THE U.S. LEGAL SYSTEM IN A PEANUT

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[Note: This Peanut provides a brief, non-technical introduction to legally complex issues. In the interest of brevity, generalizations are made without the qualifications needed to make them accurate. This Peanut is for use by John Akula as an instructional aid in his classes, and should not be used for any other purpose without the author's permission.]

This Peanut provides an introduction to the U.S. legal system, especially as it relates to business and commerce. It is designed to be of use to readers who are not trained in law, as well as readers who are trained in a legal system other than that of the U.S.

Much of this description emphasizes aspects of the U.S. legal system that are distinctive in comparison to the legal system of other economically highly developed nations, especially Europe and Japan. While a comparative perspective is helpful, the reader should be aware that the U.S. legal system is the only one I know well, and that comparative legal scholarship is largely impressionistic. Thus, while the comparative views offered here are for the most part widely shared, they are not grounded in any rigorous analysis.

I. THE "RULE OF LAW" – AND LOTS OF LAWYERS.

Certain distinctive features of the U.S. system are relatively clear. There are an exceptionally large number of lawyers in the U.S., who play an unusually broad role as advisors to business. Business deals are legalistic, with heavy reliance on detailed contracts, and with lawyers often advising their clients on a broad range of issues which go beyond technical legal matters, and assisting or representing their clients in negotiations. If deals go sour, U.S. companies are quicker to litigate than their counterparts elsewhere in the world.

The high profile of law and lawyers extends beyond the world of business. In the U.S., the judicial branch of government has exceptionally high stature relative to the executive and legislative branches, and disputes of all kinds tend to end up in court. Lawyers are prominent in politics – about half of the men and women who sit in Congress are lawyers.

Many commentators believe that underlying these tangible features are more fundamental differences in values and belief – that, in the U.S., there is a greater tendency to think of law as the appropriate tool for the solution to many kinds of problems; and that individual "rights" and the "rule of law" both have an especially central role in the political culture.

If this characterization has some truth – and I think it does – there are many different considerations that might help explain it. The U.S. legal system has its historical roots in that of

England, with its own strong traditions of an independent judiciary and judge-made law. The U.S. is an exceptionally diverse nation, which can weaken the role of less formal cultural norms in channeling behavior into acceptable directions, and shift more of that burden to the legal system. The strong belief in the U.S. in democracy and the rejection of rigid class lines resonate with the "rule of law" as a constraint upon privilege. The strong emphasis on individualism and freedom may also have a role here, with law being both an especially tolerant form of restraint in some ways but also a final check on excess.

The business community, like the rest of the U.S., is ambivalent about this legalistic tilt, which is seen as having both major costs and benefits. For example, when, in the early 1930's, soon after the stock market crash of 1929, Congress enacted the system of securities market regulation which is still largely in effect today, many in the financial community considered this as a disastrous intrusion of government and predicted that "grass would grow on Wall Street." There are still widespread concerns about the burdensomeness of securities regulation, especially on new issuers, and on its role as a generator of what the business community views as often frivolous litigation. Nevertheless, the financial community generally regards the system of securities regulation as the foundation for what it sees as the best functioning securities markets in the world.

II. FEDERALISM AND THE CONSTITUTION

Two key distinctive features of the U.S. legal system are federalism and the role of the federal Constitution in the design of that federalism. The legal system in the U.S. reflects the fundamental division of power between the unitary national or "federal" government on the one hand and the fifty state governments on the other. (There are also "local" governments such as counties, cities and towns, but these are creatures of state law operating under what are usually very modest delegations of a state's authority.) The framework of this division of power, and a great deal else of importance, is set out in the federal Constitution, which is for many purposes the highest "law of the land." (Individual states also have constitutions, which are significant as to many state law matters, but in this discussion, the term "Constitution" refers to the federal document, unless otherwise indicated.)

A. The division of power between the national and state governments. Read literally, the Constitution sets out certain specific powers granted to the federal government, reserving all others to the states, and in that sense the federal government is a government of limited powers. However, the Constitution, like other laws, for practical purposes says what judges assert that it says. In matters of constitutional law, the U.S. Supreme Court has the final say, and the long history of constitutional decision making in the U.S. has, with occasional countercurrents, expanded the federal power, to the point where, in matters of business regulation, the powers of the federal government are very broad and likely to be upheld absent some explicit constitutional check on that power.

When Congress enacts a law that is within the Constitutional limits on its powers, a state law in conflict with federal law (which for these purposes includes the Constitution, federal statutes, and federal regulations) will be struck down under the Constitution's "Supremacy Clause." However, the Supremacy Clause has an impact beyond state laws that are in direct

conflict with federal law. Under the "preemption" doctrine, state legislation can be struck down when it frustrates a federal legislative design even absent a direct conflict with federal law. The scope of preemption varies for different federal laws, depending upon explicit or implicit indications of the extent to which preemption was intended or is required to achieve the federal purpose.

The power to regulate interstate commerce under the Constitution's "Commerce Clause" is one of the federal powers which has been construed most broadly, and allows comprehensive federal regulation of many commercial activities, even including many activities that may seem primarily local, on the grounds that these local activities have significant ties with and effects upon interstate commerce. However, Congress has been selective in using its powers, and state law is still an important source of law for many commercial activities. For example, state law dominates the law of contracts, real estate, trade secrets, and security interests in property.

