbitration agreements, often unknowingly committing themselves to allow private arbitrators to solve their disputes with employers and the corporations with which they do business, such as cell phone service providers.

This trend raises some troublesome ethical issues, however. For one thing, arbitration agreements may force consumers to travel long distances to participate in these private forums. Perhaps more disturbing is that the supposedly neutral arbitrators may actually be captive to the industries they serve. Arbitrators are paid handsomely and typically would like to serve again. Thus, they may be reluctant to rule against a company that is involved in a dispute. After all, the company may well need arbitrators to resolve a subsequent dispute, whereas the other party—a consumer or employee—is unlikely to need the arbitrators again.

Private Judges Are Another Cause

Another reason for the decline in the number of civil trials in our public courts is the growing use of private judges. A private judge, who is usually a retired judge, has the power to conduct trials and grant legal resolutions of disputes. Private judges increasingly are being used to resolve commercial disputes, as well as divorces and custody battles, for two reasons. One reason is that a case can be heard by a private judge much sooner than it would be heard in a public court. The other reason is that proceedings before a private judge can be kept secret.

in the next general election. The states usually specify the number of years that judges will serve. In contrast, as you will read shortly, judges in the federal court system are appointed by the president of the United States and, if they are confirmed by the Senate, hold office for life—unless they engage in blatantly illegal conduct.

Trial Courts Trial courts are exactly what their name implies—courts in which trials are held and testimony is taken. State trial courts have either general or limited jurisdiction. Trial courts that have general jurisdiction as to subject matter may be called county, district, superior, or circuit courts.[14] State trial courts of general jurisdiction have jurisdiction over a wide variety of subjects, including both civil disputes and criminal prosecutions. In some states, trial courts of general jurisdiction may hear appeals from courts of limited jurisdiction.

Courts of limited jurisdiction as to subject matter are often called special inferior trial courts or minor judiciary courts. **Small claims courts** are inferior trial courts that hear only civil cases involving claims of less than a certain amount, such as $5,000 (the amount varies from state to state). Suits brought in small claims courts are generally conducted informally, and lawyers are not required (in a few states, lawyers are not even allowed). Decisions of small claims courts and municipal courts may sometimes be appealed to a state trial court of general jurisdiction.

Other courts of limited jurisdiction include domestic relations courts, which handle primarily divorce actions and child-custody disputes; local municipal courts, which mainly deal with traffic cases; and probate courts, as mentioned earlier.

Appellate, or Reviewing, Courts Every state has at least one court of appeals (appellate court, or reviewing court), which may be an intermediate appellate court or the state's highest court. About three-fourths of the states have intermediate appellate

14. The name in Ohio and Pennsylvania is Court of Common Pleas; the name in New York is Supreme Court, Trial Division.

In Ohio, for example, a state statute allows the parties to any civil action to have their dispute tried by a retired judge of their choosing who will make a decision in the matter.[a] Recently, though, private judging came under criticism in that state because private judges were conducting jury trials in county courtrooms at taxpayers' expense. A public judge, Nancy Margaret Russo, refused to give up jurisdiction over one case on the ground that private judges are not authorized to conduct jury trials. The Ohio Supreme Court agreed. As the state's highest court noted, private judging raises significant public-policy issues that the legislature needs to consider.[b]

One issue is that private judges charge relatively large fees. This means that litigants who are willing and able to pay the extra cost can have their case heard by a private judge long before they would be able to set a trial date in a regular court. Is it fair that those who cannot afford private judges should have to wait longer for justice? Similarly, is it ethical to allow parties to pay extra for secret proceedings before a private judge and thereby avoid the public scrutiny of a regular trial? Some even suggest that the use of private judges is leading to two different systems of justice.

a. See Ohio Revised Code Section 2701.10.

b. *State ex rel. Russo v. McDonnell,* 110 Ohio St.3d 144, 852 N.E.2d 145 (2006). (The term *ex rel.* is Latin for *ex relatione.* This phrase refers to an action brought on behalf of the state, by the attorney general, at the instigation of an individual who has a private interest in the matter.)

A Threat to the Common Law System?

The decline in the number of civil trials may also be leading to the erosion of this country's common law system. As discussed in Chapter 1, courts are obligated to consider precedents—the decisions rendered in previous cases with similar facts and issues—when deciding the outcome of a dispute. If fewer disputes go to trial because they are arbitrated or heard by a private judge, then they will never become part of the body of cases and appeals that form the case law on that subject. With fewer precedents on which to draw, individuals and businesses will have less information about what constitutes appropriate business behavior in today's world. Furthermore, private dispute resolution does not allow our case law to keep up with new issues related to areas such as biotechnology and the online world. Thus, the long-term effects of the decline of public justice could be a weakening of the common law itself.

CRITICAL THINKING

INSIGHT INTO THE SOCIAL ENVIRONMENT

If wealthier individuals increasingly use private judges, how will our justice system be affected in the long run?

courts. Generally, courts of appeals do not conduct new trials, in which evidence is submitted to the court and witnesses are examined. Rather, an appellate court panel of three or more judges reviews the record of the case on appeal, which includes a transcript of the trial proceedings, and then determines whether the trial court committed an error.

Usually, appellate courts focus on questions of law, not questions of fact. A **question of fact** deals with what really happened in regard to the dispute being tried—such as whether a party actually burned a flag. A **question of law** concerns the application or interpretation of the law—such as whether flag-burning is a form of speech protected by the First Amendment to the Constitution. Only a judge, not a jury, can rule on questions of law. Appellate courts normally defer to the trial court's findings on questions of fact because the trial court judge and jury were in a better position to evaluate testimony—by directly observing witnesses' gestures, demeanor, and other nonverbal behavior during the trial. At the appellate level, the judges review the written transcript of the trial, which does not include these nonverbal elements. Thus, an appellate court will not tamper with a trial court's finding of fact unless it is clearly erroneous (contrary to the evidence presented at trial) or when there is no evidence to support the finding.

Highest State Courts The highest appellate court in a state is usually called the supreme court but may be designated by some other name. For example, in both New York and Maryland, the highest state court is called the Court of Appeals. In Maine and Massachusetts, the highest court is labeled the Supreme Judicial Court. In West Virginia, the highest state court is the Supreme Court of Appeals.

