

8th Edition / UCC

BUSINESS LAW

Principles • Cases • Environment

Anderson / Fox / Twomey



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BUSINESS LAW

Principles • Cases • Environment

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Government and Business

Social Forces and the Law

Anderson's Pennsylvania Civil Practice

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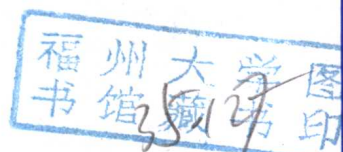
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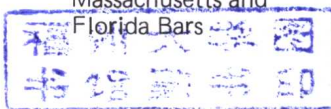
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PREFACE

This, the Eighth Edition, echoes the best features of previous editions—features (like edited opinions, ample citations, case problems, and carefully constructed hypothetical problems) whose pedagogical worth has proved timeless. Yet no text, no matter how successful, can rest on past accomplishments.

It was with this fact in mind that we set about updating the text, improving the readability, and adding the many new features that we feel will make the Eighth Edition a more useful tool for both instructors and students of business law.

NEW TITLE

Certainly one of the most conspicuous changes is the new title: **BUSINESS LAW: Principles • Cases • Environment**. The new title does not, however, signal a change in content or approach from previous editions. It is instead an overdue reflection of our longstanding efforts to provide a balanced approach to the teaching of business law. Toward that end, and like previous editions, the Eighth Edition contains not only the principles that make up private law and cases in which those principles were created and applied. It deals also with the legal and regulatory environment in which business operates. The social forces behind the creation and evolution of the specific principles and substantive rules that govern disputes and transactions between individuals are explored. A comprehensive discussion of the federal and state court structure and the procedures involved in a lawsuit from commencement to execution of the judgment is included. In addition, the special character of, and increasing role played by the administrative agencies in the government regulation of business is thoroughly examined.

CASES

Also prominent in the Eighth Edition is the change in location of the cases. They have been moved from the ends of the chapters and positioned within the chapters near the text they illustrate. To further facilitate learning, the relationship of each case to the text is clearly pointed out within the body of the text. In addition, each case is followed by questions that help the student to identify facts, issues, or distinctions important to the decision.

UNIFORM LAWS

This edition, like previous editions, contains the official text of the Uniform Commercial Code in an appendix. In this edition, however, the UCC has been updated to include the 1977 amendments respecting uncertificated securities.

Also new to this edition is the official text of both the Uniform Partnership Act and the Uniform Limited Partnership Act. The widespread adoption of these acts

has made them a prominent factor in the development of partnership law and we think their inclusion will be valuable to both students and instructors.

As in previous editions, reference is made to many other uniform statutes, model acts, and restatements of the law. In addition to the UCC, UPA, and ULPA, the uniform statutes and model acts cited pertain to consumer credit, arbitration, anatomical gifts, gifts to minors, aeronautics, fraudulent conveyances, vendor and purchaser risks, disposition of unclaimed property, business corporations, probate, and simultaneous deaths.

CITATIONS

This edition continues the policy of providing ample support, via cases cited in footnotes, for assertions made in the text, where such support is necessary or helpful. One of the less conspicuous changes in this edition is the addition of the date of decision to those case citations.

NEW FRONTIERS

Also continued in this edition is the treatment of new frontiers and developing trends in the law. Examined in this edition are a wide variety of topics ranging from the impact of electronic data processing to the continuing importance of consumer protection legislation.

Society increasingly recognizes the social importance of the conservation of natural resources and of the protection of our physical environment. The desire to obtain an unpolluted environment is becoming crystallized into a right, as set forth in Chapter 31, Environmental Law and Community Planning.

The growing area of malpractice lawsuits is recognized. The liability of professionals both to their clients and third persons is discussed fully in Chapter 14.

Numerous questions raised by the tremendous growth of franchising operations necessitate an understanding of the basic principles of the law involved. These are considered in Chapter 44.

The growing importance to the business person of a knowledge of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 has been recognized in the material on corporations.

Antidiscrimination legislation affects several areas of business law, as reflected by topics dealing with businesses serving the public (restaurants, common carriers of passengers, and hotels and motels), employment, deeds, leases, and insurance.

Numerous other topics include: transfer of title in self-service stores, condominiums, and no fault insurance.

TEST BANK

In order to meet the diverse needs of instructors and students we have changed the testing format from preprinted examination to test bank. The test bank contains a variety of questions of varying levels of difficulty. By selectively choosing appropriate questions, the instructor can produce examinations tailored to the abilities of the students.

STUDY GUIDE

Accompanying the Eighth Edition is a completely revised study guide. Nearly 50 percent larger than the study guide which accompanied previous editions, this new study guide contains highlights of each chapter in the text, a new mix of questions and problems, and special exercises designed to demonstrate the real-life application of legal rules and principles.