However, the interplay of state and federal law is quite complex, and there are a variety of different patterns, of which some examples follow. The fact that most contract law is state law does not prevent the federal government from heavily regulating certain kinds of contracts, such as those relating to consumer lending, or the sales of securities, or the transfer of rights in patents. Federal environmental law can override state regulation of land use, but states can also impose environmental standards that are stricter than federal law. Whether an employer can fire an employee is largely a matter of state law, but the federal government tightly regulates firing in the context of unionization activities, forbids discrimination in firings and other employment-related decisions, and tightly regulates the treatment of pension rights. Trade secret law is largely state law, but Congress has enacted some federal legislation to protect trade secrets, especially in the context of industrial espionage. The Constitution gives Congress the power to legislate regarding patents, and the patent system which Congress has established leaves almost no room for state law. The Constitution also gives Congress the power to legislate concerning bankruptcy, and Congress has established a system of federal bankruptcy law and bankruptcy courts, but the federal bankruptcy law leaves certain matters relating to creditors rights and remedies to state law even in the bankruptcy context. Generally, conduct forbidden by federal law cannot be protected by state law, but even that rule has exceptions; for example, the federal antitrust laws permit state governments to require or permit conduct by private parties that would otherwise violate the federal antitrust laws, under the so-called "state action" exemption. Whether or not the federal government chooses to defer to state regulation is to some extent a matter of tradition; for example, there is nothing particularly "local" about the insurance industry, but Congress has left regulation of insurance largely to the states. In short, there is no simple way to describe the many different patterns that have emerged.

The activities of a business often cross state lines, and a business generally does not like the burden of conforming to a variety of different state standards, which is a recurring problem when an activity has been left to state regulation. If a business has developed a contract for the sale of goods to its customers, it would like that contract to have the same effect in Massachusetts and Connecticut. This is one of the most common reasons that business, despite its broad mistrust of "big government," will often support federal legislative or regulatory initiatives, which impose a nationwide uniform standard. Another approach is to "harmonize" the laws of the different states. There are several well-established paths to harmonization. For example, the Uniform

Commercial Code, which has been adopted in every state, with some mostly small variations, grew out of a joint effort by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Judges in one state are not bound by the decisions of judges elsewhere, but will often give them weight.

B. Civil rights. The strong legal commitment to certain basic individual rights (or "civil rights") in the U.S. has many legal roots, but the most important, especially in recent years, are a set of provisions in the federal constitution, relating to such matters as freedom of expression; limitations on the police powers, especially in connection with investigations and prosecutions of individuals; and assurances of equal protection of the laws and due process under law. These constitutional provisions have assumed greater significance for at least three reasons. First, these provisions are typically quite skeletal, involving only a short phrase, and their scope is left to judicial interpretation which, with some cross-currents and back-eddies, have generally become broader over the last 50 years or so. Second, although these provisions often explicitly apply only to the federal government and for many years were so read, they are now interpreted as constraints upon state and local government as well. Third, the availability of practical remedies for those who allege that their rights have been abridged has over the long term expanded, through various statutes and judicial doctrines. [1]

For many legal purposes, businesses and human beings are treated alike – both are legal "persons" with similar rights under the law with respect to, for example, the rights to own property, enter contracts, and to bring law suits. However, business entities typically receive much less protection with respect to "civil rights." For example, when corporations engage in "speech" it is often so-called "commercial speech," which the government is free to regulate quite heavily. Companies and business premises do not have the same protection against intrusive searches and seizures. Under the 5th amendment to the constitution, an individual who is charged with a crime can generally refuse to supply testimony against himself, but a company has no such right.

C. International treaties. Treaties are a distinctive kind of law. Most commercial treaties represent a promise by the signatory nations to enact domestic legislation in conformity with the treaty obligations. However, the treaty typically has no direct effect until such legislation is enacted, and even then the domestic legislation is effective in accordance with its own terms, which may or may not precisely conform to the treaty obligations.

In the hierarchy of legal enactments recognized by the Constitution, the federal constitution outranks other federal law, and federal law outranks state law. However, international treaties or other agreements do not outrank U.S. law. Although there are many variations, a treaty typically has the same legal dignity as an enactment by Congress. Thus, state law which is inconsistent with such a treaty can be struck down, but Congress is free to legislate in contradiction to a treaty, just as it could legislate in contradiction to an earlier law passed by

1 Many state constitutions also address fundamental rights, but the federal provisions have generally been the cutting edge of expanding doctrine in this area. Since the federal provisions are binding upon state governments, more restrictive interpretations of parallel provisions in state constitutions have no impact. State constitutions or statutes can take a more expansive view of individual rights than the federal constitution for purposes of state law, and, especially when the federal judiciary is retrenching on one of these issues, as happens from time to time, a state's courts might interpret a state provision as having broader effect than the identical provision in the federal constitution.

Congress, thereby in effect amending the earlier law.

III. ADMINISTRATIVE AGENCIES.

The traditional branches of government recognized by the Constitution are the executive, legislature, and judiciary. However, for many government functions, especially those concerned with the regulation of business and commerce, the day-to-day work is done primarily by administrative agencies, such as the Securities and Exchange Commission (SEC), the Federal Communications Commission (FCC), or the Internal Revenue Service (IRS).

Congress (or, in the case of state agencies, the state legislature) must delegate authority to the agency. This delegation is sometimes detailed and specific, but can also be cast in terms of general standards, leaving the agency with broad discretion on how to implement its legislative mandate. Congress has also enacted the Administrative Procedure Act ("APA"), which establishes a general legal framework for the operation of federal agencies, although Congress has also enacted provisions relating to specific agencies, which are controlling for those agencies.

