Introduction to U.S. Law

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THE U.S. LEGAL SYSTEM

Insurance and risk management professionals must be familiar with legal principles of insurance, as well as general legal principles. Understanding the prevailing type of legal system in the United States and the common ways of classifying the U.S. legal system is a logical starting point for the study of legal principles.

Ever since ancient people first gathered in groups, people have adopted rules to govern their relations with one another. These rules were handed down orally to succeeding generations and eventually recorded in writing. In Europe, two basic legal systems developed over hundreds of years: the Roman Empire's civil-law system, adopted by continental European countries, and Great Britain's common-law system.

These two systems differ significantly in origin and in form, and both systems exist in the United States. The common-law system is the foundation of the U.S. legal system, although Louisiana bases its law on the civil-law system.

Civil-Law System

The civil-law system, one of the two basic western legal systems, is the foundation of law in continental Europe, Latin America, Scotland, the state of Louisiana, and some other parts of the world. Civil-law systems, such as the French Code of Napoleon, have comprehensive codes of written laws, or statutes, that apply to all legal questions. These systems rely on scholarly interpretations of their codes and constitutions rather than on court decisions, the basis of the common-law system.

Common-Law System

The common-law system is the body of law derived from court decisions as opposed to statutes or constitutions. Beginning as unwritten customs that eventually came to be recognized and enforced by local courts, the common-law system arose in England after the Norman Conquest in 1066. The "law common to all England" developed out of a constantly expanding number of disputes, or cases, settled by English royal courts and tribunals. Over time, the English legal system expanded to include written laws as well as written court cases.

The English common law, brought by English colonists to North America, became the foundation for U.S. law. Today, U.S. law consists of that common-law foundation, the written laws passed by Congress and state legislatures, and the decisions resulting from thousands of U.S. court cases.

Doctrine of stare decisis
The principle that lower courts must follow precedents set by higher courts.

The U.S. common-law system relies on prior case rulings, or precedents. Using this method of resolution, the **doctrine of stare decisis** ("to stand by things decided"), courts follow earlier court decisions when the same issues arise again in lawsuits. This common-law doctrine gives a degree of certainty to the law on which citizens can rely in conducting their affairs. Courts do not necessarily decide all similar cases exactly the same as previous courts have, but they must provide strong reasons to depart from precedents.

In common-law countries, solving a new legal problem in a current case often involves a process called synthesis. The process combines the rulings from several legal authorities into a new rule of law that is applied to the new legal problem. The authorities typically consider relevant statutes, prior cases that interpret the statutes, and prior cases that establish common-law precedents.

When developing a new rule of law using synthesis, courts analyze the reasoning and facts of the relevant prior cases as controlled by the language of a governing statute, if any, and compare the facts of the prior cases to those of the current case. This example illustrates how the common law can evolve through the process of synthesis: If an insured sues an insurer in a state court over a disagreement about a policy provision's meaning, the court analyzes prior cases in which courts have ruled on the meaning of the same or similar provisions. The court first seeks similar cases in its own state or province; if no such cases apply, the court then seeks similar cases in other states or provinces. If no cases on point are found, the court might analyze general contractual principles and court rulings in somewhat similar cases.

Courts often encounter situations for which they can find no prior case or previous law that directly applies. Such unprecedented situations are called "threshold cases" because they present new legal questions. When encountering threshold cases, judges summon all applicable law in an attempt to arrive at fair decisions.

Judicial Influence on Common Law

Methods of selecting judges, as well as individual judges' views and values, can influence judicial decisions. Judicial selection methods include election and appointment, and they vary by state. In some states judges are elected, while in other states elected officials either appoint judges or choose other officials to appoint them.

Although courts strive for objectivity in their decisions, individual judges' political beliefs, views, values, and biases can affect decisions. Newly elected judges can change the direction of a court. Appointed judges can reflect the positions of the political party in power, and court composition can change when the party in power changes. However, some judicial appointments,

particularly at the federal level, are for life. For example, U.S. Supreme Court justices are appointed by the president for life terms. Through judicial appointments, a president can influence the law for many years into the future.

The legal system has built-in controls for promoting fair outcomes in disputes. For example, a party that loses in trial court may have grounds to appeal the decision to a higher court, in some cases all the way to the U.S. Supreme Court. Because the Supreme Court is the country's highest court, the views of the court's justices have a profound influence on the law, particularly when justices decide threshold questions.

The Evolution of Common Law

The common law is not an absolute; it reflects the evolution of society's values and attitudes. What was acceptable law in the U.S. a century ago can, in many instances, be unacceptable today. A court can find a prior decision clearly wrong and discard it as precedent.

Courts generally do not follow precedent when the earlier rule of law has lost its usefulness or when the original reasons for the rule no longer exist. Absent those reasons, courts may overrule prior decisions only for sound judicial reasons. This approach helps prevent legal capriciousness and gives stability to society and business. The U.S. Congress or a state legislature can pass new legislation that changes a common-law principle.

The common law also changes through landmark decisions, historic court rulings that significantly change or add to prior law with far-reaching societal effects. One of the most well-known examples is the U.S. Supreme Court decision in *Brown v. Board of Education*,[1] which overruled previous cases condoning racial segregation in schools. Another example is *Miranda v. Arizona*,[2] which requires police to inform suspects in criminal cases of their constitutional right against self-incrimination before questioning them.

The Supreme Court made a landmark decision in 1869 affecting insurance regulation. *Paul v. Virginia*[3] established that insurance is a contract delivered locally and governed by state law rather than federal law. That decision was modified by another landmark insurance decision in 1944, the South-Eastern Underwriters case,[4] in which the Supreme Court ruled that federal law applies to insurance in some cases.

Equity

Common-law courts historically determined legal rights and remedies and awarded money damages. Courts of **equity** arose in England because of the failure of courts of law to provide adequate remedies in some cases. Courts of equity complemented law courts by recognizing many rights that common law courts did not recognize.

Equity
Fairness, or a body of principles constituting what is fair and right.

Equitable remedies seek fair solutions beyond what traditional legal remedies can offer. For example, the usual legal remedy for breach of a contract for the sale of a unique item, such as a one-of-a-kind antique, would be money damages. However, a court of equity would consider money damages inadequate as a remedy because the item, being unique, cannot be replaced. A court of equity might order the breaching party to perform the contract by transferring the antique to the injured party.

Although some states still have separate law and equity courts, many states have unified them into a single system. In some states, one court might sit as a court of equity on one occasion and as a court of law on another. In the federal system and some state systems, the same courts provide both equitable and legal remedies. In civil cases before federal courts, parties are entitled to a trial by jury on questions with which the court is operating as a court of law, but equity court decisions are made by judges.

Classifications of U.S. Law

The U.S. legal system of civil law and common law is subject to classification based on several other factors. Three of the most common ways to classify U.S. law, which can overlap, are these:

- Classification as either criminal or civil law
- Classification by subject matter
- Classification as either substantive or procedural law

Classification as Criminal or Civil Law

Criminal law

The branch of the law that imposes penalties for wrongs against society.

Criminal law applies to acts that society deems so harmful to the public welfare that government is responsible for prosecuting and punishing the perpetrators. This body of law defines offenses; regulates investigating, charging, and trying accused offenders; and establishes punishments for convicted offenders.

Criminal law covers offenses ranging from major crimes, such as murder, to minor offenses, such as traffic violations. A felony is a major crime involving long-term punishment. A misdemeanor is a minor crime punishable by a fine or short-term imprisonment. Summary offenses are crimes that are neither felonies nor misdemeanors under state law; they usually result in fines but not imprisonment. Written laws, such as statutes and ordinances (local laws), specify the nature of crimes and their punishments, whether imprisonment or fines or both. In criminal law, the government acts as the prosecutor, representing the public.

Civil law

A classification of law that applies to legal matters not governed by criminal law and that protects rights and provides remedies for breaches of duties owed to others.

Civil law applies to legal matters that are not governed by criminal law. Civil law basically protects rights and provides remedies for breaches of duties owed to others. The term "civil law" is not, within this classification context, the same as the civil-law system discussed previously.

Civil law protects rights and provides remedies for breaches of duty other than crimes. In a civil action, the injured party usually seeks reimbursement, in the form of money damages, for harm. Cases in equity courts, or those having equitable remedies, also fall under civil law. In a civil equity case, a court can order a specific action—for example, directing an insurance company to honor policy terms.