The decisions of each state's highest court on all questions of state law are final. Only when issues of federal law are involved can the United States Supreme Court overrule a decision made by a state's highest court. For example, suppose that a city ordinance prohibits citizens from engaging in door-to-door advocacy without first registering with the mayor's office and receiving a permit. Further suppose that a

religious group sues the city, arguing that the law violates the freedoms of speech and religion guaranteed by the First Amendment. If the state supreme court upholds the law, the group could appeal the decision to the United States Supreme Court—because a constitutional (federal) issue is involved.

The Federal Court System

The federal court system is basically a three-tiered model consisting of (1) U.S. district courts (trial courts of general jurisdiction) and various courts of limited jurisdiction, (2) U.S. courts of appeals (intermediate courts of appeals), and (3) the United States Supreme Court.

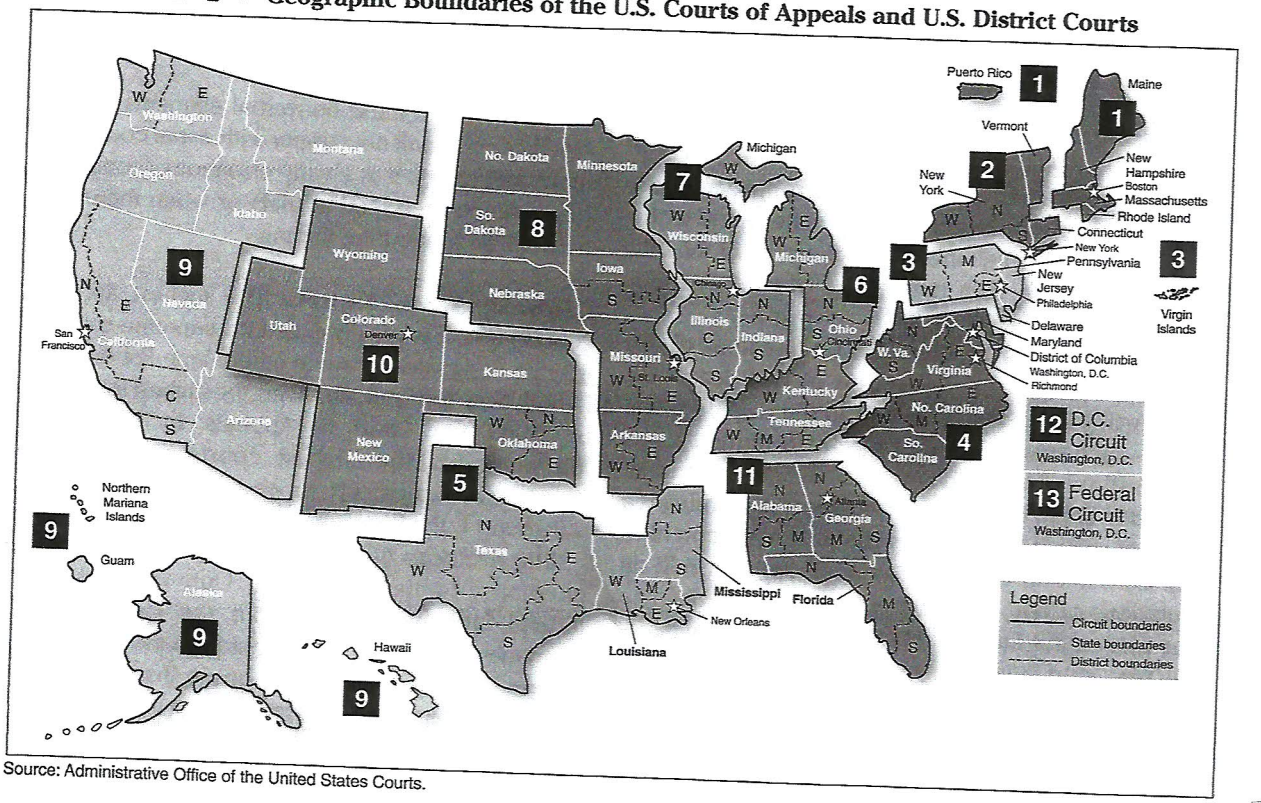
Unlike state court judges, who are usually elected, federal court judges—including the justices of the Supreme Court—are appointed by the president of the United States, subject to confirmation by the U.S. Senate. Article III of the Constitution states that federal judges "hold their offices during good Behaviour." In effect, this means that federal judges have lifetime appointments. Although they can be impeached (removed from office) for misconduct, this is rarely done. In the entire history of the United States, only seven federal judges have been removed from office through impeachment proceedings.

U.S. District Courts At the federal level, the equivalent of a state trial court of general jurisdiction is the district court. U.S. district courts have original jurisdiction in federal matters, and federal cases typically originate in district courts. There are other federal courts with original, but special (or limited), jurisdiction, such as the federal bankruptcy courts and others shown earlier in Exhibit 2–1.

There is at least one federal district court in every state. The number of judicial districts can vary over time, primarily owing to population changes and corresponding changes in caseloads. Currently, there are ninety-four federal judicial districts. Exhibit 2–2 shows the boundaries of the U.S. district courts, as well as the U.S. courts of appeals (discussed next).

U.S. Courts of Appeals In the federal court system, there are thirteen U.S. courts of appeals—referred to as U.S. circuit courts of appeals. Twelve of the federal courts of appeals (including the Court of Appeals for

EXHIBIT 2–2 • Geographic Boundaries of the U.S. Courts of Appeals and U.S. District Courts



Source: Administrative Office of the United States Courts.

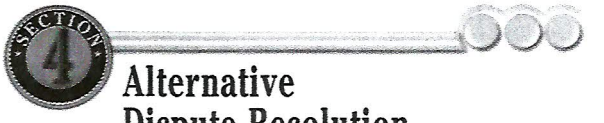
the D.C. Circuit) hear appeals from the federal district courts located within their respective judicial circuits, or geographic boundaries (shown in Exhibit 2–2).[15] The Court of Appeals for the Thirteenth Circuit, called the Federal Circuit, has national appellate jurisdiction over certain types of cases, such as those involving patent law and those in which the U.S. government is a defendant. The decisions of a circuit court of appeals are binding on all courts within the circuit court's jurisdiction and are final in most cases, but appeal to the United States Supreme Court is possible.