Administrative agencies are a mix of executive, legislative and judicial-like powers. Agencies are part of the executive branch, and enforce the law. However, they also make law, in the form of formal regulations as well as informal guidance. Formal regulations issued by a federal agency have the same dignity under the Supremacy Clause as an enactment of Congress. Agencies also typically perform judicial-like functions. They often have the power to hear and decide disputes, sometimes in "administrative courts" nested within the agency.

An industry which is regulated by an administrative agency has, as a practical matter, three primary avenues for shaping agency policy. First, there are direct appeals to the agency itself. Under the APA, opportunities for public input are required, most significantly in connection with the issuance of regulations, and there are typically many opportunities for less formal industry input as well. Second, an industry can appeal to Congress, which can formally instruct an agency through legislation and can informally influence agency policy as well, especially through the appropriations process. Third, judicial review of formal agency actions is generally available to affected parties. However, that review is by law deferential to the agency. Unless a court can be convinced that an agency misinterpreted the law – and often the legal standards applicable are very broad – agency action will typically be reversed only if the agency has "abused its discretion," a legal test which is difficult to meet. .

Agencies have differing degrees of independence from the central executive authority. One important distinction in this regard is the difference between what are commonly referred to as "independent" agencies as opposed to "line" agencies. Independent agencies are generally run by a board of commissioners, who serve for fixed staggered terms, such as the Commissioners who head the SEC or the FCC. By contrast, a "line" agency is typically run by an appointee who serves at the pleasure of the President in the case of federal agencies, or the governor in the case of state agencies, and thus may be less significant as an independent source of policy. The federal government's Department of Justice and Internal Revenue Service are line agencies in that sense.

IV. THE IMPORTANCE OF COURTS AND JUDGE-MADE LAW.

Judges everywhere resolve disputes between parties by applying the law, and in doing so to some extent clarify what the law means. However, U.S. judges are exceptionally comfortable playing an explicit role in shaping the law
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Partly this is a reflection of the "common law" tradition inherited from England. Historically, the common law was a body of judge-made law, consisting of doctrines set out in court decisions with little or no basis in statutes. There are now many fewer areas of business activity where the federal and state legislatures have been completely inactive, leaving room for a relatively pure tradition of judge-made doctrine, but the common law tradition still exerts influence.

The central role of the federal Constitution in the U.S. legal system has also contributed to the prominent role of the judiciary. When a law is challenged as unconstitutional, it is a judge who must determine whether it survives. And the Constitution itself is skeletal, with almost every key doctrine is set forth in no more than a brief phrase (such as "equal protection of the laws," or "freedom of speech" or "unreasonable searches and seizures"), thus inviting judicial elaboration.

Perhaps because of the high level of comfort in the U.S. with judges who take a broad view of their role, many legal standards in the U.S., whether statutory or judicial, are quite broad, to an extent that often surprises lawyers and businesspeople from other countries. A statute that prohibits "unfair and deceptive practices," or a common-law doctrine that requires "reasonable" care, can be very frustrating to a businessperson seeking guidance, but is a kind of standard with which the U.S. legal system is quite comfortable.

V. THE U.S. SYSTEM OF COURTS.

The U.S. has a complex system of courts, consisting of the federal system and the 50 separate state court systems.

Federal courts. The federal system has three primary levels. Almost all cases are initially brought, heard, and decided in "trial courts," which in the federal system are also called the "District Courts." There are federal district courts in each state, and some states are divided into more than one district. Thus there is the federal District Court for Wyoming, and the federal District Court for the Southern District of New York. Although these courts are identified by the locale in which they sit, they are purely instruments of federal power: that is, the federal District Court for Wyoming does not draw any of its authority from the state of Wyoming.

Federal district courts hear both civil and criminal matters. Criminal cases are brought by the state, and involve charges that an individual or a business, referred to as the defendant, has committed a crime. Thus a criminal case might be designated as *U.S. v. Jesse James*, or *Commonwealth v. Smith.* Civil matters most often involve two (or more) private parties: the "plaintiff" who has brought the suit, and the "defendant" against whom some kind of relief is being

claimed. If Smith sues Jones for damaging Smith's property, the case will be designated *Smith v. Jones.* The government can also bring civil actions under a variety of statutes, or be a defendant in a civil matter (although typically special rules apply to suits against governments).

Generally, a party who is unsatisfied with the outcome at trial can file an appeal. In the federal court system, appeals go to federal "Courts of Appeal," also called the "Circuit Courts." There are eleven numbered Circuit Courts (such as The Sixth Circuit), each of which hears appeals from a specific group of states. Thus the Sixth Circuit hears appeals from the district courts in Kentucky, Michigan, Ohio and Tennessee, and the Sixth Circuit's decisions are binding on all the district courts within those states. In addition, there is the D.C. Circuit, which hears cases arising in the District of Columbia and a disproportionate number of appeals relating to the decisions of federal agencies. Lastly, there is the "Federal Circuit," established in 1982, which hears appeals from all of the federal district courts relating to the U.S. patent laws and certain other matters. Generally, an appeal before a Circuit Court is heard by a panel of three judges, although sometimes all the judges from the Circuit will hear a case, sitting "en banc."