THE AUTHORS

This Eighth Edition signals the progression of Professor Ivan Fox of Pace University and Professor David P. Twomey of Boston College from the status of contributing authors to that of co-authors. Together, it is our hope that these books will attain more closely the goal of every teacher, author, and publisher: the producing of the best possible materials to meet the needs of our students, both as students today and for whatever may be their path in the years ahead.

R.A.A.

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PART ONE

Legal Rights and Social Forces

CHAPTER I

Law and Law Enforcement Agencies

Law has developed because people and society have wanted relationships between people, and between people and government, to conform to certain standards. The rules or laws adopted for this purpose have expressed the social, economic, and moral standards and aspirations of society.

A. NATURE OF LEGAL RIGHTS AND THE LAW

Law consists of the entire body of principles that govern conduct and can be enforced in the courts. If there were no society-made law, no doubt many persons would be guided by principles of moral or natural law. Most people would act in accordance with the dictates of conscience, the precepts of right living that are a part of religion, and the ethical concepts that are generally accepted in the community. Those who would choose to act otherwise, however, would constitute a serious problem for society. Moreover, there would be a great lack of uniformity if every person's decision would govern. In a society in which millions of commercial transactions take place every day, it is essential that uniform standards be set by someone and that everyone follow the same standards. Otherwise confusion and disagreements would arise.

§ 1:1. Legal Rights. What are legal rights? And who has them? In answering these questions, we tend to make the mistake of thinking of the present as being characteristic of what was and what will be. But consider the evolution of the concept of the "rights of the human being" and the right of privacy.

(a) The "Rights of the Human Being" Concept. Our belief in the American way of life and in the concepts on which our society or government is based should not obscure the fact that at one time there was no American way of life. While many religious leaders, philosophers, and poets spoke of the rights and dignity of

people, rulers laughed at such pretensions and held people tightly in a society based on status. A noble had the rights of a noble. A warrior had the rights of a warrior. A slave had very few rights at all. In each case, the law saw only status; rights attached not to the human being but to the status.

In the course of time, serfdom displaced slavery in much of the Western world. Eventually feudalism disappeared and, with the end of the Thirty Years War, the modern nation-state began to emerge. Surely one might say that, in such a "new order," a human being had legal rights, but not as a human being—only as a subject. Even when the English colonists settled in America, they brought with them not the rights of human beings but the rights of British subjects. Even when the colonies were within one year of war, the Second Continental Congress presented to King George III the Olive Branch Petition which beseeched the king to recognize the colonists' rights as English subjects. For almost a year the destiny of the colonies hung in the balance with the colonists unable to decide between remaining loyal to the Crown, seeking to obtain recognition of their rights as English subjects (a "status" recognition), or doing something else.

Finally, the ill-advised policies of George III and the eloquence of Thomas Paine's *Common Sense* tipped the scales and the colonies spoke on July 4, 1776, not in terms of the rights of English subjects but in terms of the rights of people existing independently of any government. Had the American Revolution been lost, the Declaration of Independence would have gone rattling down the corridors of time with many other failures. But the American Revolution was won, and the new government that was established was based upon "human beings" as the building blocks rather than upon "subjects." Rights of human beings replaced the concept of rights of subjects. With this transition, the obligations of a monarch to faithful subjects were replaced by the rights of human beings existing without regard to will or authority of any kind. Since then, America has been going through additional stages of determining what is embraced by the concept of "rights of human beings."

(b) The Right of Privacy. Today everyone recognizes that there is a right of privacy. Before 1890, however, this right did not exist in American law. Certainly those who wrote the Declaration of Independence and the Bill of Rights were conscious of rights. How can we explain that the law did not recognize a right of privacy until a full century later?

The answer is that at a particular time people worry about the problems which face them. Note the extent of the fears and concern of the framers of the Bill of Rights. The Fourth Amendment states, "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized." The people of 1790 were afraid of a recurrence of the days of George III.

The framers of the Fourth Amendment declared what we today would regard as a segment of privacy—protection from police invasion of privacy. The people of 1790 just were not concerned with invasion of privacy by a private person.

While a snooping person could be prosecuted to some extent under a Peeping Tom statute, this was a criminal liability. The victim could not sue for damages for the invasion of privacy.

If we are honest with history, all that we can say is that modern people think highly of privacy and want it to be protected. And, knowing that the law is responsive to the wishes of society, we can also say that the right is protected by government. But note that we should go no further than to say that it is a right which society wishes to protect at the present time. If circumstances arise in our national life of such a nature that the general welfare is opposed to the right of privacy we can expect that the "right" of privacy will be limited or modified. For example, although the right of privacy prevents a bank from giving out information about a customer's bank account, the federal government, acting under a 1969 statute, can require such information to see if income taxes are due or if money has been paid or received in criminal transactions.¹

§ 1:2. What Is the Law? The expression, "a law," is ordinarily used in connection with a statute enacted by a state legislature or the Congress of the United States, such as an act of the federal Congress to provide old-age benefits. However, the statutes enacted by legislative bodies are not the only source of law.