Another distinguishing factor between civil and criminal law is the burden of proof. A party to a lawsuit has the duty to prove a charge or an allegation. The extent of the proof varies depending on the type of case. The prosecution in a criminal case must establish guilt beyond a reasonable doubt, that is, proof to a moral certainty. The burden of proof in a civil case is less strict. The injured party must establish the case only by a preponderance of the evidence, that is, the evidence supporting the jury's decision must be of greater weight than the evidence against it.

A single act can be both a crime and a civil wrong. In such a case, an injured party can bring a civil suit for money damages, while the government can prosecute a criminal case and seek fines or imprisonment. Suppose an insurance agent has defrauded an insured with misleading information about coverage. This action can constitute both a civil misrepresentation and the crime of fraud and could result in separate civil and criminal trials. The injured party sues for the civil wrong, and the government prosecutes for the crime.

Classification by Subject Matter

Beyond classification as either civil or criminal law, U.S. law can be classified by subject matter. Criminal law is also a subject-matter classification. Subject-matter classifications group cases by type, defined by parties' rights and liabilities. Examples of subject-matter classifications, in addition to criminal law, are contracts, torts, agency, and property law, all of which also fall into the civil law classification. Each type of law has its own rules and precedents.

Classification as Substantive or Procedural Law

Within the classifications of law as civil or criminal, U.S. law is also either **substantive** or **procedural law**.

Substantive law

A classification of law that creates, defines, and regulates parties' rights, duties, and powers.

Procedural law

A classification of law that prescribes the steps, or processes, for enforcing the rights and duties defined by substantive law.

Substantive law governs the merits of a case, which are based on the facts giving rise to the lawsuit or criminal case. It includes rules of legislative and judicial law that specify what constitutes an enforceable contract, who can own and transfer property, and what forms of conduct are criminal. For example, substantive law is involved in how contract law applies to an insurance policy. Substantive law includes the subject-matter classifications, such as crimes, contracts, torts, agency, and property law.

These two classifications, substantive and procedural, are closely intertwined and are often difficult to distinguish. Procedural law involves the procedures,

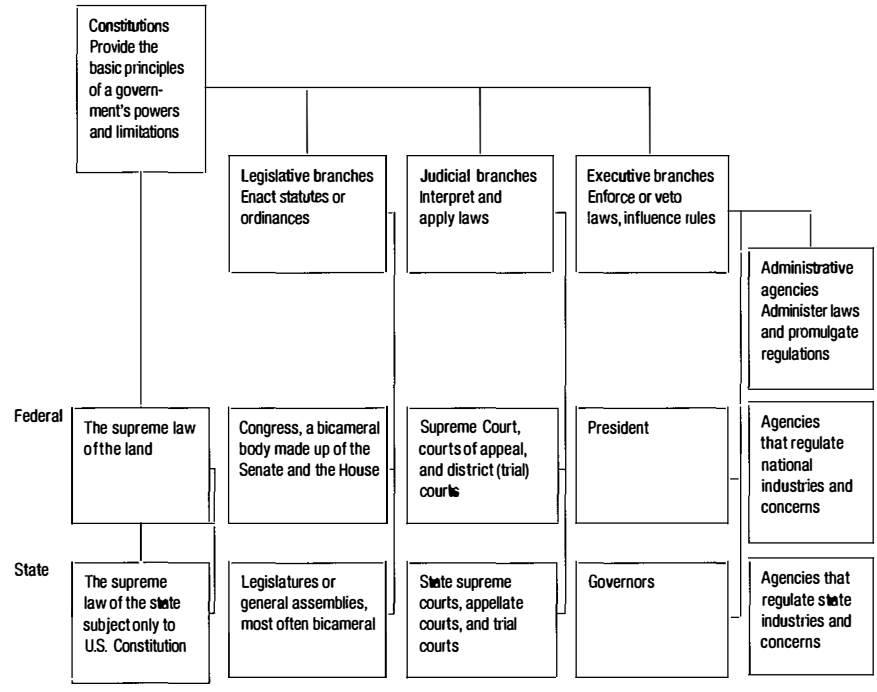
or mechanics, of court processes and the methods used to enforce substantive law. Criminal and civil actions follow different procedures, called civil procedure and criminal procedure, which specify steps that parties to actions must follow.

Procedural law also specifies the means by which courts can apply substantive law. For example, a state can set a maximum period within which a criminal defendant must come to trial, a procedural rule that enforces a criminal defendant's right to a speedy trial. Substantive law would describe the crime itself and establish the criteria for determining the defendant's guilt. An example of procedural law would be the question of in what court (federal or state, and in which state) an insured should sue an insurer.

SOURCES OF U.S. LAW

The United States federal government and each of the fifty states, Puerto Rico, and the District of Columbia have separate and distinct legal systems, each with its own sources of law. See the exhibit "Source of U.S. Law (Federal and State)."

Source of U.S. Law (Federal and State)



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Each of the legal systems has five sources of law:

- A constitution, which establishes fundamental rights and creates the other branches of government
- The legislative branch—Congress and state legislatures, for example—which enacts statutes
- The judicial branch—courts—which decides cases
- The executive branch—the president and state governors, for example—which enforces law
- Administrative agencies—part of the executive branch—which make and enforce regulations

Constitutions

In the U.S., constitutions lay the groundwork for the legal systems of both state and federal governments. The U.S. (federal) Constitution defines itself as the "supreme Law of the Land." Each state has its own constitution, which is the supreme law of that state, subservient only to the U.S. Constitution.

In the case of a conflict, the U.S. Constitution always prevails over a state constitution. Any law that violates the U.S. Constitution, whether state or federal, is void. Since its adoption in 1789, the Constitution has survived many significant social and economic developments to become the oldest constitution in the world today. In more than 200 years of U.S. history, the Constitution has undergone few changes.

A constitution, whether federal or state, specifies a government's powers and the limitations on those powers. Not all countries have constitutions (England, for example, does not); some countries are developing constitutions. In democratic countries, constitutions not only define governmental powers but also specify individual rights. The U.S. Constitution has served as a model for many countries in specifying individual rights.

Each state has its own constitution. A state can grant broader rights to its citizens than those that federal law or the U.S. Constitution grants as long as the state does not violate the federal Constitution. For example, although the U.S. Constitution does not contain an amendment explicitly prohibiting gender-based discrimination, some state constitutions do.

Separation of Powers

The U.S. Constitution provides for separation of powers among three co-equal branches of government: legislative, judicial, and executive. State constitutions, and most local government charters, follow this model. Inherent in the U.S. legal system is the concept of checks and balances, designed to ensure that no single branch of government can become too pow-

erful. The branches, their powers, and how they check and balance the other branches are summarized in this manner:

- The executive branch (led by the president on the federal level and governors on the state level) has power to recommend, approve, or veto laws and to administer and carry out many laws through administrative agencies. This branch's checks on the other two branches include the power to appoint some judges (those who are not elected at the state level) and the power to veto laws passed by the legislative branch. Administrative agencies are part of the executive branch of government, although some may be independent of executive oversight. These agencies are created by law, and they often develop and enforce regulations to carry out the law.
- The legislative branch (the federal Congress and state legislatures) has the power to pass laws. This branch's checks on the other two branches include its power to approve or deny many of the executive's appointments (judges and heads of administrative agencies, for example) and its ability to pass constitutional laws negating judicial opinions.
- The judicial branch (the courts) interprets, affirms, or negates laws. Supreme courts at both the federal and state levels also interpret their respective constitutions. The judicial branch's checks on the other two branches include the power to declare laws—and sometimes actions or regulations of the executive branch—unconstitutional or unlawful.

Provisions Relevant to Insurance

The U.S. Constitution has several provisions relevant to the insurance business:

- Delegation of powers to Congress
- Commerce Clause
- Due Process Clause
- Equal Protection Clause

The Constitution establishes the express powers of Congress, including the power to regulate commerce, levy and collect taxes, borrow money, and establish uniform laws on bankruptcy. The Constitution also establishes the implied powers of Congress to pass laws necessary to implement all of Congress's express powers. The Constitution delegates to states any powers that it does not specifically reserve for the federal government or forbid states to exercise.

