

CHAPTER 2

COURTS AND ALTERNATIVE DISPUTE RESOLUTION

ANSWERS TO CRITICAL THINKING QUESTIONS IN THE FEATURE

MANAGERIAL STRATEGY—BUSINESS QUESTIONS (PAGE 38)

1A. *What are some of the costs of increased litigation delays caused by court budget cuts?* Most attorneys require a retaining fee. The longer this fee is held by the attorney, the higher the present value cost of the litigation. In addition, the opportunity cost of all of the company employees who work on the litigation must be included, too. Also, if there is any negative press during the litigation, that will have an impact on the company's revenues. Uncertainty about the results of the litigation may cause investors to back away. Uncertainty about the outcome of the litigation may also cause managers to forestall new projects.

2A. *In response to budget cuts, many states have increased their filing fees. Is this fair? Why or why not?* Some argue that those businesses that avail themselves of the court system should pay a higher percentage of the actual costs of that court system. Others point out that the higher the costs imposed by the states to those businesses that wish to litigate, the less litigation there will be. And some of that reduced litigation may be meritorious.

ANSWERS TO QUESTIONS AT THE ENDS OF THE CASES

CASE 2.1—LEGAL REASONING QUESTIONS (PAGE 32)

1A. *What is "diversity of citizenship?"* Diversity of citizenship exists when the plaintiff and defendant to a suit are residents of different states (or similar independent political subdivisions, such as territories). When a suit involves multiple parties, they must be completely diverse—no plaintiff may have the same state or territorial citizenship as any defendant. For purposes of

diversity, 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.

2A. How does the presence—or lack—of diversity of citizenship affect a lawsuit? A federal district court can exercise original jurisdiction over a case involving diversity of citizenship. There is a second requirement to exercise diversity jurisdiction—the dollar amount in controversy must be more than \$75,000. In a case based on diversity, a federal court will apply the relevant state law, which is often the law of the state in which the court sits.

3A. What did the court conclude with respect to the parties’ “diversity of citizenship” in this case? In the *Mala* case, the court concluded that the parties did not have diversity of citizenship. A plaintiff who seeks to bring a suit in a federal district court based on diversity of citizenship has the burden to prove that diversity exists. Mala—the plaintiff in this case—was a citizen of the Virgin Islands. He alleged that Crown Bay admitted to being a citizen of Florida, which would have given the parties diversity. Crown Bay denied the allegation and asserted that it also was a citizen of the Virgin Islands. Mala offered only his allegation and did not provide any evidence that Crown Bay was anything other than a citizen of the Virgin Islands. There was thus no basis for the court to be “left with the definite and firm conviction that Crown Bay was in fact a citizen of Florida.”

4A. How did the court’s conclusion affect the outcome? The court’s conclusion determined the outcome in this case. Mala sought a jury trial on his claim of Crown Bay’s negligence, but he did not have a right to a jury trial unless the parties had diversity of citizenship. Because the court concluded that the parties did not have diversity of citizenship, Mala was determined not to have a jury-trial right.

The outcome very likely would have been different if the court had concluded otherwise. The lower court had empaneled an advisory jury, which recommended a verdict in Mala’s favor. This verdict was rejected, however, and a judgment issued in favor of Crown Bay. On appeal, the U.S. Court of Appeals for the Third Circuit affirmed the lower court’s judgment.

CASE 2.2—QUESTIONS (PAGE 36)

WHAT IF THE FACTS WERE DIFFERENT?

Suppose that Gucci had not presented evidence that Wang Huoqing had made one actual sale through his Web site to a resident (the private investigator) of the court’s district. Would the court still have found that it had personal jurisdiction over Wang Huoqing?

Why or why not? The single sale to a resident of the district, Gucci’s private investigator, helped the plaintiff establish that the defendant’s Web site was interactive and that the defendant used the Web site to sell goods to residents in the court’s district. It is possible that without proof of such a sale, the court would not have found that it had personal jurisdiction over the foreign defendant. The reason is that courts cannot exercise jurisdiction over foreign defendants unless they can show the defendants had minimum contacts with the forum, such as by selling goods within the forum.

THE LEGAL ENVIRONMENT DIMENSION

Is it relevant to the analysis of jurisdiction that Gucci America's principal place of business is in New York state rather than California? Explain. The fact that Gucci's headquarters is in New York state was not relevant to the court's analysis here because Gucci was the plaintiff. Courts look only at the defendant's location or contacts with the forum in determining whether to exercise personal jurisdiction. The plaintiff's location is irrelevant to this determination.