Constitutional law includes the constitutions in force in the particular area or territory. In each state, two constitutions are in force, the state constitution and the national constitution.

Statutory law includes statutes adopted by the lawmakers. Each state has its own legislature and the United States has the Congress, both of which enact laws. In addition, every city, county, or other subdivision has some power to adopt ordinances which, within their sphere of operation, have the same binding effect as legislative acts.

Of great importance are the *administrative regulations*, such as rules of the Securities and Exchange Commission and the National Labor Relations Board. The regulations promulgated by national and state administrative agencies generally have the force of statute and are therefore part of "the law."

Law also includes principles that are expressed for the first time in court decisions. This is *case law*. For example, when a court decides a new question or problem, its decision becomes a *precedent* and stands as the law for that particular problem in the future. This rule that a court decision becomes a precedent to be followed in similar cases is the doctrine of *stare decisis*.

Law also includes treaties made by the United States, and proclamations and orders of the President of the United States or of other public officials.

§ 1:3. Uniform State Laws. To secure uniformity as far as possible, the National Conference of Commissioners on Uniform State Laws, composed of representatives from all the states, has drafted statutes on various business subjects for adoption by the states.

¹ United States v Bisciglia, 420 US 141 (1975). But see § 28:4(a) of this book.

The best example of such laws is the Uniform Commercial Code (UCC).² The Code regulates the fields of sales of goods; commercial paper, such as checks; secured transactions in personal property; bulk transfers; and particular aspects of banking, letters of credit, warehouse receipts, bills of lading, and investment securities.

National uniformity has also been brought about in some areas of consumer protection by the adoption of the federal Consumer Credit Protection Act (CCPA), Title I of which is popularly known as the Truth in Lending Act.³ A Uniform Consumer Credit Code (UCCC) has been proposed and is now before the states for adoption. To the extent that it is adopted, it will complement the Uniform Commercial Code.⁴

§ 1:4. Classifications of Law. Law is classified in many ways. For example, *substantive law*, which creates, defines, and regulates rights and liabilities, is contrasted with *procedural law*, which specifies the steps that must be followed in enforcing those rights and liabilities. Law may also be classified in terms of its origin, as coming from the Roman (or civil) law, the common law of England, or the law merchant. It may be classified as to subject matter, such as the law of contracts, the law of real estate, and the law of wills.

B. AGENCIES FOR ENFORCEMENT OF LEGAL RIGHTS

Legal rights are meaningless unless they can be enforced. Government, therefore, provides a system by which the rights of the parties under the law can be determined and enforced. Generally the instrumentality of government by which this is accomplished is a court; the process involved is an action or a lawsuit. Administrative agencies have also been created to enforce law and to determine rights within certain areas. At the same time private agencies have developed as an out-of-court method of dispute determination.

§ 1:5. Courts. A *court* is a tribunal established by government to hear and decide matters properly brought before it, to give redress to the injured or enforce punishment

² The Code has been adopted in every state except Louisiana. It has also been adopted in the Virgin Islands and for the District of Columbia. Louisiana has adopted Articles 1, 3, 4, and 5 of the Code. In 1972, a group of amendments to the Code was recommended. These have been adopted in Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin. The changes made by the 1972 amendments to the UCC are confined mainly to Article 9 on secured transactions. In 1977, Article 8 of the Code, relating to investment securities, was amended. This amended version has been adopted in Connecticut, Minnesota, and West Virginia.

³ 15 United States Code § 1601 et seq., and 18 USC § 891 et seq.

⁴ As of January, 1981, the 1968 version of the Uniform Consumer Credit Code has been adopted in Colorado, Idaho, Indiana, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming. This earlier version, however, has been replaced by a 1974 version, which has been adopted in Iowa, Kansas, and Maine.

against wrongdoers, and to prevent wrongs. A *court of record* is one in which the proceedings are preserved in an official record. In a *court not of record* the proceedings are not officially recorded.

Each court is empowered to decide certain types or classes of cases. This power is called *jurisdiction*. A court may have original or appellate jurisdiction, or both. A court with *original jurisdiction* has the authority to hear a controversy when it is first brought into court. A court having *appellate jurisdiction*, on the other hand, has authority to review the judgment of an inferior court.

The jurisdiction of a court may be general as distinguished from limited or special. A court having *general jurisdiction* has power to hear and decide all controversies involving legal rights and duties. A court of *limited* or *special jurisdiction* has authority to hear and decide only those cases that fall within a particular class, such as cases in which the amounts are below a specified sum.