The Constitution's Commerce Clause gives Congress the power to regulate commerce (trade) with foreign nations and among the states (interstate commerce). Interstate commerce includes any commercial activity, whether interstate or intrastate, that has any appreciable direct or indirect effect on trade among states. Any state law or action that interferes with interstate commerce is, therefore, unconstitutional. Commerce includes such activities as underwriting and selling insurance, distributing movies, transacting real

estate, gathering news, and playing professional sports. An insurer that conducts business in more than one state is subject to federal law.

The Fifth Amendment's Due Process Clause guarantees notice and a hearing before the federal government can deprive any person of life, liberty, or property. The Fourteenth Amendment extends the same protection in state government actions. An example of a state due process case is an insurer's complaint against the department of insurance for attempting to lower the insurer's premium without notifying the insurer or giving the insurer an opportunity to be heard. The insurer charges that it was adversely affected because it had no opportunity to protect its interests.

The Fourteenth Amendment's **Equal Protection Clause** also addresses individual rights by prohibiting state laws that discriminate unfairly or arbitrarily and requiring equal treatment to all persons under like circumstances and conditions, in terms of both privileges and liabilities. It protects both individuals and corporations. Many state constitutions contain equal protection clauses.

Equal Protection Clause
A part of the Fourteenth Amendment to the U.S. Constitution prohibiting state laws that discriminate unfairly or arbitrarily, and requiring equal treatment to all persons under like circumstances and conditions.

Legislative Bodies

Constitutions delegate the power to make laws to legislative bodies. At practically every level of government, legislative bodies enact laws, or statutes. Major U.S. legislative bodies are Congress and the fifty state legislatures. Local governments also have legislative bodies—for example, city councils, which enact laws that are usually called ordinances.

The U.S. Congress is bicameral—that is, it has two chambers: the Senate and the House of Representatives. Each state has two senators and a number of representatives in the House based on that state's population. Only Congress can enact legislation regarding any powers granted exclusively to the federal government by the Constitution. In the areas that are primarily the concern of the individual states, only the respective states' legislatures can enact legislation.

Most states have bicameral legislatures, or assemblies, mirroring the federal Congressional structure. A few states and U.S. territories have unicameral—single house—legislatures. At the city, county, township, and village levels, thousands of local legislative bodies enact written ordinances governing their citizens. A state or local legislative body can clarify or change the common law and can proscribe unacceptable conduct as long as the laws it enacts do not violate either the U.S. Constitution or federal law or the state constitution and laws.

Questions about whether Congress or a state legislative body has the power to enact a law must be decided by the courts. Courts also interpret statutes and ordinances.

With the federal, state, and territorial governments—as well as thousands of local governments—enacting laws, confusion and conflict can result. Business

law can be complicated by laws that vary by state and by local government. To minimize such difficulties, many states have adopted uniform laws. For example, all states except Louisiana have adopted the Uniform Commercial Code (UCC), which regulates the sale of goods and other commercial transactions. The UCC has resulted in uniformity in commercial transactions throughout the country.

Efforts to promote uniformity among state laws have also been made in insurance law. Insurance companies are subject to a multitude of statutes, rules, and regulations in the states. As early as 1871, states recognized the need to establish an organization to promote uniformity in regulation among the states and to exchange regulatory information, resulting in the creation of the **National Association of Insurance Commissioners (NAIC)**. The NAIC pools information to help regulators coordinate responses to changing conditions in the insurance marketplace. The NAIC also develops model laws, regulations, and guidelines.

National Association of Insurance Commissioners (NAIC)
An association of insurance commissioners from the fifty U.S. states, the District of Columbia, and the five U.S. territories and possessions, whose purpose is to coordinate insurance regulation activities among the various state insurance departments.

Courts

In addition to constitutions and legislative bodies, courts are another source of laws. The federal government has its own court system, as does each of the state governments. The state and federal court systems are separate in most respects. A party can appeal from a state to a federal court, but only in cases involving a violation of the U.S. Constitution or a federal statute.

Federal courts have jurisdiction over such cases. Jurisdiction is the power of a court to decide cases of a certain type or within a specific territory. For example, a state trial court has territorial jurisdiction over cases involving state law. Jurisdiction related to types of cases is called subject matter jurisdiction. Courts in which cases are initiated have **original jurisdiction**. Courts that hear appeals from other courts have appellate jurisdiction. Courts that hear a variety of types of cases have general jurisdiction.

Original jurisdiction
The power of a court in which cases are initiated to hear those cases.

Federal Court System

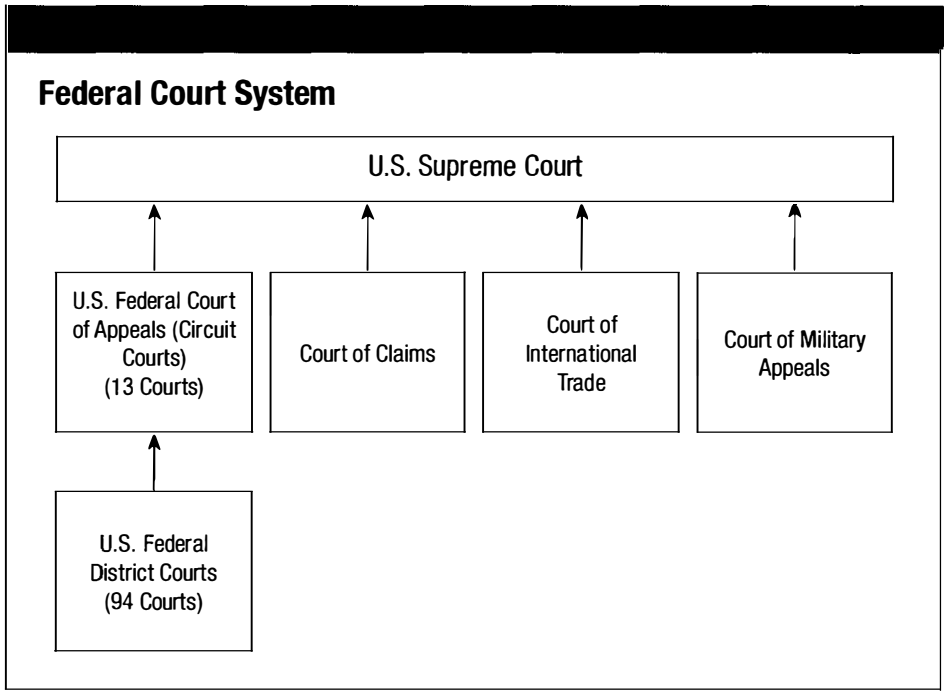
The U.S. Constitution provides that "the judicial power of the United States shall be vested in one Supreme Court, and in such inferior courts as Congress may from time to time ordain and establish." Congress has provided for many U.S. district courts, which are federal trial courts, and for courts of appeal in twelve multi-state judicial circuits and a federal circuit. Special federal courts, including the U.S. Customs Court, Bankruptcy Courts, Patent Appeals Court, and the Court of Military Appeals, hear particular kinds of cases. Federal courts handle cases raising federal questions, such as those involving the U.S.

Constitution, federal laws, and the United States as either plaintiff or defendant. Original jurisdiction also rests with federal courts in these kinds of cases:

- Cases involving admiralty and maritime law
- Lawsuits in which citizens of different states claim land under grants by different states
- Cases involving a legal minimum amount in damages between citizens of different states or between citizens of one state and of a foreign state

The U.S. District Courts are the trial courts of the federal system. For example, a person accused of a federal crime stands trial in a U.S. District Court. District courts hear lawsuits for damages involving federal law and also try cases involving **diversity jurisdiction**, such as a case between an insured in one state and an insurer in another state. A small state may have one federal district court. Larger states have more than one. See the exhibit "Federal Court System."

Diversity jurisdiction
The authority of federal district courts to hear cases involving parties from different states that involve amounts in controversy over a legal minimum.



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A party who is dissatisfied with the outcome in a case before a federal district court, and who has a properly preserved appealable issue, can appeal to the appropriate U.S. Circuit Court of Appeals. For example, a party who loses a lawsuit in the U.S. District Court in Maine can appeal to the U.S. Circuit Court of Appeals for the First Circuit, which serves as the federal appellate court for Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island.