CASE 2.3—QUESTIONS (PAGE 44)**THE LEGAL ENVIRONMENT DIMENSION**

How would business be affected if each state could pass a statute, like the one in Texas, allowing parties to void out-of-state arbitrations? If all states could pass statutes like the one in Texas, many parties would probably be less inclined to transact business. An arbitration provision allows a party to limit the burden and expense of settling any disputes. If another party could freely void such an agreement, there would be a greater risk of arbitration in an inconvenient forum, costly formal litigation, or both. That risk increases the perceived costs of doing business, making the business opportunity less attractive. Thus, many parties may decline to enter contracts without enforceable arbitration provisions.

THE SOCIAL DIMENSION

Considering the relative bargaining power of the parties, was it fair to enforce the arbitration clause in this contract? Why or why not? Yes, because either party could have refused to agree to the contract when it contained the arbitration clause. Of course, such clauses are likely to be ruled fair and enforceable when, as in this case, the parties are of relatively equal bargaining strength.

**ANSWERS TO QUESTIONS IN THE REVIEWING FEATURE
AT THE END OF THE CHAPTER****1A. Federal jurisdiction**

The federal district court exercises jurisdiction because the case involves diversity of citizenship. Diversity jurisdiction requires that the plaintiff and defendant be from different jurisdictions and that the dollar amount of the controversy exceed \$75,000. Here, Garner resides in Illinois, and Foreman and his manager live in Texas. Because the dispute involved the promotion of boxing matches with George Foreman, the amount in controversy exceeded \$75,000.

2A. Original or appellate jurisdiction

Original jurisdiction, because the case was initiated in that court and that is where the trial will take place. Courts having original jurisdiction are courts of the first instance, or trial courts—that is courts in which lawsuits begin and trials take place. In the federal court system, the district courts are the trial courts, so the federal district court has original jurisdiction.

3A. Jurisdiction in Illinois

No, because the defendants lacked minimum contacts with the state of Illinois. Because the defendants were from another state, the court would have to determine if they had sufficient contacts with the state for the Illinois court to exercise jurisdiction based on a long arm statute. Here, the defendants never went to Illinois, and the contract was not formed in Illinois. Thus, it is unlikely that an Illinois state court would find sufficient minimum contacts to exercise jurisdiction.

4A. Jurisdiction in Nevada

Yes, because the defendants met with Garner and formed a contract in the state of Nevada. A state can exercise jurisdiction over out-of-state defendants under a long arm statute if defendants had sufficient contacts with the state. Because the parties met Garner and negotiated the contract in Nevada, a court would likely hold these activities were sufficient to justify a Nevada court's exercising personal jurisdiction.

**ANSWER TO DEBATE THIS QUESTION IN THE REVIEWING FEATURE
AT THE END OF THE CHAPTER**

In this age of the Internet, when people communicate via e-mail, texts, tweets, Facebook, and Skype, is the concept of jurisdiction losing its meaning? Many believe that yes, the idea of determining jurisdiction based on individuals' and companies' physical locations no longer has much meaning. Increasingly, contracts are formed via online communications. Does it matter where one of the parties has a physical presence? Does it matter where the e-mail server or Web page server is located? Probably not.

In contrast, in one sense, jurisdiction still has to be decided when conflicts arise. Slowly, but ever so surely, courts are developing rules to determine where jurisdiction lies when one or both parties used online systems to sell or buy goods or services. In the final analysis, a specific court in a specific physical location has to try each case.

**ANSWERS TO ISSUE SPOTTERS IN THE EXAMPREP FEATURE
AT THE END OF THE CHAPTER**

1A. Sue uses her smartphone to purchase a video security system for her architectural firm from Tipton, Inc., a company that is located in a different state. The system arrives a month after the projected delivery date, is of poor quality, and does not function as advertised. Sue files a suit against Tipton in a state court. Does the court in Sue's state have jurisdiction over Tipton? What factors will the court consider? Yes, the court in Sue's state has jurisdiction over Tipton on the basis of the company's minimum contacts with the state.

Courts look at the following factors in determining whether minimum contacts exist: the quantity of the contacts, the nature and quality of the contacts, the source and connection of the cause of action to the contacts, the interest of the forum state, and the convenience of the parties. Attempting to exercise jurisdiction without sufficient minimum contacts would violate the due process clause. Generally, courts have found that jurisdiction is proper when there is substantial business conducted online (with contracts, sales, and so on). Even when there is only some interactivity through a Web site, courts have sometimes held that jurisdiction is proper. Jurisdiction is not proper when there is merely passive advertising.

Here, examining all of these factors, particularly the sale of the security system to a resident of the state and the relative inconvenience of the plaintiff to litigate in the defendant's state, the defendant had sufficient minimum contacts with the state to justify the exercise of jurisdiction over the defendant without violating the due process clause.