United States Supreme Court At the highest level in the three-tiered federal court system is the United States Supreme Court. According to the language of Article III of the U.S. Constitution, there is only one national Supreme Court. All other courts in the federal system are considered "inferior." Congress is empowered to create other inferior courts as it deems necessary. The inferior courts that Congress has created include the second tier in our model—the U.S. circuit courts of appeals—as well as the district courts and the various federal courts of limited, or specialized, jurisdiction.

The United States Supreme Court consists of nine justices. Although the Supreme Court has original, or trial, jurisdiction in rare instances (set forth in Article III, Sections 1 and 2), most of its work is as an appeals court. The Supreme Court can review any case decided by any of the federal courts of appeals, and it also has appellate authority over cases involving federal questions that have been decided in the state courts. The Supreme Court is the final arbiter of the Constitution and federal law.

Appeals to the Supreme Court. To bring a case before the Supreme Court, a party requests the Court to issue a writ of *certiorari*.[16] A **writ of *certiorari*** is an order issued by the Supreme Court to a lower court requiring the latter to send it the record of the case for review. The Court will not issue a writ unless at least four of the nine justices approve of it. This is called the **rule of four.** Whether the Court will issue a writ of *certiorari* is entirely within its discretion, and most petitions for writs are denied. (Thousands of cases are filed with the Supreme Court each year, yet it hears, on average, fewer than one hundred of these cases.[17]) A denial is not a decision on the merits of a case, nor does it indicate agreement with the lower court's opinion. Also, denial of the writ has no value as a precedent. Denial simply means that the lower court's decision remains the law in that jurisdiction.

Petitions Granted by the Court. Typically, the Court grants petitions in cases that raise important constitutional questions or when the lower courts have issued conflicting decisions on a significant issue. The justices, however, never explain their reasons for hearing certain cases and not others, so it is difficult to predict which type of case the Court might select. (See *Concept Summary 2.2* on the following page to review the various types of courts in the federal and state court systems.)



Alternative Dispute Resolution

Litigation—the process of resolving a dispute through the court system—is expensive and time consuming. Litigating even the simplest complaint is costly, and because of the backlog of cases pending in many courts, several years may pass before a case is actually tried. For these and other reasons, more and more businesspersons are turning to **alternative dispute resolution (ADR)** as a means of settling their disputes.

The great advantage of ADR is its flexibility. Methods of ADR range from the parties sitting down together and attempting to work out their differences to multinational corporations agreeing to resolve a dispute through a formal hearing before a panel of experts. Normally, the parties themselves can control how the dispute will be settled, what procedures will be used, whether a neutral third party will be present or make a decision, and whether that decision will be legally binding or nonbinding. ADR also offers more privacy than court proceedings and allows disputes to be resolved relatively quickly.

15. Historically, judges were required to "ride the circuit" and hear appeals in different courts around the country, which is how the name "circuit court" came about.
16. Pronounced sur-shee-uh-*rah*-ree.
17. From the mid-1950s through the early 1990s, the Supreme Court reviewed more cases per year than it has since then. In the Court's 1982–1983 term, for example, the Court issued written opinions in 151 cases. In contrast, during the Court's 2006–2007 term, the Court issued written opinions in only 75 cases.

CONCEPT SUMMARY 2.2
Types of Courts

Court	Description
TRIAL COURTS	Trial courts are courts of original jurisdiction in which actions are initiated. 1. *State courts*—Courts of general jurisdiction can hear any case that has not been specifically designated for another court; courts of limited jurisdiction include, among others, domestic relations courts, probate courts, municipal courts, and small claims courts. 2. *Federal courts*—The federal district court is the equivalent of the state trial court. Federal courts of limited jurisdiction include the bankruptcy courts and others shown in Exhibit 2–1 on page 37.
INTERMEDIATE APPELLATE COURTS	Courts of appeals are reviewing courts; generally, appellate courts do not have original jurisdiction. About three-fourths of the states have intermediate appellate courts; in the federal court system, the U.S. circuit courts of appeals are the intermediate appellate courts.
SUPREME COURT	The highest state court is that state's supreme court, although it may be called by some other name. Appeal from state supreme courts to the United States Supreme Court is possible only if a federal question is involved. The United States Supreme Court is the highest court in the federal court system and the final arbiter of the Constitution and federal law.

Today, more than 90 percent of civil lawsuits are settled before trial using some form of ADR. Indeed, most states either require or encourage parties to undertake ADR prior to trial. Many federal courts have instituted ADR programs as well. In the following pages, we examine the basic forms of ADR.

Negotiation

The simplest form of ADR is **negotiation,** a process in which the parties attempt to settle their dispute informally, with or without attorneys to represent them. Attorneys frequently advise their clients to negotiate a settlement voluntarily before they proceed to trial. In some courts, pretrial negotiation is mandatory before parties can proceed to trial. Parties may even try to negotiate a settlement during a trial or after the trial but before an appeal. Negotiation traditionally involves just the parties themselves and (typically) their attorneys. The attorneys, though, are advocates—they are obligated to put their clients' interests first.

Mediation

In **mediation,** a neutral third party acts as a mediator and works with both sides in the dispute to facilitate a resolution. The mediator normally talks with the parties separately as well as jointly, emphasizes points of agreement, and helps the parties to evaluate their options. Although the mediator may propose a solution (called a mediator's proposal), he or she does not make a decision resolving the matter. The mediator, who need not be a lawyer, usually charges a fee for his or her services (which can be split between the parties). States that require parties to undergo ADR before trial often offer mediation as one of the ADR options or (as in Florida) the only option.

One of the biggest advantages of mediation is that it is not as adversarial in nature as litigation. In mediation, the mediator takes an active role and attempts to bring the parties together so that they can come to a mutually satisfactory resolution. The mediation process tends to reduce the antagonism between the disputants, allowing them to resume their former relationship while minimizing hostility. For this reason, mediation is often the preferred form of ADR for disputes involving business partners, employers and employees, or other parties involved in long-term relationships.

Today, characteristics of mediation are being combined with those of arbitration (to be discussed next). In *binding mediation,* for example, the parties agree that if they cannot resolve the dispute, the mediator

can make a legally binding decision on the issue. In *mediation-arbitration*, or "med-arb," the parties first attempt to settle their dispute through mediation. If no settlement is reached, the dispute will be arbitrated.