There are eleven circuits, each covering more than one state or territory, a circuit for the District of Columbia, and a federal circuit, which has nationwide jurisdiction to hear appeals in specialized cases. In early U.S. history, federal appeals judges "rode the circuits" on horses or in carriages over a large area, holding court in different places. The federal appeals courts have retained the name "circuit courts." Appeals courts at any level of government are also called appellate courts.

Writ of certiorari

An appellate court's order directing a lower court to deliver its record in a case for appellate review.

A party who does not prevail on appeal in a circuit court of appeals, and who has a properly preserved legal issue, can take the case to the U.S. Supreme Court by filing a petition for a **writ of certiorari**, a request for the Supreme Court to consider a case. The U.S. Supreme Court grants review solely within its discretion, and it is not required to explain its reasons for granting or denying a petition for a writ of certiorari.

The Supreme Court is the final avenue of appeal in the U.S. legal system for the parties involved in a case. Because the Court does not consider most cases, the Circuit Courts' decisions usually stand as the law for their circuits.

State Court Systems

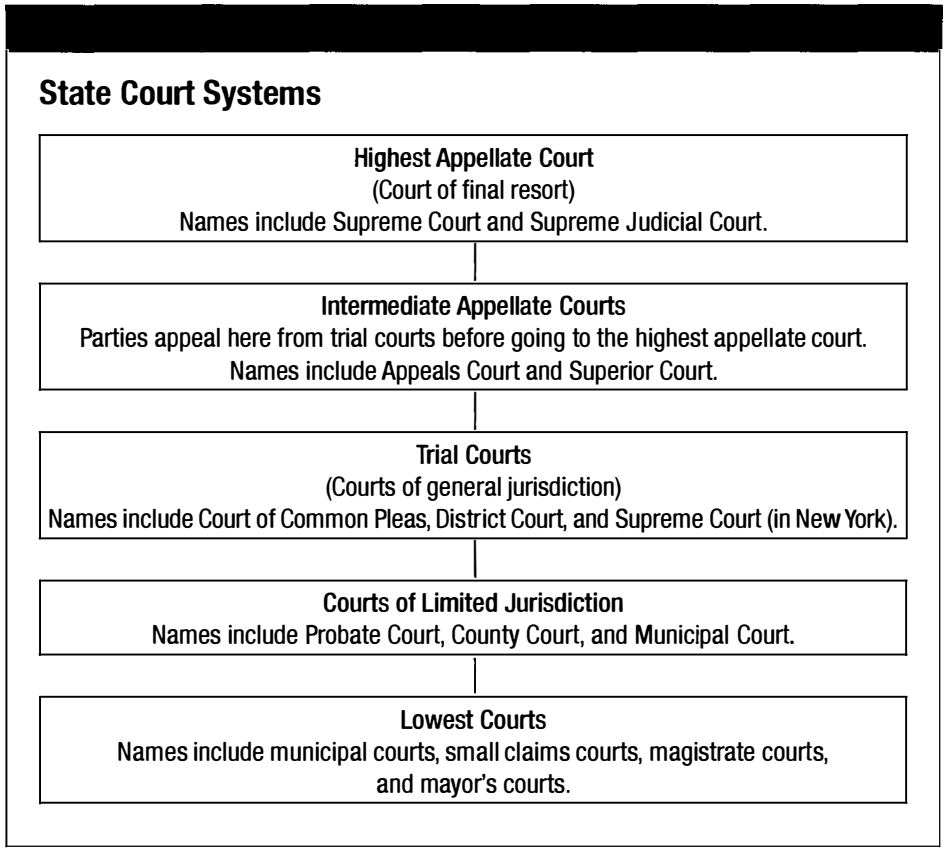
The state court systems are similar to the federal court system. However, no uniformity exists in the use of court names at various levels among the states and territories.

The highest appellate court in each state is usually called the supreme court. Exceptions include the highest Massachusetts court, which is the Supreme Judicial Court, and the highest New York court, the New York Court of Appeals.

Most states have an intermediate appellate-level court, which hears appeals from trial courts. For example, Pennsylvania has two intermediate appellate courts: the Commonwealth Court, which hears all appeals involving the state, local governments, and regulatory agencies, and the Superior Court, which hears appeals involving all other parties. Cases with properly preserved appealable issues can be appealed from either of these courts to the Pennsylvania Supreme Court.

A state's trial courts in which most litigation starts are courts of general jurisdiction. States have various names for this court, including court of common pleas, superior court, and district court. The term "superior court" can mean a trial court in some states but an appellate court in others.

A state's trial court system also includes courts of limited jurisdiction, which hear specific types of cases. Examples are probate courts, county courts, and municipal courts. Probate courts hear primarily estate cases; municipal courts might hear cases involving only limited amounts of money. The lowest courts may be called municipal, small claims, or mayor's courts, depending on local custom. Judges in these courts can be justices of the peace or magistrates. See the exhibit "State Court Systems."



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Conflicts of law often arise about which states' law should apply when a dispute is subject to the laws of two or more jurisdictions. In tort cases (cases that involve wrongs between parties), the law in force where the injury occurred generally applies. Courts in contract cases, in contrast, use the center of gravity rule, applying the law of the state with the most significant relationship to the case. To attempt to avoid conflicts of law, the parties to a contract may include in their contract an agreement on which state's laws will apply if a dispute arises.

Conflicts of law
A body of law that resolves questions when states' laws conflict.

Executive Branches

An additional source of law, along with constitutions, legislative bodies, and courts, is executive branches of government, which include chief executives, such as the U.S. president and state governors, and administrative agencies. A president, governor, or mayor can either recommend, approve, or veto laws after the legislative body enacts them but before they become effective. The executive can also appoint the heads of administrative agencies to assist in enforcing the laws. Some of these appointments require legislative approval.

The executive branch can influence the numerous rules and regulations that administrative agencies issue. For example, a state governor may appoint the

insurance commissioner. Through this appointment power in some states, a governor can influence insurance industry activities.

Administrative Agencies

Administrative agencies, although part of the executive branch, can be considered a separate source of law. The legislative branch, whether Congress or a state legislature, creates administrative agencies by statute. These agencies implement and enforce governmental functions. At the federal level, more than 150 regulatory agencies administer laws affecting thousands of organizations and all citizens.

The federal regulatory system arose to regulate certain large and powerful industries, such as railroads and banking. The federal government has since created agencies to regulate particular functions across all industries, such as equal employment, financial disclosure, worker health and safety, and environmental concerns. Agencies regulate specific areas, such as taxation, health, and labor, and they vary in the scope of their functions, purposes, and powers. However, they all generally have the power to make rules and to prescribe behavior.

Administrative law

The statutory laws that grant power to administrative agencies to act and the body of law that is created by administrative agencies themselves.

Agency rules, regulations, and rulings have the full force of law and constitute the body of **administrative law**. Federal agencies promulgate thousands of rules every year; that is, they initiate and finalize formal rules and make them known through formal public announcements. The legislative delegation of rulemaking power to an administrative agency is constitutional as long as it meets these three conditions:

- The legislation carefully defines the scope of the delegated power.
- The agency exercises its rulemaking power within the defined scope.
- The rules are subject to court (judicial) review.

Few businesses, if any, escape administrative agency supervision. To be valid, business regulations must apply uniformly to all members within the same business class. The federal government can impose regulations on any aspect of business necessary for the nation's economic needs. The states can regulate business as long as they do not impose unreasonable burdens on interstate commerce or on any federal government activity.

CIVIL TRIAL PROCEDURES

When individuals or businesses cannot resolve their differences privately, they can go to court for resolution. Procedures are prescribed for every stage of the legal process. While jurisdictions vary in procedure and terminology, it is useful to understand the procedures followed in most federal and state courts.

Litigation is extremely costly and time consuming and often proceeds for several years. Its complex legal process can involve meticulous pretrial prepa-

ration by lawyers, carefully plotted trial tactics, and procedural complexities. At any point during litigation (the process of carrying on a lawsuit), parties can settle a case by agreeing to terms. The legal system encourages out-of-court settlements.

Pretrial Procedure

Although trials are the most prominent stage of the legal process, lawyers do substantial pretrial preparation to gather as much information as possible about all **allegations** and evidence the parties might present. See the exhibit "Pretrial Procedure."