The right of a party to appeal a trial court decision to a Circuit Court is very broad. (One major exception is that the government cannot appeal a "not guilty" verdict in a criminal matter.) However, an appeal is not a fresh trial. The appellate court will review certain specified issues which have been raised by the party initiating the appeal (called the "appellant", in contrast to the "appellee," who is the party who will be arguing in favor of sustaining the decision of the trial court). These issues are reviewed under a complex set of legal standards that are typically quite deferential to the decisions made below by the trial court. For example, findings of fact made by a trial court are very rarely disturbed, unless the appeals court finds a total lack of supporting evidence in the record. Likewise, a trial judge makes a great many discretionary decisions in connection with managing a trial, ruling on motions on discovery and evidence and procedure, which are also rarely overturned, except in exceptional circumstances where the appeals court finds an "abuse of discretion." However, an appeals court will take a fresh look at the way the trial court interpreted the law applied to a case, and substitute its own reading of the law if it concludes that the trial court was in error.

At the top of the federal court system sits the U.S. Supreme Court. Except in certain very limited circumstances, usually relating to the constitutionality of a statute, there is no right of appeal to the Supreme Court. A party who wants a case heard by the Supreme Court petitions the court (by filing a "writ of certiorari"), and the court decides whether or not to hear the case by "granting cert." or "denying cert." The great majority of such petitions are denied.

The Supreme Court's decision on whether to hear a case is likely to be shaped by many factors other than the interest in a correct outcome for the particular party seeking review. For example, if a new statute is to be construed, the Supreme Court may wish to wait several years before hearing any matters relating to it, in order to have the benefit of a rich array of lower court decisions.

State courts. Each of the 50 states has its own system of courts, and the specific arrangements vary, as do the names by which the different levels of courts are known. However, the pattern of trial courts, one of more levels of intermediate appellate courts, and a high court

which to a large degree controls its own docket is a common pattern. Lower state courts are also typically identified with reference to the specific locality in which they sit. For example, Massachusetts is divided into counties, one of which is called Middlesex, and the state trial courts for Middlesex county are commonly referred to as the Middlesex County courts. However, these are state courts, and not courts which draw their authority from county government. There are sometimes truly local courts which have been established pursuant to special state legislation, especially in some large cities, but these generally deal with limited matters such as housing.

VI. JURISDICTION: THE POWER TO MAKE LAWS

The terminology of "jurisdiction" sounds technical, but the practical implications are important and clear: the rules on "jurisdiction" determine which laws apply to what conduct, and which courts will hear what disputes.

"Jurisdiction" has multiple meanings. It sometimes refers to the power of a court to hear and decide a particular dispute – that aspect of jurisdiction is discussed in Section VII below.

"Jurisdiction" also sometimes refers to the geographical area under the control of a lawful authority, as in "He found out the police were looking for him and he fled the jurisdiction."

A closely-related meaning refers to the geographical reach of a state's law-making power. Generally speaking, conduct which takes place within a governing entity's geographical boundaries is subject to that entity's law-making power, or "jurisdiction." But complex factual patterns can arise, and often do in the world of business. For example, can the U.S. claim jurisdiction under its insider trading laws on trades implemented in London on the London stock exchange? The answer to this question might depend on many factors, such as whether the trades were in the stock of a company also listed on a U.S. exchange, whether the parties implementing the trades were U.S. nationals, and whether the trades were intended to have an impact within the U.S. Jurisdiction in this sense must be based on some reasonable relationship to the conduct at issue. This is a loose test, and often conduct which is not purely local will arguably be subject to the jurisdiction of more than one law-making authority. To complicate matters further, any one law-making entity claiming jurisdiction may be more or less cooperative or obstructionist with respect to competing jurisdictional claims.

VII. JURISDICTION: THE POWER OF COURTS TO HEAR DISPUTES.

Another important meaning of "jurisdiction" refers to the power of a particular court to hear and decide a particular dispute. The jurisdiction of a court typically has two components. First, the court must have "subject matter jurisdiction," which is to say that the legal issues raised in the matter must be ones which that court is empowered to hear. Second, a court must have "jurisdiction over the parties" to that particular dispute, which is sometimes referred to as "personal jurisdiction." The U.S. system of federalism makes these issues much more complex than they are in most other countries.

Subject-matter jurisdiction. One key issue in the U.S. is the delineation of subject-matter jurisdiction for federal courts as opposed to state courts. Generally speaking, a federal court has subject matter jurisdiction over a case if the case meets either the "federal question" test or the "diversity" test. A case involves a "federal question" if one of the legal issues arises under the U.S. Constitution, a federal statute, or a federal regulation. A case meets the "diversity" test if the plaintiff and the defendant are from different states. Historically, diversity jurisdiction was more important during the nation's early development, when there were deeper concerns about geographical bias in state courts. Federal question jurisdiction has become more central as that concern has relaxed, and as there has been a great expansion of substantive federal law. Federal courts hear state law issues in diversity cases, and also in cases where there is a mixture of state and federal law questions.

State courts generally have subject matter jurisdiction for cases arising under either state or federal law (including federal constitutional questions). However, Congress can require that certain federal law issues be heard exclusively by federal courts, and has done so in a few areas, including cases arising under the U.S. patent statutes and antitrust statutes.

Another issue which arises in the U.S. system is the subject matter jurisdiction of the courts of any one particular state in relation to other states. If two residents of Illinois have an automobile accident in Illinois, and the only issue in the case is whether the drivers were being careful, a court in California, would not accept subject matter jurisdiction, even if both parties preferred having the matter heard there. However, in a business transaction which touches multiple states, the courts in more than one state are likely to have subject-matter jurisdiction over disputes relating to that transaction, and there are complex rules for determining in such a case where the matter will be heard. Often, as a practical matter, the party who initiates the law suit will be able to make that determination. Federal courts have national jurisdiction and sometimes take full advantage of that fact, but with respect to geographical reach in routine cases the federal courts have adopted rules very similar to the rules imposed on the states, so that typically the federal District Courts in Illinois will generally hear only cases which bear some relationship to Illinois.