Arbitration

A more formal method of ADR is **arbitration,** in which an arbitrator (a neutral third party or a panel of experts) hears a dispute and imposes a resolution on the parties. Arbitration differs from other forms of ADR in that the third party hearing the dispute makes a decision for the parties. Exhibit 2–3 outlines the basic differences among the three traditional forms of ADR. Usually, the parties in arbitration agree that the third party's decision will be *legally binding*, although the parties can also agree to *nonbinding* arbitration. (Additionally, arbitration that is mandated by the courts often is not binding on the parties.) In nonbinding arbitration, the parties can go forward with a lawsuit if they do not agree with the arbitrator's decision.

The Arbitration Process In some respects, formal arbitration resembles a trial, although usually the procedural rules are much less restrictive than those governing litigation. In a typical arbitration, the parties present opening arguments and ask for specific remedies. Evidence is then presented, and witnesses may be called and examined by both sides. The arbitrator then renders a decision, called an **award.**

An arbitrator's award is usually the final word on the matter. Although the parties may appeal an arbitrator's decision, a court's review of the decision will be much more restricted in scope than an appellate court's review of a trial court's decision. The general view is that because the parties were free to frame the issues and set the powers of the arbitrator at the outset, they cannot complain about the results. The award will be set aside only if the arbitrator's conduct or "bad faith" substantially prejudiced the rights of one of the parties, if the award violates an established public policy, or if the arbitrator exceeded her or his powers (by arbitrating issues that the parties did not agree to submit to arbitration).

Arbitration Clauses and Statutes Virtually any commercial matter can be submitted to arbitration. Frequently, parties include an **arbitration clause** in a contract (a written agreement—see Chapter 10) specifying that any dispute arising under the contract will be resolved through arbitration rather than through the court system. Parties can also agree to arbitrate a dispute after it arises.

Most states have statutes (often based in part on the Uniform Arbitration Act of 1955) under which arbitration clauses will be enforced, and some state statutes compel arbitration of certain types of disputes, such as those involving public employees. At the federal level, the Federal Arbitration Act (FAA), enacted in 1925, enforces arbitration clauses in contracts involving

EXHIBIT 2–3 • Basic Differences in the Traditional Forms of ADR

Type of ADR	Description	Neutral Third Party Present	Who Decides the Resolution
Negotiation	Parties meet informally with or without their attorneys and attempt to agree on a resolution.	No	The parties themselves reach a resolution.
Mediation	A neutral third party meets with the parties and emphasizes points of agreement to bring them toward resolution of their dispute.	Yes	The parties, but the mediator may suggest or propose a resolution.
Arbitration	The parties present their arguments and evidence before an arbitrator at a hearing, and the arbitrator renders a decision resolving the parties' dispute.	Yes	The arbitrator imposes a resolution on the parties that may be either binding or nonbinding.

maritime activity and interstate commerce. Because of the breadth of the commerce clause (see Chapter 4), arbitration agreements involving transactions only slightly connected to the flow of interstate commerce may fall under the FAA.

The question in the following case was whether a court or an arbitrator should consider a claim that an entire contract, including its arbitration clause, is rendered void by the alleged illegality of a separate provision in the contract.

CASE 2.2 Buckeye Check Cashing, Inc. v. Cardegna

Supreme Court of the United States, 2006. 546 U.S. 440, 126 S.Ct. 1204, 163 L.Ed.2d 1038.
www.law.cornell.edu/supct/index.html[a]

● **Background and Facts** Buckeye Check Cashing, Inc., cashes personal checks for consumers in Florida. Buckeye agrees to delay submitting a check for payment in exchange for a consumer's payment of a "finance charge." For each transaction, the consumer signs a "Deferred Deposit and Disclosure Agreement," which states, "By signing this Agreement, you agree that i[f] a dispute of any kind arises out of this Agreement * * * th[e]n either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration." John Cardegna and others filed a suit in a Florida state court against Buckeye, alleging that the "finance charge" represented an illegally high interest rate in violation of Florida state laws, rendering the agreement "criminal on its face." Buckeye filed a motion to compel arbitration. The court denied the motion. On Buckeye's appeal, a state intermediate appellate court reversed this denial, but on the plaintiffs' appeal, the Florida Supreme Court reversed the lower appellate court's decision. Buckeye appealed to the United States Supreme Court.

IN THE LANGUAGE OF THE COURT
Justice *SCALIA* delivered the opinion of the Court.

* * * *

* * * Section 2 [of the Federal Arbitration Act (FAA)] embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts:

> A written provision in * * * a contract * * * to settle by arbitration a controversy thereafter arising out of such contract * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

* * * The crux of the [respondents'] complaint is that the contract as a whole (including its arbitration provision) is rendered invalid by the * * * finance charge.

* * * *

* * * [Our holdings in previous cases] answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, *an arbitration provision is severable [capable of being legally separated] from the remainder of the contract.* Second, unless the challenge is to the arbitration clause itself, *the issue of the contract's validity is considered by the arbitrator in the first instance.* Third, *this arbitration law applies in state as well as federal courts.* * * * Applying [those holdings] to this case, we conclude that because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court. [Emphasis added.]

* * * *

* * * Since, respondents argue, the only arbitration agreements to which [Section] 2 applies are those involving a "contract," and since an agreement void *ab initio* [from the beginning] under state law is not a "contract," there is no "written provision" in or "controversy arising out of" a "contract," to which [Section] 2 can apply. * * * We do not read "contract" so narrowly. The word

a. In the "Supreme Court Collection" menu at the top of the page, click on "Search." When that page opens, in the "Search for:" box, type "Buckeye Check," choose "All decisions" in the accompanying list, and click on "Search." In the result, scroll to the name of the case and click on the appropriate link to access the opinion.

CASE 2.2 CONTINUED

appears four times in [Section] 2. Its last appearance is in the final clause, which allows a challenge to an arbitration provision "upon such grounds as exist at law or in equity for the revocation of any contract." There can be no doubt that "contract" as used this last time must include contracts that later prove to be void. Otherwise, the grounds for revocation would be limited to those that rendered a contract voidable—which would mean (implausibly) that an arbitration agreement could be challenged as voidable but not as void. Because the sentence's final use of "contract" so obviously includes putative [alleged] contracts, we will not read the same word earlier in the same sentence to have a more narrow meaning.