A party, whether an individual or an organization, starts a lawsuit by filing a **complaint** in the court that has jurisdiction over the dispute. The party who files the complaint is the plaintiff, and the party against whom the plaintiff files a complaint is the defendant. The complaint is the first **pleading** filed with the court. The complaint sets out the plaintiff's allegations, explains why the plaintiff has a **cause of action** against the defendant, and states what remedy the plaintiff requests. The complaint also tells the court why it has jurisdiction over the matter.

In small claims or municipal courts that handle cases involving small amounts of damages, parties can usually file a complaint without a lawyer's assistance. In courts of general jurisdiction, lawyers are usually needed to file pleadings. Pleadings follow prescribed forms that have developed over many years, and lawyers have pleading forms that they can adapt to individual cases.

After a complaint has been filed, the court issues a summons notifying the defendant of the lawsuit, with a copy of the complaint attached. The summons specifies how long the defendant has to file an **answer** to the complaint. The answer can include **counterclaims**. Alternatively, the defendant can file an entry of appearance, which neither admits nor denies any allegations in the complaint; it only states that the defendant will appear in court.

After receiving the defendant's answer, the plaintiff files a reply. Taken together, all pleadings—the complaint, the answer, and the reply—constitute a written dialogue between the parties that informs the court about the substance of the dispute. Given that information, the parties can respond by filing **motions**.

For example, the defendant might file a **motion to dismiss**. An example of a procedural defect is the failure of the plaintiff to state a legally recognized cause of action. A motion for judgment on the pleadings is a request made after the pleadings but before trial for a judgment on the pleadings based on the admissions in the pleadings. At the close of discovery, but before trial, the plaintiff or the defendant can file a **motion for summary judgment**, arguing that the other side has failed to meet the legal standard to submit the case to a judge or jury to decide. Courts apply strict standards when reviewing a motion for summary judgment because if the motion is successful, the nonmoving

Allegation

A claim made in the complaint by the plaintiff, specifying what the plaintiff expects to prove to obtain a judgment against the defendant.

Complaint

The allegations made by a plaintiff in a lawsuit.

Pleading

A formal written statement of the facts and claims of each party to a lawsuit.

Cause of action

A plaintiff's legal grounds to sue a defendant.

Answer

A document filed in court by a defendant responding to a plaintiff's complaint and explaining why the plaintiff should not win the case.

Counterclaim

A complaint brought by the defendant against the plaintiff.

Motion

A formal request for the court to take a particular action.

Motion to dismiss

A request that a court terminate an action because of settlement, voluntary withdrawal, or procedural defect.

Motion for summary judgment

A pretrial request asking the court to enter a judgment when no material facts are in dispute.

Pretrial Procedure

Action	Acting Party	Purpose/Result
Complaint	Plaintiff	• Sets out allegations. • States cause of action. • Requests remedy.
Summons	Court	• Notifies defendant of lawsuit. • Contains copy of complaint. • Sets out time frame for defendant to answer.
Answer	Defendant	• States why plaintiff should not win. • May include counterclaims. • In the alternative, may be only "entry of appearance," which neither admits nor denies allegations.
Reply	Plaintiff	• Responds to defendant's answer.
Motions		
• To dismiss	Defendant	• Asserts that plaintiff has failed to state a claim for which the court can grant relief.
• For judgment on the pleadings, or summary judgment	Defendant	• Admits the allegations but questions whether the law provides a remedy.
		Granted motion ends lawsuit.
Pretrial conference	Both parties, with judge	• Parties may stipulate some or all of the facts. • Judge encourages settlement.
		Settlement ends lawsuit.
Discovery	Both parties	• Parties elicit evidence, using depositions, interrogatories, and motions to produce evidence.

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party is deprived of a jury trial. To grant a summary judgment motion, the court must find that there are no genuine issues of material fact in dispute and that the moving party is entitled to judgment as a matter of law. Many cases end when the court grants one of these motions and never proceed to trial.

Another pretrial option for either party is to request a pretrial conference with the judge. At the pretrial conference, the plaintiff and defendant stipulate, or agree, to the truth of some or all of the facts in the pleadings. Courts use pretrial conferences to encourage settlements—agreements between both parties to end a case rather than to proceed to trial. Stipulations can also shorten a trial by reducing the amount of evidence presented.

The pretrial stage also includes **discovery**. In cases involving complex business questions, such as insurance antitrust cases, discovery can span months or even years and can involve tedious examination of thousands of documents and records. Parties to lawsuits use the discovery tools of **depositions**, **interrogatories**, **subpoenas**, and motions to compel compliance with discovery requests.

Discovery
A pretrial exchange of all relevant information between the plaintiff and defendant.

Deposition
A pretrial discovery tool involving oral examination of a witness to produce a written verbatim record.

Interrogatories
Specific written questions or requests raised by one party to a lawsuit that the opposing party must answer in writing.

Subpoena
A legal order to a witness to appear at a certain place and time to testify or to produce documents.

Parties must provide everything requested in discovery. A party can object to a request for discovery and ask the court to rule on whether the evidence is required. Discovered information enables the parties to know as much as possible before trial and prevents surprises. If testimony at trial contradicts an earlier deposition or an answer to a written interrogatory, lawyers can use the pretrial evidence to challenge the evidence presented at trial. Discovery can sometimes lead to settlement; once the parties know all the evidence, they may decide to settle rather than go to trial.

Trial Procedure

Although the legal system encourages settling disputes at each step of litigation, many cases still go to trial. Trials are costly but often provide the best means to determine truth and provide justice. A trial gives a judge or jury the opportunity to observe witnesses, hear subjective arguments, and evaluate those factors (in addition to written or other tangible evidence) in reaching a decision. See the exhibit "Trial Procedure."

A jury is a group of people who hear and consider the evidence in a case and decide what facts are true. In a jury trial, the jury decides all questions of fact, and the judge decides all questions of law. If the parties choose not to have a jury, the judge makes all decisions about both facts and law. For example, a question of law in an insurance coverage case is whether the insurance policy covers the loss. A question of fact in the same case might be whether the insured actually bought the policy.

Parties to a lawsuit (usually their lawyers) select jurors from a pool. Each party can exclude potential jurors by using challenges. A challenge for cause can be used to exclude any number of jurors for apparent bias. Each party also has a specified number of peremptory challenges to eliminate jurors for no stated cause.

The trial begins with opening statements. In trials with a jury, opening statements occur after the jury has been selected and sworn in. First, the plaintiff's lawyer summarizes the facts of the case and explains why the plaintiff should

Trial Procedure

Action	Acting Party	Purpose/Result
Jury selection (if parties choose to have a jury)	Both parties	• Parties' lawyers select jury members.
Swearing-in of jury	Judge	• Jury members take oath.
Opening statements	Plaintiff, followed by defendant	• Presents summary of what the party expects to prove.
Direct examination	Plaintiff	• Questions witnesses to establish allegations.
Cross-examination	Defendant	• Questions witnesses to challenge testimony or to bring out evidence favorable to defendant.
Direct examination	Defendant	• Questions witnesses to establish defense.
Cross-examination	Plaintiff	• Questions witness to challenge testimony or bring out evidence favorable to plaintiff.
Closing arguments	Plaintiff, then defendant	• Summarizes evidence.
Instructions to jury	Judge	• Instructs the jury about applicable law.
Deliberation and delivery of verdict (if no jury, judge delivers verdict)	Jury	• Confers to reach a verdict and delivers it to court.
Alternatively, judge can end trial at any point by declaring one of the following:	Judge	
• Directed verdict		• Tells the jury what verdict to reach.
• Mistrial		• Ends trial because of error or event that would make it impossible for the jury to reach a fair verdict, or because the jury cannot reach a verdict.
• Nonsuit		• Ends trial because the plaintiff has failed to present a sufficient case or has not complied with a court order.

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prevail. The defendant's lawyer follows with an opening statement summarizing the defendant's position.

Next, the lawyers present the evidence, starting with the plaintiff's case. The plaintiff's attorney calls and examines witnesses to present the facts to estab-

lish the case against the defendant. Questioning of witnesses is called **direct examination**. The defendant's attorney can then conduct **cross-examination** of each of these witnesses. When the plaintiff finishes presenting evidence, the defendant follows the same procedure to establish the facts of the defense.