At both the federal and state levels, the U.S. court system is tilted strongly towards courts of broad subject-matter jurisdiction. By contrast, some nations rely heavily on relatively specialized courts which hear only a narrow range of legal issues. A U.S. federal or state court will typically hear the full range of criminal and civil matters as to which that federal or state court system as a whole has jurisdiction. There are only a few exceptions to this pattern. For example, there are specialized federal courts which hear only bankruptcy matters, and at the appellate court

level there is the Federal Circuit, which hears all appeals from trial courts relating to patent matters. Delaware has separate state courts that hear matters under its corporation law.

Jurisdiction over the parties or "personal jurisdiction." In order to hear a case, a court must also have "jurisdiction over the parties" or "personal jurisdiction" over each party. If a court has personal jurisdiction over a defendant, it has the right to require that defendant's presence before it. Personal jurisdiction over the plaintiff is almost never a problem: by initiating a law-suit in a particular court, the plaintiff has consented to the exercise by that court of personal jurisdiction over himself. Personal jurisdiction over the defendant can be more problematic. If the defendant is physically present within the jurisdiction (in the geographical sense), the court can assert personal jurisdiction over the defendant as well. The more interesting cases involve defendants who do not have a clear physical presence within the jurisdiction, such as a manufacturer whose goods have been shipped to the jurisdiction, or the owner of a web site which is on a server outside the jurisdiction but the content of which can be accessed in the jurisdiction. Courts can sometimes but not always exercise personal jurisdiction over such remote defendants, under the exercise of what is often referred to as "long arm jurisdiction."

The reach of long-arm jurisdiction is especially significant to businesses. Many businesses participate in commerce that extends beyond the particular states in which those businesses have a substantial physical presence, and businesses are very concerned about the extent to which they can be forced to defend law-suits brought in remote jurisdictions. The controlling principles are very complicated, but one central principle is that a business will be generally be subject to the long arm jurisdiction of the courts in a particular jurisdiction if the business has in some way purposefully taken advantage of the opportunity of doing business in that state (a test often referred to as the "purposeful availment" test).

VIII. JURISDICTION: PRIVATE AGREEMENTS AS TO "CHOICE OF FORUM" AND "CHOICE OF LAW."

In many business transactions, the parties will attempt to reduce the uncertainties relating to jurisdictional questions by explicitly agreeing on which jurisdictions' law should apply (a "choice of law" provision), and on which courts should hear any disputes (a "choice of forum" provision). Such choices will usually be respected by the courts, but not always. For example, a court may not enforce a choice of law clause if the choice made undermines an important public policy of the jurisdiction.

In most cases, a court in a particular jurisdiction applies the laws of that jurisdiction, but this is not always the case. For example, a court in New York might hear a matter which involved some issues relating to a Delaware corporation as to which it was appropriate to apply Delaware law, which in that case would be referred to as "foreign law."

One "choice of forum" option that is of special interest to businesses is a binding agreement to use arbitration rather than go to court. Generally, this choice will also be respected. Courts will decline to hear a matter as to which the parties have agreed to arbitrate, even though one party now wishes to litigate. Courts will also generally enforce a valid arbitration award.

IX. SOME REASONS WHY LITIGATION IS SO COMMON

The United States has much more litigation than any other economically developed nation, and businesses in particular are the targets of law-suits. In many nations, the involvement of a business in a law suit is an extraordinary event. In the U.S., it is a routine part of running a business of any substantial size.

The reasons for this outlying position are many, and some are probably broad cultural factors which cannot be assessed with precision. However, there are also some very concrete reasons which we discuss below.

Contingent fee arrangements and the "plaintiff's bar." In the U.S., lawyers are allowed to take on a client who wants to obtain damages from another party under an arrangement in which the client is charged a "contingent fee." In a typical contingent fee arrangement, the client does not pay his or her lawyer anything unless damages are recovered from the party against whom the client has a grievance. If that other party does make a payment, either when litigation is threatened or after a lawsuit is commenced, the lawyer takes his expenses and his fee out of that payment. Typically, the lawyer's expenses are paid in full and then the client and the lawyer divide the rest with the client taking about two-thirds and the lawyer taking about a third.

The availability of such contingent fee arrangements, which are considered improper in much of the rest of the world, has several consequences. First, it makes litigation, and the credible threat of litigation, broadly available. In the absence of a contingent fee arrangement, a person with a meritorious claim but without the substantial funds otherwise needed to retain a lawyer and pursue litigation would typically be unable to effectively pursue that claim. As the defenders of the U.S. system point out, contingent fee arrangements are "the poor man's key to the courthouse."

Second, these arrangements provide a broad financial base for what is commonly called the "plaintiff's bar" – a large group of lawyers who specialize in bringing a constant stream of litigation against "deep pocket" defendants – most of which are businesses – from which substantial damages can be obtained. The plaintiff's bar adds a level of commitment to this kind of litigation. Bringing a law suit, even a meritorious one with a prospect of substantial recovery, is onerous, and a distraction from other obligations and opportunities which often drags on for years. A system which relies on the individual complainant to provide initiative and long-term commitment to the litigation process will generate and sustain much less litigation than a system in which a major segment of the legal profession earns its living by initiating and pushing such matters along.