2A. *The state in which Sue resides requires that her dispute with Tipton be submitted to mediation or nonbinding arbitration. If the dispute is not resolved, or if either party disagrees with the decision of the mediator or arbitrator, will a court hear the case? Explain.* Yes, if the dispute is not resolved, or if either party disagrees with the decision of the mediator or arbitrator, a court will hear the case. It is required that the dispute be submitted to mediation or arbitration, but this outcome is not binding.

ANSWERS TO BUSINESS SCENARIOS AND BUSINESS CASE PROBLEMS AT THE END OF THE CHAPTER

2-1A. **Standing**
(Chapter 2—Page 36)

This problem concerns standing to sue. As you read in the chapter, to have standing to sue, a party must have a legally protected, tangible interest at stake. The party must show that he or she has been injured, or is likely to be injured, by the actions of the party that he or she seeks to sue. In this problem, the issue is whether the Turtons had been injured, or were likely to be injured, by the county's landfill operations. Clearly, one could argue that the injuries that the Turtons complained of directly resulted from the county's violations of environmental laws while operating the landfill. The Turtons lived directly across from the landfill, and they were experiencing the specific types of harms (fires, scavenger problems, groundwater contamination) that those laws were enacted to address. Thus, the Turtons would have standing to bring their suit.

2-2A. **Jurisdiction**
(Chapter 2—Page 29)

Marya can bring suit in all three courts. The trucking firm did business in Florida, and the accident occurred there. Thus, the state of Florida would have jurisdiction over the defendant. Because the firm was headquartered in Georgia and had its principal place of business in that state, Marya could also sue in a Georgia court. Finally, because the amount in controversy

exceeds \$75,000, the suit could be brought in federal court on the basis of diversity of citizenship.

2–3A. BUSINESS CASE PROBLEM WITH SAMPLE ANSWER—*Arbitration clause*

Based on a recent holding by the Washington state supreme court, the federal appeals court held that the arbitration provision was invalid as unconscionable. Because it was invalid, the restriction on class action suits was also invalid. The state court held that for consumers to be offered a contract that class action restrictions placed in arbitrations agreements improperly stripped consumers of rights they would normally have to attack certain industry practices. Such suits are often brought in cases of deceptive or unfair industry practices when the losses suffered by the individual consumer are too small to warrant a consumer bringing suit. That is, the supposed added cell phone fees are small, so no one consumer would be likely to litigate or arbitrate the matter due to the expenses involved. Eliminating that cause of action by the arbitration agreement violates public policy and is void and unenforceable.

2–4A. *Venue*
(Chapter 2—Page 36)

The purpose behind most venue statutes is to ensure that a defendant is not “hailed into a remote district, having no real relationship to the dispute.” The events in dispute have no connection to Minnesota. The Court stated: “Looked at through the lens of practicality—which is, after all, what [the venue statute] is all about—Nestlé’s motion can really be distilled to a simple question: does it make sense to compel litigation in Minnesota when this state bears no relationship to the parties or the underlying events?” The court answered no to this simple question. The plaintiff resides in South Carolina, her daughter’s injuries occurred there, and all of her medical treatment was provided (and continues to be provided) in that state. South Carolina is the appropriate venue for this litigation against Nestlé to proceed.

2–5A. *Arbitration*
(Chapter 2—Page 42)

In many circumstances, a party that has not signed an arbitration agreement (Kobe in this case) cannot compel arbitration. There are exceptions, however. According to the court, “The first relies on agency and related principles to allow a nonsignatory (Kobe) to compel arbitration when, as a result of the nonsignatory’s close relationship with a signatory (Primenergy), a failure to do so would eviscerate [gut] the arbitration agreement.” That applies here. Kobe and Primenergy claimed to have entered into a licensing agreement under the terms of the agreement between PRM and Primenergy. The license agreement is central to the resolution of the dispute, so Kobe can compel arbitration. Similarly, all claims PRM has against Primenergy go to arbitration because the arbitration clause covers “all disputes.” That would include allegations of fraud and theft. Such matters can be resolved by arbitration. “Arbitration may be compelled under ‘a broad arbitration clause ... as long as the underlying factual allegations simply “touch matters covered by” the arbitration provision.’ It generally does not matter that claims sound in tort, rather than in contract.” The reviewing court affirmed the trial court’s decision.

2–6A. SPOTLIGHT ON NATIONAL FOOTBALL LEAGUE—Arbitration

An arbitrator's award generally is the final word on the matter. A court's review of an arbitrator's decision is extremely limited in scope, unlike an appellate court's review of a lower court's decision. A court will set aside an award 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.

In this problem, and in the actual case on which this problem is based, the NFLPA argued that the award was contrary to public policy because it required Matthews to forfeit the right to seek workers' compensation under California law. The court rejected this argument, because under the arbitrator's award Matthews could still seek workers' compensation under Tennessee law. Thus, the arbitration award was not clearly contrary to public policy.