Direct examination

Questioning one's own witness during a legal proceeding.

Cross-examination

Questioning an opposing party during a legal proceeding to bring out information favorable to the questioner's own position or to challenge the witness's testimony.

The attorneys follow the rules of evidence in presenting their evidence and in challenging the evidence and testimony presented by the opposing party. Lawyers must be alert during trials to recognize when evidence might violate evidentiary rules and to object immediately. Rules of evidence require that evidence be relevant, material, and competent. Trial courts exclude evidence that does not meet these conditions, meaning that it cannot be considered either by the judge or the jury when reaching a decision in the case.

Evidence must have **relevance** to the case. For example, evidence of the dollar limits of a defendant's liability insurance, or even the existence of such an insurance policy, is irrelevant to determining whether a defendant was negligent in an auto accident case. Insurance coverage is not relevant as to whether an accident occurred, whether the defendant was at fault, or whether the plaintiff suffered damages.

Relevance

A quality of evidence that suggests the evidence is more or less likely to be true.

Evidence also must be material, a concept closely related to relevance. A fact can be relevant but might have no **materiality** in a case, rendering it immaterial. For example, evidence that the car in an automobile accident was a recent model is immaterial unless that model had a defect that might have caused the accident.

Materiality

A quality of evidence that tends to establish a particular element of the claim that has legal significance.

Evidence must have **competence**. Many objections related to competence are based on the **hearsay rule**. Such evidence is presented by witnesses who repeat the statement but who have no personal knowledge of whether the statement is true. Hearsay can be either a spoken statement or a written document containing the statement. For example, Wilma testifies about actuarial figures in a book that someone else prepared and about which Wilma has no personal knowledge. John testifies about a conversation he overheard. Both witnesses' testimony is inadmissible hearsay unless it falls under an exception set out in the rules of evidence. A lawyer who perceives hearsay testimony during a trial must object and provide a sound reason for that objection for the court to rule that the evidence is not admissible.

Competence

A quality of evidence that suggests the source is reliable and the evidence is adequate to justify admission in court.

Hearsay rule

The rule of evidence that prevents the admission of out-of-court statements not made under oath by a person who is unavailable to testify.

Opinion evidence, in general, can also be challenged on the basis of competence. An expert in a particular area can give opinion testimony within that area of expertise. For example, an expert in insurance might testify about underwriting practices or policy coverage. First, however, the expert's credibility as an expert witness must be established in court. This process usually involves detailed questioning about the witness's background and qualifications.

After both sides have presented their evidence, they make closing arguments to the jury to summarize their evidence. The judge instructs the jury about the law applicable to the case, and the jury retires, or confers, to reach its final decision, or verdict. Jurisdictions may allow either a **general verdict**, a **special**

General verdict

A kind of verdict that entails a complete finding and a single conclusion by a jury on all issues presented.

Special verdict

A kind of verdict reached by a jury that makes findings of fact by answering specific questions posed by the judge. The judge then applies the law to the facts as the jury has found them.

verdict, or both. The judge can decide to take the case from the jury using any one of these actions:

- Issuing a directed verdict telling the jury how to decide the case
- Declaring a mistrial because of an egregious error, an extraordinary event, or the jury's inability to reach a decision
- Declaring a nonsuit if the plaintiff has failed to present a sufficient case or has not complied with a court order

All lower-court decisions can be appealed to higher courts. However, parties cannot relitigate claims in the lower courts based on transactions or on issues already decided by a lower court. Two doctrines evolved in the common law to prevent parties from relitigation:

Res judicata

A doctrine that bars parties to a lawsuit on which final judgment has been rendered from bringing a second lawsuit on the same claim or on related transactions.

- The doctrine of **res judicata** (sometimes called claim preclusion) prevents parties from raising, in a subsequent lawsuit, issues or facts that could have been, but were not, included in the first lawsuit. For example, if judgment was against Marie in her lawsuit against Danford Plumbing for negligence that caused damage to her kitchen, she cannot bring another lawsuit against Danford for the same act of negligence that caused damage to her living room at the same time the kitchen was damaged. Nor can she sue Danford Plumbing for intentional destruction of property, having failed on the negligence claim.
- Collateral estoppel (sometimes called issue preclusion) bars parties from relitigating an issue on which a court has already ruled, even if the second lawsuit differs significantly from the first. For example, if a court has ruled that Marco's insurance policy did not cover fire damage to his outbuilding, Marco cannot sue the insurer for loss from a later fire in the same building under the same policy.

Appeals

An appeal is a request to a higher court for a review of a case. The appellant is the losing party in a court case who appeals the case to a higher court. The nonappealing party, usually the winner of the original lawsuit, is the appellee. Appeals must be filed to the appropriate court within a prescribed period. Appeals courts do not conduct new trials but decide whether law has been applied appropriately to a case in the lower court.

To decide whether the trial court's decision was correct, the appeals court relies on a transcript of the lower-court proceedings and on briefs and arguments made by the lawyers for both parties. A brief is a lawyer's written statement submitted on appeal to establish legal and factual arguments and provide supportive authoritative sources, such as statutes and case precedents. Briefs are mandatory in appeals, and courts prescribe their format and content. Many appellate courts base their decisions on the briefs in most cases; they hear oral arguments only in a few cases.

Any objection by either party before, during, or after a trial that is overruled by the court is a potential ground, or basis, for appeal. An appellate court can affirm the trial court outcome, reverse it, or send the case back (remand it) to the trial court for a new trial. For example, if an appellate court finds that the trial court improperly admitted evidence prejudicial, or harmful, to the appellant's case, the court can send the case back to the lower court for a new trial. However, an appellate court might determine that evidence, although improperly admitted at trial, did not prejudice the appellant.

A new trial is not necessarily a victory for the appellant because it can reach the same result as the first trial. The time involved in the appeal process also can jeopardize the appellant's case by making testimony stale or unavailable. Losing parties in lawsuits often decide not to appeal after they weigh the probability of an ultimate victory against the high costs of appeal.

ALTERNATIVE DISPUTE RESOLUTION

As the number of lawsuits filed in the U.S. continues to increase, congested court dockets (calendars), long delays, and additional costs result. While the judicial system handles thousands of disputes, most controversies are resolved by compromise or settlement agreements.

Out-of-court settlements offer the advantages of economy, greater speed of resolution, less hostility between the parties, and some degree of privacy. **Alternative dispute resolution (ADR)** procedures, including arbitration, mediation, and negotiation, are methods that help settle disputes without litigation.

Alternative dispute resolution (ADR)
Procedures to help settle disputes without litigation, including arbitration, mediation, and negotiation.

Arbitration

One ADR method, arbitration, involves taking a dispute to an impartial third party (an arbiter or arbitration panel) for a decision the parties agree will be final and binding. Arbitration has become a major means of dealing with disputes in contracts, labor-management relations, and insurance. Some states' laws and court rules mandate court-administered arbitration for some types of cases.

Arbitration is frequently used for settling insurance disputes. Many insurance policies specifically provide for arbitration. For example, uninsured motorist coverage in automobile policies may include a provision requiring arbitration of policy disputes. Insurers use special arbitration agreements to allocate costs of settlements when coinsurers are involved and to resolve disputes resulting from overlapping coverages. Use of arbitration has also increased under no-fault automobile statutes, under which people involved in automobile accidents seek benefits payments from their own insurers.

Most states have enacted laws that cover all aspects of arbitration procedures. Both the Uniform Arbitration Act, drafted by the National Conference of

Commissioners of Uniform State Laws, and the Federal Arbitration Act, passed in 1925, provide specific remedies if one of the parties refuses to arbitrate or denies the existence of an arbitration agreement.

The American Arbitration Association, which provides arbitration services, designs arbitration systems, and provides training about ADR, has developed the following procedure for selecting an arbitrator: Each party receives a list of proposed arbitrators and has ten days to select several preferred arbitrators from the list. The association then appoints an arbitrator acceptable to both parties. Alternatively, each party can appoint an arbitrator, and those arbitrators, in turn, can appoint a third arbitrator.

Most states allow parties to call witnesses in arbitration proceedings, but strict adherence to rules of evidence and procedure is not required. An arbitrator's award or judgment is filed with the appropriate court and is as valid and enforceable as any court judgment. Parties have limited grounds for appealing an arbitrator's award and must do so within a legally prescribed period.