- **Decision and Remedy** *The United States Supreme Court reversed the judgment of the Florida Supreme Court and remanded the case for further proceedings. The United States Supreme Court ruled that a challenge to the validity of a contract as a whole, and not specifically to an arbitration clause contained in the contract, must be resolved by an arbitrator.*

- **The Ethical Dimension** *Does the holding in this case permit a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void? Is this fair? Why or why not?*

- **The Legal Environment Dimension** *As indicated in the parties' arguments and the Court's reasoning in this case, into what categories can contracts be classified with respect to their enforceability?*

Arbitrability When a dispute arises as to whether the parties to a contract with an arbitration clause have agreed to submit a particular matter to arbitration, one party may file suit to compel arbitration. The court before which the suit is brought will not decide the basic controversy but must decide the issue of *arbitrability*—that is, whether the matter is one that must be resolved through arbitration. If the court finds that the subject matter in controversy is covered by the agreement to arbitrate, then a party may be compelled to arbitrate the dispute. Even when a claim involves a violation of a statute passed to protect a certain class of people, a court may determine that the parties must nonetheless abide by their agreement to arbitrate the dispute. Usually, a court will allow the claim to be arbitrated if the court, in interpreting the statute, can find no legislative intent to the contrary.

No party, however, will be ordered to submit a particular dispute to arbitration unless the court is convinced that the party has consented to do so.[18] Additionally, the courts will not compel arbitration if it is clear that the prescribed arbitration rules and procedures are inherently unfair to one of the parties.[19]

Mandatory Arbitration in the Employment Context A significant question in the last several years has concerned mandatory arbitration clauses in employment contracts. Many claim that employees' rights are not sufficiently protected when they are forced, as a condition of being hired, to agree to arbitrate all disputes and thus waive their rights under statutes specifically designed to protect employees. The United States Supreme Court, however, has held that mandatory arbitration clauses in employment contracts are generally enforceable.[20]

Compulsory arbitration agreements often spell out the rules for a mandatory proceeding. For example, an agreement may address in detail the amount and payment of filing fees and other expenses. Some courts have overturned provisions in employment-related agreements that require the parties to split the costs when an individual worker lacks the ability to pay. The court in the following case took this reasoning a step further.

18. See, for example, *Wright v. Universal Maritime Service Corp.*, 525 U.S. 70, 119 S.Ct. 391, 142 L.Ed.2d 361 (1998).

19. *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999).

20. For a landmark decision on this issue, see *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991).

EXTENDED CASE 2.3 Morrison v. Circuit City Stores, Inc.

United States Court of Appeals, Sixth Circuit, 2003. 317 F.3d 646.
www.ca6.uscourts.gov/internet/index.htm[a]

***KAREN NELSON MOORE*, Circuit Judge.**

* * * *

* * * Plaintiff-Appellant Morrison, an African-American female with a bachelor's degree in engineering from the U.S. Air Force Academy and a master's degree in administration from Central Michigan University, submitted an application for a managerial position at a Circuit City store in Cincinnati, Ohio. As part of the application process, Morrison was required to sign a * * * "Dispute Resolution Agreement." This document contained an arbitration clause that required resolution of all disputes or controversies arising out of employment with Circuit City in an arbitral forum. * * * Circuit City would not consider any application for employment unless the arbitration agreement was signed * * *.

* * * *

Pursuant to [the agreement] each party is required to pay one-half of the costs of arbitration following the issuance of an arbitration award * * *. In addition, * * * if an employee is able to pay her share of the arbitration costs within [ninety days], her costs (not including attorney fees) are then limited to the greater of either five hundred dollars or three percent of her most recent annual compensation.

* * * *

* * * Morrison began her employment at Circuit City on or about December 1, 1995. Two years later, on December 12, 1997, she was terminated. Morrison alleges that her termination was the result of race and sex discrimination.[b] She filed this lawsuit * * * in Ohio state court, alleging federal and state claims of race and sex discrimination * * *. Circuit City removed the case to federal court and then moved to compel arbitration and to dismiss Morrison's claims. The district court granted Circuit City's motion * * *.

* * * Morrison's appeal followed.

* * * *

We hold that *potential litigants must be given an opportunity, prior to arbitration on the merits, to demonstrate that the potential costs of arbitration are great enough to deter them and similarly situated individuals from seeking to vindicate [assert] their federal statutory rights in the arbitral forum.* * * * Thus, in order to protect the statutory rights at issue, the reviewing court must look to more than just the interests and conduct of a particular plaintiff. * * * [A] court considering whether a cost-splitting provision is enforceable should consider similarly situated potential litigants, for whom costs will loom as a larger concern, because it is, in large part, their presence in the system that will deter discriminatory practices. [Emphasis added.]

For this reason, *if the reviewing court finds that the cost-splitting provision would deter a substantial number of similarly situated potential litigants, it should refuse to enforce the cost-splitting provision in order to serve the underlying functions of the federal statute.* * * * [Emphasis added.]

* * * *

This analysis will yield different results in different cases. It will find, in many cases, that high-level managerial employees and others with substantial means can afford the costs of arbitration, thus making cost-splitting provisions in such cases enforceable. In the case of other employees, however, this standard will render cost-splitting provisions unenforceable in many, if not most, cases.

* * * Circuit City argues that Morrison could have avoided having to pay half of the cost of the arbitration * * * if she could have arranged to pay the greater of $500 or 3 percent of her

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a. This is a page within the Web site of the U.S. Court of Appeals for the Sixth Circuit. In the left-hand column, click on "Opinions Search." In the "Short Title *contains*" box, type "Morrison," and click "Submit Query." In the "Opinion" box corresponding to the name of the case, click on the number to access the opinion.

b. Employment discrimination will be discussed in detail in Chapter 34.