The plaintiff's bar also provides sophistication. These firms are experts in identifying vulnerable targets. They build networks of ties with experts who can provide sympathetic testimony, and networks of informal communication and cooperation among firms pursuing the same targets. The larger plaintiffs' firms have the financial resources to fund long-term strategic litigation, which may involve carefully building a set of beneficial precedents which are themselves not profitable but which lay the groundwork for later profitable work.

Class action law-suits. The U.S. encourages "class action" lawsuits. If a group of potential plaintiffs can claim similar injuries with a common source – such as all of the shareholders of a company who are claiming to have lost money because of management misconduct, or a group of consumers who have been injured by a deceptive business practice or a product of a company – it is often possible to bring a single "class action" suit on behalf of that group of plaintiffs. This is especially important when it is unlikely that any significant number of individual plaintiffs would bring individual actions, perhaps because the damages suffered by any individual were small. Even modest individual claims, with a large enough class, can generate substantial recoveries. As a practical matter, such class action lawsuits are often orchestrated by the plaintiff's bar on a contingent fee basis approved by the court overseeing the class action procedure.

Private rights of action. When a law permits the government to seek penalties for misconduct, private parties harmed by that misconduct may or may not be allowed to seek damages. A good many regulatory statutes in the U.S. explicitly grant such "private rights of action." If the statute is silent, the question then arises of whether courts should recognize an "implied" private right of action, and in the U.S. such implied rights are often found.

Generous damages, compensatory and punitive. Litigation is also encouraged by the prospect of generous damages. The rules on the damages available for different legal injuries are very complex, but in general the U.S. system tilts to generous damages. Certain statutes provide for expansive damages to encourage litigation that might not otherwise be brought. For example, triple damages are available under certain state consumer protection statutes, or under the federal antitrust laws.

The U.S. is also permissive with respect to "punitive damages." Damages in civil litigation are usually "compensatory", i.e., designed to make up for the harm that has been suffered. Even compensatory damages may be more or less expansive – for example, compensation for "pain and suffering" in a personal injury case may allow far greater recovery than if compensation is limited to financially tangible harm, such as lost wages. However, punitive damages are based on the view that in some circumstances damages beyond compensation should be awarded to punish the party who committed the wrong and to deter others who might consider engaging in similar conduct. The U.S. Supreme Court has recently imposed some tighter limits on punitive damage awards, but such awards are one of the primary fears of businesses and a strong incentive for plaintiffs and their lawyers.

The jury system. The U.S. system of justice relies heavily on juries. Juries are often thought to be sympathetic to the "little people" who are frequently the plaintiffs in U.S. litigation, and willing to award generous damages, especially against corporate defendants.

Plaintiffs and the plaintiffs' bar as "private attorneys general." Many businesspeople believe that the U.S. approach to litigation makes them too vulnerable. They also believe that this vulnerability is often exploited with litigation that has little relationship to fundamental fairness and, in some cases, only a tenuous connection with the interests of the nominal plaintiffs as opposed to their lawyers.

In my view, that criticism has some merit, but there is a clear rationale, also with merit, for a system that so strongly encourages private litigation. When government polices standards of conduct in the business world, it typically brings limited resources to the task, and political pressures and lack of incentives may blunt the effective use of even those resources. The plaintiffs' bar and its clients subjects business to more systematic, penetrating, and zealous scrutiny. In that respect, they function as "private attorneys general." An "attorney general" is always a public office, and this play on words highlights that private litigants perform a public function, benefiting not just themselves, but everyone who is better off if businesses know that their conduct will get a "hard look" even when public regulatory scrutiny is lax.

X. THE STAGES OF A LAW-SUIT

Litigation can take many different paths, but the following is a brief discussion of what are typically the major stages in a lawsuit. At any point in this process, the parties may settle the matter, and are typically very strongly encouraged to do so by the court, except in the rare case in which there is a public interest in having a full adjudication. The proportion of lawsuits which actually go to trial is very small – settlement is the norm.

Initiating a law-suit and "notice pleading." Every legal system must strike a balance between permitting a party to bring a claim which it cannot yet prove and using the lawsuit as a vehicle for developing that proof, while protecting the potential defendant from frivolous litigation. The U.S. tilts towards permitting litigation, and generally a good faith belief that sufficient evidence may subsequently be developed is all that is required. A civil lawsuit in the U.S. may also generally be initiated with what is called "notice pleading" – a complaint which does little besides put the defendant on notice of the general nature of the law suit.

The early framing of the issues and parties. Once a lawsuit has been initiated, it is common for many related parties to be swept into it, and there is also a strong tendency for each every party to raise every legal issue that might relate to the initial dispute. Partly this reflects tactics, as each party looks for leverage. It also reflects the rules of procedure, which strongly encourage a broad framing of the issues, so as to minimize the likelihood of multiple law suits on different aspects of the same dispute. In fact, a party which does not raise a relevant issue may lose its right to do so at a later time.

Discovery. After the initial round of filings has been completed, the case enters the "discovery" phase. Discovery is the process by which the parties are given the right to search for evidence. There are many discovery tools: requests for documents, which include not only paper documents but e-mail and other electronic records; interrogatories, in which a party provides written questions to which written answers must be provided; and depositions, in which the attorneys for one party can question another party under oath with a written transcript made of the proceedings. The boundaries of discovery are very broad – a party can attempt to elicit not just information that would be admissible as evidence at trial but information that might lead to such evidence.

One important set of materials generally excluded from discovery is privileged communications between an attorney and a client and the attorney's work product.