Mediation

Mediation
An alternative dispute resolution (ADR) method by which disputing parties use a neutral outside party to examine the issues and develop a mutually agreeable settlement.

Another ADR procedure is **mediation**. The mediator is a neutral third party who acts as a catalyst to help parties analyze their dispute, consider possible solutions, and devise a compromise formula. Mediation is nonbinding. Judges often try to mediate during settlement conferences in court cases, but formal mediation involves submitting a dispute to an outside mediator. Mediators are often experienced trial lawyers or retired judges.

Negotiation

Using the ADR procedure of negotiation, parties to a dispute discuss all issues and determine a mutually satisfactory resolution. Negotiation is often the most direct route to dispute resolution. Because negotiations can end at any time, they do not limit opportunities to pursue other dispute resolution methods.

Private mini-trials and court-sponsored mock summary jury trials can lead to negotiation of major disputes. In a mini-trial, lawyers or others familiar with the dispute present evidence and arguments to a panel that may include business executives or other professionals. A neutral party, such as a retired judge or another expert, can act as mediator or issue an advisory opinion after the presentation of evidence and arguments. Because the mini-trial presents the issues to both parties in a dispute, it can encourage negotiation and settlement. Summary jury trials are brief mock trials before juries. The parties can accept the jury's advisory verdict, or the verdict can provide the basis for further negotiations toward settlement.

ADMINISTRATIVE AGENCY PROCEDURES

Administrative law is pervasive in the activities of people and organizations. The legislative output of administrative agencies far exceeds that of legislatures, and the number of administrative decisions far exceeds the thousands of court decisions.

The legal procedures of administrative agencies entail these matters:

- Agencies' rulemaking function
- Agencies' adjudication function
- Agencies' investigative powers
- Judicial review

Role of Administrative Agencies

Legislators at the federal and state levels delegate responsibilities to administrative agencies in much the same way that a supervisor delegates responsibilities to an employee. Legislators do not have the time to pass all the rules and regulations necessary to implement legislation; to develop expertise in every area regulated; or to settle disputes arising from legislation, rules, and regulations. For example, a state legislature that passes a law prohibiting excessive insurance rates delegates the power to administer and enforce the law to its state department of insurance (DOI), which has the insurance expertise to set standards for and examine insurance rates.

Courts generally have upheld legislative delegation to administrative agencies. Although legislators cannot delegate their ultimate power and responsibility, they can delegate the duty to fill in the details of legislation by allowing agencies to make rules and regulations and to resolve disputes. "Enabling legislation" creates an administrative agency and states its purpose.

Administrative agencies have two primary functions: rulemaking and adjudication. Rulemaking is the process by which agencies promulgate rules to implement legislative policies. Adjudication is the process by which agencies decide cases and settle disputes.

To illustrate DOI rulemaking and adjudication, after a state legislature passes a law prohibiting excessive insurance rates, the DOI makes rules about insurance rate review and creates guidelines to determine whether rates are excessive. The insurance commissioner, a private citizen, or a group of citizens might contest an insurance rate as excessive. The DOI then holds a hearing to adjudicate the rate in question. This adjudication affects only the insurer involved and the insureds who would pay the new rate.

Agencies' Rulemaking Function

Agencies promulgate three types of rules:

Legislative rule

A type of substantive administrative agency rule that comes from a statutory delegation of authority and that has the same force as a law enacted by Congress or a legislature.

Interpretative rule

A type of administrative agency rule that interprets statutes, providing guidance for agency staff or regulated parties, but that lacks the force and effect of law and therefore is not binding on individuals.

Procedural rule

A type of administrative agency rule that prescribes procedures for agency operations, legislative rulemaking, and adjudication proceedings.

- **Legislative rules** (substantive rules) come from a statutory delegation of authority and have the same force as a law enacted by Congress or a legislature. The development and passage of legislative rules require adherence to rulemaking procedures.
- **Interpretative rules** interpret statutes, providing guidance for agency staff or regulated parties. However, these rules lack the force and effect of law, and, therefore, are not binding on individuals.
- **Procedural rules**, primarily internal, prescribe procedures for agency operations, for legislative rulemaking, and for adjudication proceedings.

The Administrative Procedure Act (APA) prescribes the procedure for administrative agency rulemaking at the federal level. Most states follow the rulemaking procedures of the Model State Administrative Procedure Act (MSAPA), which requires agencies to adhere to three basic steps:

1. Publish a notice of intent to adopt a regulation
2. Provide opportunity for public comment
3. Publish the final regulation

Federal agencies publish notices of proposed regulations in the weekly *Federal Register*. States usually have similar publications for state agency notices. Notice in one of these official publications usually suffices as official notice to all interested parties that the agency is considering an action that will affect them. For example, a state DOI notice of its plan to adopt a regulation about an aspect of the insurance business, published in the state's official publication for agency notices, is legally sufficient notice to insurers and consumers.

Typically, the published notice of a proposed regulation invites comments by a certain date, usually within a month. Public hearings are required for some, but not all, proposed regulations. The MSAPA requires a public hearing if either a governmental agency or twenty-five interested individuals request it. If no hearing is required, interested organizations and individuals can submit written comments on a proposed regulation.

Interested individuals and representatives of organizations can speak at public hearings; comments can also be submitted in writing. A presiding hearing examiner usually has discretion about who testifies. If large groups of people attend, the examiner can require that only their chosen representatives testify.

If the proposed regulation is controversial, the examiner can require advance registration of those who will testify. After the agency has reviewed all comments about the proposed rule, it can take one of these actions:

- Adopt the originally proposed rule
- Make minimal or extensive changes
- Nullify the proposed rule

If the agency decides to adopt the rule, it must publish the final version. A rule usually becomes effective thirty days after publication, giving affected parties time to conform to the new rule or to challenge its legality. Agencies can publish emergency rules with immediate effective dates when necessary for the public health and welfare.

Agencies' Adjudicatory Function

In addition to rulemaking, agencies have an adjudicatory function. Adjudicatory proceedings are similar to court cases. They affect the rights of an individual or a limited number of people. As in court, people in an agency adjudicatory process have a constitutional right to due process of law. The specific requirements for due process can vary by the nature of the proceeding.

The Due Process Clause of the U.S. Constitution grants parties whose rights are affected by an agency decision the right to be heard. Not every case requires a hearing. However, the agency must provide reasonable notice of the opportunity for a fair hearing. If the party does not waive the right to a hearing, the agency must hold a fair hearing and must render a decision supported by the evidence. Denying due process can be grounds for reversing a decision if the party was harmed by denial.

Appropriate notice is essential to due process, and improper notice can result in nullification of an entire proceeding. Appropriate notice has several factors:

- Statement of the hearing time, place, and nature
- Statement of the hearing's legal authority and jurisdiction
- Reference to the particular statute or rule involved
- A short, clear statement of the matters at issue

The test of appropriate notice is whether it informs the interested party fairly and sufficiently about the case so that the party can respond adequately at the hearing.

Many disputes, such as pension or Social Security claims, do not warrant full hearings and are too numerous to make formal proceedings practical. However, any party faced with deprivation of an alleged property or liberty right can demand a hearing before action is taken. Such hearings are often informal. Agencies can use informal hearings when time, the nature of the proceedings, and the public interest permit. Adjudication, complete with a full hearing, is necessary only if the law specifically requires it or if either party demands one. A hearing examiner or an administrative law judge (ALJ), who is usually both an agency employee and a lawyer, presides.

Generally, any person compelled to appear before an agency and every party to a dispute have the right to counsel. Counsel need not be a lawyer but can be a qualified representative, that is, any trusted person. The government is not required to provide counsel to a party for an administrative hearing.

As in court proceedings, expert witnesses can testify in agency cases. Generally, the rules governing witnesses in court proceedings apply in agency hearings, but agency rules are not as strict. Agency cases do not have juries; the hearing examiner decides factual and legal matters. Generally, evidence in an agency hearing must be relevant, but the rules of evidence are much more relaxed than in a court trial.

Counsel in an adjudicatory hearing can make arguments relating to both fact and law. Most arguments are relatively short and often written instead of oral. Parties have no inherent right or duty to present formal written briefs arguing the law. The hearing examiner or ALJ considers the parties' arguments and makes findings of fact and law. Such decisions may accept, reject, or modify the parties' arguments.