CASE 2.3 CONTINUED

annual salary (in this case, 3 percent of $54,060, or $1,622) within ninety days of the arbitrator's award. * * *

In the abstract, this sum may not appear prohibitive, but it must be considered from the vantage point of the potential litigant in a case such as this. Recently terminated, the potential litigant must continue to pay for housing, utilities, transportation, food, and the other necessities of life in contemporary society despite losing her primary, and most likely only, source of income. * * *

The provision reducing the (former) employee's exposure to the greater of $500 or three percent of her annual compensation presents a closer issue. However, a potential litigant considering arbitration would still have to arrange to pay three percent of her most recent salary, in this case, $1,622, within a three-month period, or risk incurring her full half of the costs * * *. Faced with this choice—which really boils down to risking one's scarce resources in the hopes of an uncertain benefit—it appears to us that a substantial number of similarly situated persons would be deterred from seeking to vindicate their statutory rights under these circumstances.[c]

Based on this reasoning, we hold that Morrison has satisfied her burden in the present case in demonstrating that * * * the cost-splitting provision in the agreement was unenforceable with respect to her claims.

QUESTIONS

1. On what argument did Morrison base her appeal of the court's order to arbitrate her employment-discrimination claims?
2. Why did the U.S. Court of Appeals for the Sixth Circuit hold in Morrison's case that the arbitration agreement's cost-splitting provision was unenforceable?

c. The court also concluded that the provision could be severed from the agreement, which meant that the rest of the agreement could be enforced. Because the arbitration in this case had already occurred, and Morrison had not been required to pay any share of the costs, the court affirmed the lower court's order compelling arbitration "on these different grounds."

Other Types of ADR

The three forms of ADR just discussed are the oldest and traditionally the most commonly used forms. As mentioned earlier, a variety of new types of ADR have emerged in recent years, including those described here.

1. In **early neutral case evaluation,** the parties select a neutral third party (generally an expert in the subject matter of the dispute) to evaluate their respective positions. The parties explain their positions to the case evaluator, and the case evaluator assesses the strengths and weaknesses of each party's claims.
2. In a **mini-trial,** each party's attorney briefly argues the party's case before the other and a panel of representatives from each side who have the authority to settle the dispute. Typically, a neutral third party (usually an expert in the area being disputed) acts as an adviser. If the parties fail to reach an agreement, the adviser renders an opinion as to how a court would likely decide the issue.
3. Numerous federal courts now hold **summary jury trials (SJTs),** in which the parties present their arguments and evidence and the jury renders a verdict. The jury's verdict is not binding, but it does act as a guide to both sides in reaching an agreement during the mandatory negotiations that immediately follow the trial.
4. Other alternatives being employed by the courts include summary procedures for commercial litigation and the appointment of special masters to assist judges in deciding complex issues.

Providers of ADR Services

Both government agencies and private organizations provide ADR services. A major provider of ADR services is the **American Arbitration Association (AAA),** which was founded in 1926 and now handles more than two hundred thousand claims each year in its numerous offices around the country. Cases brought before the AAA are heard by an expert or a panel of experts in the area relating to the dispute and are usually settled quickly. Generally, about half of the panel

members are lawyers. To cover its costs, the AAA charges a fee, paid by the party filing the claim. In addition, each party to the dispute pays a specified amount for each hearing day, as well as a special additional fee in cases involving personal injuries or property loss.

Hundreds of for-profit firms around the country also provide dispute-resolution services. Typically, these firms hire retired judges to conduct arbitration hearings or otherwise assist parties in settling their disputes. The judges follow procedures similar to those of the federal courts and use similar rules. Usually, each party to the dispute pays a filing fee and a designated fee for a hearing session or conference.

Online Dispute Resolution

An increasing number of companies and organizations are offering dispute-resolution services using the Internet. The settlement of disputes in these online forums is known as **online dispute resolution (ODR).** The disputes resolved in these forums have most commonly involved disagreements over the rights to domain names (Web site addresses—see Chapter 8) or the quality of goods sold via the Internet, including goods sold through Internet auction sites.

At this time, ODR may be best for resolving small- to medium-sized business liability claims, which may not be worth the expense of litigation or traditional ADR methods. Rules being developed in online forums, however, may ultimately become a code of conduct for everyone who does business in cyberspace. Most online forums do not automatically apply the law of any specific jurisdiction. Instead, results are often based on general, more universal legal principles. As with offline methods of dispute resolution, any party may appeal to a court at any time.

International Dispute Resolution

Businesspersons who engage in international business transactions normally take special precautions to protect themselves in the event that a party with whom they are dealing in another country breaches an agreement. Often, parties to international contracts include special clauses in their contracts providing for how disputes arising under the contracts will be resolved.

Forum-Selection and Choice-of-Law Clauses

As you will read in Chapter 20, parties to international transactions often include forum-selection and choice-of-law clauses in their contracts. These clauses designate the jurisdiction (court or country) where any dispute arising under the contract will be litigated and the nation's law that will be applied. When an international contract does not include such clauses, any legal proceedings arising under the contract will be more complex and attended by much more uncertainty. For example, litigation may take place in two or more countries, with each country applying its own national law to the particular transactions.

Furthermore, even if a plaintiff wins a favorable judgment in a lawsuit litigated in the plaintiff's country, the defendant's country could refuse to enforce the court's judgment. As will be discussed in Chapter 52, for reasons of courtesy, the judgment may be enforced in the defendant's country, particularly if the defendant's country is the United States and the foreign court's decision is consistent with U.S. national law and policy. Other nations, however, may not be as accommodating as the United States, and the plaintiff may be left empty-handed.

Arbitration Clauses

Parties to international contracts also often include arbitration clauses in their contracts that require a neutral third party to decide any contract disputes. In international arbitration proceedings, the third party may be a neutral entity (such as the International Chamber of Commerce), a panel of individuals representing both parties' interests, or some other group or organization. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards[21]—which has been implemented in more than fifty countries, including the United States—assists in the enforcement of arbitration clauses, as do provisions in specific treaties among nations. The American Arbitration Association provides arbitration services for international as well as domestic disputes.

21. June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997 (the "New York Convention").

REVIEWING Courts and Alternative Dispute Resolution

Stan Garner resides in Illinois and promotes boxing matches for SuperSports, Inc., an Illinois corporation. Garner created the concept of "Ages" promotion—a three-fight series of boxing matches pitting an older fighter (George Foreman) against a younger fighter, such as John Ruiz or Riddick Bowe. The concept included titles for each of the three fights ("Challenge of the Ages," "Battle of the Ages," and "Fight of the Ages"), as well as promotional epithets to characterize the two fighters ("the Foreman Factor"). Garner contacted George Foreman and his manager, who both reside in Texas, to sell the idea, and they arranged a meeting at Caesar's Palace in Las Vegas, Nevada. At some point in the negotiations, Foreman's manager signed a nondisclosure agreement prohibiting him from disclosing Garner's promotional concepts unless the parties signed a contract. Nevertheless, after negotiations between Garner and Foreman fell through, Foreman used Garner's "Battle of the Ages" concept to promote a subsequent fight. Garner filed a suit against Foreman and his manager in a federal district court located in Illinois, alleging breach of contract. Using the information presented in the chapter, answer the following questions.