Being the target of discovery can be very burdensome. It can cost millions of dollars in major commercial litigation, and be extremely disruptive to a business. It can also be threatening to a business or its managers in other ways, depending in part upon the extent of conduct within the business which would be an embarrassment were it to come to light. This is a fact which plaintiff's attorneys understand well. While a business defendant is likely to view such pressures as extortion, the plaintiffs' bar is more likely to view this leverage as a social good, discouraging businesses from the kind of conduct which makes them vulnerable to these pressures.

Discovery is designed to eliminate the element of surprise in any subsequent trial and to encourage settlement. For example, once key witnesses have been deposed, their testimony has in effect been heard. As discovery moves forward, the parties' views of the merits of the case, which are often divergent at the outset, may converge as the record becomes clearer, and settlement becomes more likely.

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Narrowing the issues and motions for "summary judgment." Although the early framing of a lawsuit is typically very broad, there are procedures for narrowing the issues as an increasingly clear factual record emerges during discovery. The most important of these procedures is the motion for "summary judgment." As a lawsuit goes forward, a party may bring a motion for summary judgment, arguing that it should win on a particular legal issue on the basis of the undisputed facts, or, to the extent relevant facts are still genuinely disputed, even if the opposing party's view of those facts is assumed to be true. A motion for summary judgment may be sought by a plaintiff to establish liability, or by a defendant to establish the absence of liability. Cases often settle after one or more motions for summary judgment have been decided. When that happens the judge's opinion on summary judgment will be as close as the court comes to a final decision.

Preliminary relief. Occasionally, a court may grant preliminary relief, prior to a final decision on the merits. The most important of these is preliminary injunctive relief, which is an order to a party to take or stop taking certain action. Preliminary injunctive relief is available only under narrow circumstances, but is more common in some kinds of disputes than others. For example, in cases where a defendant is alleged to be infringing a patent, a plaintiff can often obtain preliminary injunctive relief if the plaintiff can convince the court that the plaintiff is likely to prevail on the merits after a full trial. If preliminary injunctive relief is granted, the parties often settle in light of the court having clearly signaled what it expects to be the final outcome.

Trial and the roles of the judge and the jury. If a case comes to trial, there are a new set of rules of procedure and evidence that apply to the trial itself. Generally speaking, these rules are designed (unlike the rules of discovery) to keep the proceeding focused narrowly on the particular dispute at hand.

Juries play an especially important role in the U.S. The right to a jury is enshrined in the Constitution**.** It is the judge's role to decide matters of law, but it is the jury's responsibility to determine the facts, based upon the testimony and other evidence which has been presented.

Typically, after all the evidence has been heard, a judge will provide the jury with a set of instructions, setting out the rules of law which apply to the case, giving the jury a roadmap to the results it should reach in compliance with the law depending upon its conclusions as to the key facts. In a case where the jury has been waived, the judge decides matters of both fact and law.

XI. SOME SUBSTANTIVE CHARACTERISTICS OF U.S. BUSINESS LAW.

Several relatively distinctive features of the U.S. legal system have already been discussed. This section is a very brief survey of some others that have a direct impact on business.

A. The criminal law as a tool of business regulation. The United States places especially heavy reliance upon the harsher aspects of the criminal law in the policing of business misconduct. This applies to the punishment of business entities such as corporations, but even more dramatically to the use of jail and other severe sanctions against individual managers.

B. Contractual and non-contractual liability: a very expansive tort law. There are two primary sources of liability among private parties. One is the law of contracts, which imposes liability upon a party who fails to live up to the obligations which it voluntarily assumed in a contractual relationship. Business contracts in the U.S. are often thought to be more detailed than in most other countries, although that may have more to do with heavier "lawyering" of business deals than with any differences in the underlying law of contracts, and in any event there has been a strong trend in other major nations in recent years towards more detailed "American-style" contracts and documentation in major deals.

The second source of liability is referred to as "non-contractual" liability in most countries, and called "tort" liability in the U.S. Here the U.S. is very distinctive. Non-contractual or tort liability is a broad collection of doctrines that relate generally to the responsibilities we take on to others apart from those which are imposed by the contracts to which we agree. If contracts are "the law of the deal," torts, or non-contractual liability, are "the law of duties." There is a very long list of these duties, of which a small sampling might include the duty of the driver of a car to exercise reasonable care to not injure other drivers or pedestrians; the duty of a doctor to provide professional adequate medical care to a patient; the duty of the directors of a corporation to act in the best interests of the shareholders; and the duties all of us have to respect the privacy of others. As the list suggests, some of these duties arise in relatively narrow circumstances, and some apply more broadly. Liability arises when one party fails to meet such a duty, and that failure causes harm to another party, who is then allowed to seek compensation and perhaps other forms of redress. The distinctiveness of the U.S. system is not so much in the list of duties, but in the much stronger tendency of the U.S. system to generate litigation, especially litigation that pushes the limits of doctrine, and substantial damages.

C. Corporate law and finance: The primacy of shareholders and securities markets. Most business activity is conducted through corporations. Corporations represent a complex body of stakeholders and interests, but U.S. law tilts sharply towards recognizing the primacy of one group of stakeholders, the shareholders. Likewise, the U.S. has been especially aggressive in regulating securities markets, and imposing standards of public disclosure and restraints on insider

trading.