To illustrate an adjudication, a hearing examiner's findings in a case challenging an insurer's rates might be one of these:

- The insurer kept statistics properly.
- The insurer interpreted those statistics properly.
- The statistics indicated the insurer had a loss ratio of 35 percent.
- Insurers can make a profit with a loss ratio of 50 percent.

From these facts, the hearing officer could conclude that the 35 percent loss ratio was too low and that the proper loss ratio should be 50 percent. The hearing officer's decision, based on a statute prohibiting excessive rates, could be to require the insurer to lower rates by a stated percentage to produce a 50 percent loss ratio.

Agencies can impose fines or grant, revoke, or suspend licenses. Enabling legislation for an agency usually defines appeal rights and whether they involve a court or the agency. Most agencies have at least one, and sometimes three or four, tiers of appeal. Once a case has gone through all levels of the agency adjudication and appeals process, the party has exhausted all administrative remedies and can seek judicial review in a court of law.

Administrative agencies can give advisory opinions, unlike courts, which, with very limited exceptions, do not indicate in advance how they would decide a case based on a given set of facts. Although agency advisory opinions are not binding either on the agency or on any parties, the recipient of an advisory opinion can usually rely on it.

Agencies' Investigative Powers

Many federal and state laws contain provisions authorizing agency investigations, which typically relate to rulemaking, ratemaking, adjudicating, licensing, prosecuting, establishing general policy, or recommending legislation.

Agencies may need information and evidence for administrative proceedings and may use subpoenas to gather such information. A subpoena is a legal order to a witness to appear at a certain place and time to testify or to produce documents. Those who disobey subpoenas are subject to penalties.

Agencies receive the power to use subpoenas from legislation. Not all agencies are given the power. If authorized by law, an agency can issue a subpoena on its own behalf or at a party's request. For example, a policyholder alleging an insurer's discriminatory practice can request the DOI to subpoena the insurer's records for a hearing that resolves the dispute.

A party to a dispute has the right not only to testify personally, but also to obtain relevant testimony and records from others. If the other parties refuse to cooperate, then due process requires compelling them to cooperate by subpoena. A subpoena to compel a witness to testify is a subpoena *ad testificandum* (command to testify), usually termed, simply, a subpoena. A subpoena to compel production of documents or records is a subpoena *duces tecum* (literally, a command to "bring things with you").

Violations of constitutional rights can defeat an investigation. The U.S. Constitution places the following limitations on agency investigations:

- Fourth Amendment protection against unreasonable searches and seizures
- Fifth Amendment protection against self-incrimination

In administrative law, the Fourth Amendment prohibition against unreasonable searches and seizures applies primarily to inspecting records. Records demanded must be relevant to the investigation. However, the connection between the requested records and the subject of the investigation can be slight; courts usually find such records relevant and require their production.

For example, a government agency may ask an insurer for all automobile insurance accident records for the past twenty years, even though these records might be voluminous and might require many hours to produce, as long as the agency demonstrates a need for the records. Some courts have held that, when record retrieval and production are very expensive, the burden is on the agency to establish the records' relevance. Sometimes a regulatory agency has no specific purpose but is "fishing" through the records for a possible legal violation.

The Fifth Amendment states that no person "shall be compelled in any criminal case to be a witness against himself." Court decisions have broadened the term "criminal case" to mean almost any type of investigation or proceeding from which legal sanctions might arise. The term "witness" includes not only oral testimony but also the production of records and documents.

A legislative body can require firms to keep certain records and can delegate the power to enforce this requirement to an agency. Inspection power is not limited to records required by law but extends to other relevant records. Agencies do not have a general unlimited right to investigate beyond what

is necessary, and any agency request must be reasonably relevant to the investigation.

The Privacy Act and Freedom of Information Act protect the public from agency misuse of the vast amounts of information they collect, including insurance information. The Privacy Act prohibits the government and its agencies from releasing any information that would violate individual privacy. The Freedom of Information Act guarantees public access to some government and agency records and documents to prevent abuse of information collection.

Judicial Review

Generally, federal courts review actions of federal agencies, and state courts review actions of state agencies. As the actions of agencies increasingly affect personal interests, the courts seek to protect those interests more vigorously by insisting on strict judicial scrutiny of agency action. Judicial review is available as long it is not precluded by statute or as long as the action reviewed is not left by statute solely to administrative agency discretion. Judicial review is not limited to agency adjudications but also can apply to agency rulemaking.

Standing to sue

A party's right to sue, as one who has suffered or will suffer a legal wrong or an adverse effect from an action.

To take an administrative action to a court for judicial review, a plaintiff must have **standing to sue**. A party who seeks judicial review of a rulemaking procedure must show that the rule or its application would impair or interfere with that party's legal rights or privileges. If an adjudicatory hearing is involved, the party usually must be "aggrieved," that is, the order has substantially affected his or her personal rights.

Judicial review of a case can occur only after two requirements have been met:

Final order

An administrative agency's final conclusion or disposition of any material private right of a party, terminating an agency proceeding.

- The agency has issued a final order in the case. This **final order** is the basis of the appeal.
- The doctrine called **exhaustion of administrative remedies** has been satisfied: a party can appeal to the courts only after having taken the case through all possible administrative procedures and appeals. A court will make exceptions to this doctrine only when the available administrative remedy is inadequate or when it would be futile to require the party to exhaust administrative remedies.

Exhaustion of administrative remedies

The completion of all possible administrative procedures and appeals in a case; required before a party can appeal an agency action to a court.

A court can set aside agency action on these grounds:

- The action was arbitrary and capricious, an abuse of discretion, or otherwise unlawful.
- The action was unconstitutional.
- The action violated statutory authority.
- The action violated agency procedural rules or was the result of illegal procedures.
- The action is unsupportable by substantial evidence in the record.

A court can review the law and substitute its own interpretation for the agency's interpretation, just as appellate courts review lower court decisions. Courts review facts only to determine whether substantial evidence supports an agency's action. Courts do not set aside agency actions unless they are clearly erroneous.

On appeal, parties often allege that an administrative agency's action was arbitrary and capricious or an abuse of discretion. An action is arbitrary and capricious if it is so clearly erroneous that it has no rational basis or if it is willful and unreasonable. Generally, courts give great deference to agency conclusions on questions of fact because of the agencies' assumed special knowledge and expertise. If a reviewing court determines that it needs more facts to make a judgment, it can send a case back (remand it) to the agency for another hearing.

SUMMARY

The U.S. legal system had its origins in the English common-law system. The foundation of the common-law system is the doctrine of stare decisis, the application of precedents to current court cases. The common-law system differs from the European civil-law system, founded exclusively on codified laws rather than case law.

U.S. law can be classified several ways, including:

- As either criminal or civil law
- In subject matter classifications
- As either substantive and procedural law

Sources of U.S. law include these:

- Constitutions
- Legislative bodies
- Courts
- Executive branches
- Administrative agencies

Court legal procedures fall into different phases, including pretrial, trial, and appellate procedures. Substantial pretrial preparation provides parties with information about allegations and evidence and gives them an opportunity to settle. If a case goes to trial, the evidence presented must be relevant, material, and competent. After a verdict has been reached, the appellant may appeal to a higher court for a review of the case, although the losing party must decide whether the potential for a favorable appellate decision outweighs the high cost of an appeal.

Alternative dispute resolution (ADR) methods, such as arbitration, mediation, and negotiation, are ways to resolve disputes more efficiently than through the overloaded court system.

Administrative agencies have investigatory powers but are also subject to Constitutional limitations. Administrative agencies promulgate legislative, interpretative, and procedural rules. Agency adjudicatory procedure is similar to court procedures, requiring notice, hearing, and adjudication. Judicial review of agency decisions involves issues of standing to sue and exhaustion of administrative remedies, as well as standards of review, such as determining the existence of agency abuse of discretion.

ASSIGNMENT NOTES

1. *Brown v. Board of Education*, 347 U.S. 483 (1954).
2. *Miranda v. Arizona*, 384 U.S. 436 (1966).
3. *Paul v. Virginia*, 8 Wall. 168 (1869).
4. *South-Eastern Underwriters Association, et al.* 322 U.S. 533 (1944).