1. On what basis might the federal district court in Illinois exercise jurisdiction in this case?
2. Does the federal district court have original or appellate jurisdiction?
3. Suppose that Garner had filed his action in an Illinois state court. Could an Illinois state court exercise personal jurisdiction over Foreman or his manager? Why or why not?
4. Assume that Garner had filed his action in a Nevada state court. Would that court have personal jurisdiction over Foreman or his manager? Explain.

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QUESTIONS AND CASE PROBLEMS

2–1. In an arbitration proceeding, the arbitrator need not be a judge or even a lawyer. How, then, can the arbitrator's decision have the force of law and be binding on the parties involved?

2–2. QUESTION WITH SAMPLE ANSWER

The defendant in a lawsuit is appealing the trial court's decision in favor of the plaintiff. On appeal, the defendant claims that the evidence presented at trial to support the plaintiff's claim was so scanty that no reasonable jury could have found for the plaintiff. Therefore, argues the defendant, the appellate court should reverse the trial court's decision. Will an appellate court ever reverse a trial court's findings with respect to questions of fact? Discuss fully.

- **For a sample answer to Question 2–2, go to Appendix I at the end of this text.**

2–3. Appellate courts normally see only written transcripts of trial proceedings when they are reviewing cases. Today, in some states, videotapes are being used as the official trial reports. If the use of videotapes as official reports continues, will this alter the appellate process? Should it? Discuss fully.

2–4. Marya Callais, a citizen of Florida, was walking along a busy street in Tallahassee, Florida, when a large crate flew off a passing truck and hit her, causing numerous injuries. She experienced a great deal of pain and suffering, incurred significant medical expenses, and could not work for six months. She wants to sue the trucking firm for $300,000 in damages. The firm's headquarters are in Georgia, although the company does business in Florida. In what court might Callais bring suit—a Florida state court, a Georgia state court, or a federal court? What factors might influence her decision?

2–5. E-Jurisdiction. American Business Financial Services, Inc. (ABFI), a Pennsylvania firm, sells and services loans to businesses and consumers. First Union National Bank, with its principal place of business in North Carolina, provides banking services. Alan Boyer, an employee of First Union, lives in North Carolina and has never been to Pennsylvania. In the course of his employment, Boyer learned that the bank was going to extend a $150 million line of credit to ABFI. Boyer then attempted to manipulate the price of ABFI's stock for personal gain by sending disparaging e-mails to ABFI's independent auditors in Pennsylvania. Boyer also posted negative statements about ABFI and its management on a Yahoo bulletin board. ABFI filed a suit in a Pennsylvania state court against Boyer, First Union, and others, alleging wrongful interference with a contractual relationship, among other things. Boyer filed a motion to dismiss the complaint for lack of personal jurisdiction. Could the court exercise jurisdiction over Boyer? Explain. [*American Business Financial Services, Inc. v. First Union National Bank*, __ A.2d __ (Pa.Comm.Pl. 2002)]

2–6. Arbitration. Alexander Little worked for Auto Stiegler, Inc., an automobile dealership in Los Angeles County, California, eventually becoming the service manager. While employed, Little signed an arbitration agreement that required the submission of all employment-related disputes to arbitration. The agreement also provided that any award over $50,000 could be appealed to a second arbitrator. Little was later demoted and terminated. Alleging that these actions were in retaliation for investigating and reporting warranty fraud and thus were in violation of public policy, Little filed a suit in a California state court against Auto Stiegler. The defendant filed a motion with the court to compel arbitration. Little responded that the arbitration agreement should not be enforced because, among other things, the appeal provision was unfairly one sided. Is this provision enforceable? Should the court grant Auto Stiegler's motion? Why or why not? [*Little v. Auto Stiegler, Inc.*, 29 Cal.4th 1064, 63 P.3d 979, 130 Cal.Rptr.2d 892 (2003)]

2–7. Jurisdiction. KaZaA BV was a company formed under the laws of the Netherlands. KaZaA distributed KaZaA Media Desktop (KMD) software, which enabled users to exchange digital media, including movies and music, via a peer-to-peer transfer network. KaZaA also operated the KaZaA.com Web site, through which it distributed the KMD software to millions of California residents and other users. Metro-Goldwyn-Mayer Studios, Inc., and other parties in the entertainment industries based in California filed a suit in a federal district court against KaZaA and others, alleging copyright infringement. KaZaA filed a counterclaim, but while legal action was pending, the firm passed its assets and its Web site to Sharman Networks, Ltd., a company organized under the laws of Vanuatu (an island republic east of Australia) and doing business principally in Australia. Sharman explicitly disclaimed the assumption of any of KaZaA's liabilities. When the plaintiffs added Sharman as a defendant, Sharman filed a motion to dismiss on the ground that the court did not have jurisdiction. Would it be fair to subject Sharman to suit in this case? Explain. [*Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 243 F.Supp.2d.1073 (C.D.Cal. 2003)]

2–8. CASE PROBLEM WITH SAMPLE ANSWER

Michael and Karla Covington live in Jefferson County, Idaho. When they bought their home, a gravel pit was across the street. In 1995, the county converted the pit to a landfill. Under the county's operation, the landfill accepted major appliances, household garbage, spilled grain, grass clippings, straw, manure, animal carcasses, containers with hazardous content warn-

ings, leaking car batteries, and waste oil, among other things. The deposits were often left uncovered, attracting insects and other scavengers and contaminating the groundwater. Fires broke out, including at least one started by an intruder who entered the property through an unlocked gate. The Covingtons complained to the state, which inspected the landfill, but no changes were made to address their concerns. Finally, the Covingtons filed a suit in a federal district court against the county and the state, charging violations of federal environmental laws. Those laws were designed to minimize the risks of injuries from fires, scavengers, groundwater contamination, and other pollution dangers. Did the Covingtons have standing to sue? What principles apply? Explain. [*Covington v. Jefferson County*, 358 F.3d 626 (9th Cir. 2004)]