D. The law of employment: limited rights and expansive mobility. Compared to most other economically advanced nations, workers in the U.S. have very modest rights relating to employment. There is very little of the kind of legislation, common elsewhere, which give a worker a vested interest in his job, or impose major burdens on an employer who wishes to terminate an employee. There is one major exception to this pattern, and that is in the area of "anti-discrimination law." The broad body of anti-discrimination law in the U.S. is designed to prohibit employers from making any employment-related decisions based on race, gender, or ethnicity. More recently, disabled workers have also received substantial protection.

On the other hand, the U.S. worker, including the manager, is relatively free to leave a job and seek other employment.

E. Antitrust law: Competition policy with sharp teeth. The U.S. antitrust laws represent an especially strong legal commitment to competition. As in the case of tort law, the primary difference between the U.S. and other countries is not at the level of general legal principles, but in the vigorousness of enforcement and the severity of sanctions. Both enforcement and sanctions can be initiated by government, or by private parties who can allege harm, and who are encouraged to pursue relief by the availability of triple damages and the payment by the offending party of the damaged party's legal fees.

F. A gentle bankruptcy law and the encouragement of risk. U.S. bankruptcy law is unusually kind to the debtor who cannot meet his payment obligations, whether the debtor is an individual or a business. Many commentators believe this to be one exceptionally clear aspect of a broader pattern of legal encouragement of risk-taking. Other aspects of this broader pattern include high labor mobility, venture capital, and the regulation of securities markets through disclosure rather than the policing of the quality of investments.

G. Strong protection for intellectual property. To a modest degree, the U.S. seems to take a more expansive view of intellectual property rights, especially with respect to patents.

XII. HOW TO READ A CASE

Legal analysis in the U.S. depends primarily upon the reading of cases. Let me here provide some advice to the non-lawyer who wishes to read some cases.

Cases are often complex. A lawyer will usually read a case more than once to figure it out, and so the non-lawyer should expect to also. To the non-lawyer, there will frequently be some technical language in a case dealing with procedural or substantive matters that is opaque at first reading and will remain so because the court does not further explain its meaning. However, this is not as serious a problem as it might first appear, because as to the central issues in a case a court will usually be relatively clear, spelling out its reasoning rather than using the legal "shorthand" by which it disposes of more tangential issues. My suggestion to the non-lawyer reading a case is to just plow through whatever seems like legal mumbo-jumbo, and focus on a few key matters.

The key elements of a case. Figure out who the parties in interest are, and what they are in disagreement about. The name of the case can help here: that name is typically in the form of *Smith v. Jones*, which usually means that Smith is the plaintiff or complaining party and has initiated an action against Jones, the defendant or responding party. Unfortunately, the case name is sometimes not that helpful. Often there are multiple plaintiffs or defendants, and typically only one of each is listed in the name of the case. A particular issue in a case may or may not involve the initially named parties. Also, as a case evolves, the role of the parties can shift. For example, it may come to pass that Jones, initially the defendant, pursues a counterclaim against Smith in the same case, so that for purposes of that issue Jones has become the plaintiff. In the full text of the opinion, the key parties and issues should be outlined clearly.

Figure out what stage the litigation is at as described in the case. Is this a motion for summary judgment? A final decision at trial? A ruling of an appellate court? Many published decisions are generated by appellate courts. The appealing party is usually referred to as the appellant, and the responding party as the appellee or respondent. If, for example, the defendant has appealed, he will be referred to as the defendant-appellant.

Determine what the court is being asked to do. In the U.S. system of legislation, parties and not the court generally take the initiative in raising an issue. Is the plaintiff is asking for damages? An injunction? If the case is before an appeals court, what decisions below are being challenged? Is the appellant challenging a ruling below on a summary judgment motion, or the granting or denial of a preliminary injunction, or a final disposition in the form of a finding of liability and the awarding of final relief? Is the appeals court being asked to review the way the trial court interpreted the law establishing liability, or the way it ruled on certain evidentiary or procedural matters?

Decisions and holdings. The final key point to grasp in the case is the resolution which the court has reached. When a court issues an opinion, it is virtually always because it has resolved something in a case, although it might not be the full dispute between the parties, or a final disposition of an issue, but rather one single issue or an intermediate issue. Some resolutions are more definitive than others. For example, if a court grants a motion of summary judgment, the matter at issue is decided, unless that ruling is reversed on appeal. If the court denies the motion for summary judgment, the dispute can go forward and the party whose motion for summary judgment was denied might win a motion for summary judgment later on, or win on the same issue after a full trial.

In analyzing the resolution set out in an opinion, there are two different levels of analysis. The parties in the case care about what is usually called the decision – the disposition as it is binding upon them. Was one party liable to the other? Were damages awarded, or other kinds of relief? This is basically the determination from the point of view of the parties involved of who won and who lost.

However, a case is also an attempt to state the law in a way that provides guidance to others and will have some impact on later cases. This broader reading of the case is commonly referred to as the "holding" – the broader rule or rules of law that are explicit or implicit in the decision.

Since a case may raise several related issues of law, there may be several "holdings" in a case.

Typically the decision and the holding point in the same direction, but there can be many complexities. For example, a party may bring what might be called "strategic" litigation, where its goal is not so much to win the particular dispute before the court but to establish a precedent that nudges the law in a direction helpful to that party's general interests.

Sometimes, the decision and holding point in different directions. Consider the case where a recording company sues a party for copyright infringement relating to the Internet, an area where the law may be unsettled. A court could find infringement under the facts of that particular case, but in doing so utilize a rationale which narrows the law of infringement and which will make many future cases by recording companies harder to win. In that situation, the plaintiff may feel that it has "won the decision but lost the holding."

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