2–7A. *Minimum contacts*

(Chapter 2—Page 29)

No. This statement alone was insufficient to establish that Illinois did not have jurisdiction over the defendant. The court ruled that Med-Express failed to introduce factual evidence proving that the Illinois trial court lacked personal jurisdiction over Med-Express. Med-Express had merely recited that it was a North Carolina corporation and did not have minimum contacts with Illinois. Med-Express sent a letter to this effect to the clerk of Cook County, Illinois, and to the trial court judge. But that was not enough. When a judgment of a court from another state is challenged on the grounds of personal jurisdiction, there is a presumption that the court issuing the judgment had jurisdiction until the contrary is shown. It was not.

2–8A. *Arbitration*

(Chapter 2—Page 42)

Yes, a court can set aside this order. The parties to an arbitration proceeding can appeal an arbitrator's decision, but court's review of the decision may be more restricted in scope than an appellate court's review of a trial court's decision. In fact, the arbitrator's decision is usually the final word on a matter. A court will set aside an award if the arbitrator exceeded her or his powers—that is, arbitrated issues that the parties did not agree to submit to arbitration.

In this problem, Horton discharged its employee de la Garza, whose union appealed the discharge to arbitration. Under the parties' arbitration agreement, the arbitrator was limited to determining whether the rule was reasonable and whether the employee violated it. The arbitrator found that de la Garza had violated a reasonable safety rule, but "was not totally convinced" that the employer should have treated the violation more seriously than other rule violations and ordered de la Garza reinstated. This order exceeded the arbitrator's authority under the parties' agreement. This was a ground for setting aside the order.

In the actual case on which this problem is based, on the reasoning stated here, the U.S. Court of Appeals for the Fifth Circuit reached the same conclusion.

2–9A. A QUESTION OF ETHICS—Agreement to arbitrate

(a) This is very common, as many hospitals and other health-care providers have arbitration agreements in their contracts for services. There was a valid contract here. It is presumed in valid contracts that arbitration clauses will be upheld unless there is a violation of public policy. The provision of medical care is much like the provision of other services in this regard. There was not evidence of fraud or pressure in the inclusion of the arbitration agreement. Of course there is concern about mistreatment of patients, but there is no reason to believe that arbitration will not provide a professional review of the evidence of what transpired in this situation. Arbitration is a less of a lottery that litigation can be, as there are very few gigantic arbitration awards, but there is no evidence of systematic discrimination against plaintiffs in arbitration compared to litigation, so there may not be a major ethical issue.

(b) McDaniel had the legal capacity to sign on behalf of her mother. Someone had to do that because she lacked mental capacity. So long as in such situations the contracts do not contain terms that place the patient at a greater disadvantage than would be the case if the patient had mental capacity, there is not particular reason to treat the matter any differently.

2–10A. LEGAL REASONING GROUP ACTIVITY—Access to courts

(a) The statute violates litigants' rights of access to the courts and to a jury trial because the imposition of arbitration costs on those who improve their positions by less than 10 percent on an appeal is an unreasonable burden. And the statute forces parties to arbitrate before they litigate—an added step in the process of dispute resolution. The limits on the rights of the parties to appeal the results of their arbitration to a court further impede their rights of access. The arbitration procedures mandated by the statute are not reasonably related to the legitimate governmental interest of attaining less costly resolutions of disputes.

(b) The statute does not violate litigants' constitutional right of access to the courts because it provides the parties with an opportunity for a court trial in the event either party is dissatisfied with an arbitrator's decision. The burdens on a person's access to the courts are reasonable. The state judicial system can avoid the expense of a trial in many cases. And parties who cannot improve their positions by more than 10 percent on appeal are arguably wasting everyone's time. The assessment of the costs of the arbitration on such parties may discourage appeals in some cases, which allows the courts to further avoid the expense of a trial. The arbitration procedures mandated by the statute are reasonably related to the legitimate governmental interest of attaining speedier and less costly resolution of disputes.

(c) The determination on rights of access could be different if the statute was part of a pilot program and affected only a few judicial districts in the state because only parties who fell under the jurisdiction of those districts would be subject to the limits. Opponents might argue that the program violates the due process of the Fifth Amendment because it is not applied fairly throughout the state. Proponents might counter that parties who object to an arbitrator's decision have an opportunity to appeal it to a court. Opponents might argue that the program exceeds what the state legislature can impose because it does not reasonably relate to a legitimate governmental objective—it arbitrarily requires only litigants who reside in a few jurisdictions to submit to arbitration. Proponents might counter that this is aimed at the reduction of court costs—that the statute rationally relates to a legitimate governmental end. An equal protection challenge would most likely be subject to a similar rational basis test. Under these

and other arguments, the reduction of court costs would be a difficult objective to successfully argue against.