- **To view a sample answer for Problem 2–8, go to this book's Web site at academic.cengage.com/blaw/clarkson, select "Chapter 2," and click on "Case Problem with Sample Answer."**

2–9. Jurisdiction. Xcentric Ventures, LLC, is an Arizona firm that operates the Web sites RipOffReport.com and BadBusinessBureau.com. Visitors to the sites can buy a copy of a book titled *Do-It-Yourself Guide: How to Get Rip-Off Revenge*. The price ($21.95) includes shipping to anywhere in the United States, including Illinois, to which thirteen copies have been shipped. The sites accept donations and feature postings by individuals who claim to have been "ripped off." Some visitors posted comments about George S. May International Co., a management consulting firm. The postings alleged fraud, larceny, possession of child pornography, and possession of controlled substances (illegal drugs). May filed a suit in a federal district court in Illinois against Xcentric and others, charging, among other things, "false descriptions and representations." The defendants filed a motion to dismiss for lack of jurisdiction. What is the standard for exercising jurisdiction over a party whose only connection to a jurisdiction is over the Web? How would that standard apply in this case? Explain. [*George S. May International Co. v. Xcentric Ventures, LLC*, 409 F.Supp.2d 1052 (N.D.Ill. 2006)]

2–10. Jurisdiction. In 2001, Raul Leal, the owner and operator of Texas Labor Contractors in East Texas, contacted Poverty Point Produce, Inc., which operates a sweet potato farm in West Carroll Parish, Louisiana, and offered to provide field workers. Poverty Point accepted the offer. Jeffrey Brown, an owner of, and field manager for, the farm, told Leal the number of workers needed and gave him forms for them to fill out and sign. Leal placed an ad in a newspaper in Brownsville, Texas. Job applicants were directed to Leal's car dealership in Weslaco, Texas, where they were told the details of the work. Leal recruited, among others, Elias Moreno, who lives in the Rio Grande Valley in Texas, and transported Moreno and the others to Poverty Point's farm. At the farm, Leal's brother Jesse oversaw the work with instructions from Brown, lived with the workers in the on-site housing, and gave them their paychecks. When the job was done, the workers were returned to Texas. Moreno and others filed a suit in a federal district court against Poverty Point and others, alleging, in part, violations of Texas state law related to the work. Poverty Point filed a motion to dismiss the suit on the ground that the court did not have personal jurisdiction. All of the meetings between Poverty Point and the Leals occurred in Louisiana. All of the farmwork was done in Louisiana. Poverty Point has no offices, bank accounts, or phone listings in Texas. It does not advertise or solicit business in Texas. Despite these facts, can the court exercise personal jurisdiction? Explain. [*Moreno v. Poverty Point Produce, Inc.*, 243 F.R.D. 275 (S.D.Tex. 2007)]

2–11. A QUESTION OF ETHICS

Linden Research, Inc., operates a multiplayer role-playing game in the virtual world known as "Second Life" at ***secondlife.com****. Participants create avatars to represent themselves on the site. In 2003, Second Life became the only virtual world to recognize participants' rights to buy, own, and sell digital content—virtual property, including "land." Linden's chief executive officer, Philip Rosedale, joined efforts to publicize this recognition and these rights in the real world media. Rosedale also created an avatar to tout the rights in Second Life town meetings. March Bragg, an experienced Pennsylvania attorney, was a Second Life participant whose avatar attended the meetings, after which Bragg began to invest in Second Life's virtual property. In April 2006, Bragg bought "Taessot," a parcel of virtual land. Linden decided that the purchase was improper, however, and took Taessot from Bragg. Linden also froze Bragg's account, effectively confiscating all of his virtual property and currency. Bragg filed a suit against Linden and Rosedale, claiming that the defendants acted unlawfully. [*Bragg v. Linden Research, Inc.*, 487 F.Supp.2d 593 (E.D.Pa. 2007)]*

(a) In the federal district court in Pennsylvania that was hearing the suit, Rosedale, who lives in California, filed a motion to dismiss the claim against him for lack of personal jurisdiction. On what basis could the court deny this motion and assert jurisdiction? Is it fair to require Rosedale to appear in a court in a distant location? Explain.

(b) To access Second Life, a participant must accept its "Terms of Service" (TOS) by clicking an "accept" button. Under the TOS, Linden has the right "at any time for any reason or no reason to suspend or terminate your Account," to refuse to return a participant's money, and to amend the terms at its discretion. The terms also stipulate that any dispute be resolved by binding arbitration in California. Is there anything unfair about the TOS? Should the court compel Bragg to arbitrate this dispute? Discuss.

2-12. VIDEO QUESTION

Go to this text's Web site at **academic.cengage.com/blaw/clarkson** and select "Chapter 2." Click on "Video Questions" and view the video titled *Jurisdiction in Cyberspace*. Then answer the following questions.

(a) What standard would a court apply to determine whether it has jurisdiction over the out-of-state computer firm in the video?
(b) What factors is a court likely to consider in assessing whether sufficient contacts existed when the only connection to the jurisdiction is through a Web site?
(c) How do you think the court would resolve the issue in this case?

LAW ON THE WEB

For updated links to resources available on the Web, as well as a variety of other materials, visit this text's Web site at

academic.cengage.com/blaw/clarkson

For the decisions of the United States Supreme Court, as well as information about the Supreme Court and its justices, go to either

www.supremecourtus.gov

or

www.oyez.org

The Web site for the federal courts offers information on the federal court system and links to all federal courts at

www.uscourts.gov

The National Center for State Courts (NCSC) offers links to the Web pages of all state courts. Go to

www.ncsconline.org

For information on alternative dispute resolution, go to the American Arbitration Association's Web site at

www.adr.org

Legal Research Exercises on the Web

Go to **academic.cengage.com/blaw/clarkson**, the Web site that accompanies this text. Select "Chapter 2" and click on "Internet Exercises." There you will find the following Internet research exercises that you can perform to learn more about the topics covered in this chapter.

Internet Exercise 2–1: Legal Perspective
Alternative Dispute Resolution

Internet Exercise 2–2: Management Perspective
Resolve a Dispute Online

Internet Exercise 2–3: Historical Perspective
The Judiciary's Role in American Government