Courts are frequently classified in terms of the nature of their jurisdiction. A *criminal court* is one that is established for the trial of crimes, which are regarded as offenses against the public. A *civil court*, on the other hand, is authorized to hear and decide issues involving private rights and duties and also noncriminal public matters. In like manner, courts are classified as equity courts, juvenile courts, probate courts, and courts of domestic relations, upon the basis of their limited jurisdiction.

Each court has inherent power to establish rules necessary to preserve order in the court or to transact the business of the court. An infraction of these rules or the disobedience to any other lawful order, as well as a willful act contrary to the dignity of the court or tending to pervert or obstruct justice, may be punished as *contempt of court*.

§ 1:6. Administrative Agencies. The difficulties of courts administering laws regulating business, labor, agriculture, public utilities, and other phases of the economy led Congress and the state legislatures to establish commissions or agencies of experts to make the rules and to pass upon violations of the rules. Thus we find the Interstate Commerce Commission regulating interstate commerce and passing upon whether conduct of a carrier is a violation of its regulations. The Commission is thus a lawmaker, an executive that enforces the law, and a court which interprets and applies the law. This is also true of the Civil Aeronautics Board, the Federal Trade Commission, the Securities and Exchange Commission, the National Labor Relations Board, and many other federal and state administrative agencies.

§ 1:7. Private Agencies. Because of the rising costs, delays, and complexities of litigation, business people often seek to resolve disputes out of court.

(a) **Arbitration.** By the use of *arbitration* a dispute is brought before one or more arbitrators (disinterested persons selected by the parties to the dispute) who make a decision which the parties have agreed to accept as final. This procedure first reached an extensive use in the field of commercial contracts. Parties to a contract which is to be in effect for some time may specify in the contract that any dispute

shall be submitted to arbitrators to be selected by the parties. Arbitration today is encouraged as a means of avoiding expensive litigation and easing the workload of courts. Arbitration enables the parties to present the facts before the arbitrators who are trained experts and are familiar with the practices that form the background of the dispute.

A Uniform Arbitration Act has been adopted in a number of states.⁵ Under this Act and similar statutes, the parties to a contract may agree in advance that all disputes arising thereunder will be submitted to arbitration. In some instances the contract will name the arbitrators for the duration of the contract.

(b) Reference to Third Person. An out-of-court determination of disputes under construction contracts is often made under a term of the contract that any dispute shall be referred to the architect in charge of the construction and that the architect's decision shall be final.

Increasingly, other types of transactions provide for a third person or a committee to decide rights of persons. Thus, employees and an employer may have agreed as a term of the employment contract that claims of employees under retirement and pension plans shall be decided by a designated board or committee. The seller and buyer may have selected a third person to determine the price to be paid for goods. Ordinarily the parties agree that the decision of such a third person or board shall be final and that no appeal or review may be had in any court. In most cases, the referral situation involves the determination of a particular fact in contrast to arbitration which seeks to end a dispute.

(c) Association Tribunals. Many disputes never reach the law courts because both parties to the dispute belong to a group or association and the tribunal created by the group or association disposes of the matter. Thus, a dispute between members of a labor union, a stockbrokers' exchange, or a church, may be heard by some board or committee within the association or group. Courts will review the action of such tribunals to determine that a fair and proper procedure was followed but generally the courts will not go any further and will not examine the facts of the case to see if the association tribunal reached the same conclusion that the court would have reached.

C. COURT ORGANIZATION

Courts in the United States are organized in two distinct systems: the federal courts and the state courts. Although created under separate governments, the methods of operation and organization of these two systems are similar.

§ 1:8 Personnel of Courts. Both the federal and state court systems require the assistance of

⁵ The 1955 version of the Uniform Arbitration Act has been adopted in Alaska, Arizona, Arkansas, Colorado, Delaware, Idaho, Illinois, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nevada, New Mexico, North Carolina, Oklahoma, Pennsylvania, South Carolina, South Dakota, Texas, and Wyoming; and the District of Columbia. The earlier 1925 version of the Act is in force in Pennsylvania, Utah, and Wisconsin.

many people. These include not only those in the direct employ of the court, but also those described as officers of the court and in many cases a jury as well.

(a) **Officers of the Court.** The *judge* is the primary officer of the court. A judge is either elected or appointed. *Attorneys* or counselors at law are also officers of the court. They are usually selected by the parties to the controversy—but in some cases by the judge—to present the issue of a case to the court.

The *clerk* of the court is appointed in some of the higher courts but is usually elected to office in the lower courts. The principal duties of the clerks are to enter cases upon the court calendar, to keep an accurate record of the proceedings, to attest the same, and, in some instances, to approve bail bonds and to compute the amount of costs involved.

The *sheriff* is the chief executive of a county. In addition to the duty of maintaining peace and order within the territorial limits of a county, the sheriff has many other duties in connection with the administration of justice in county courts of record: summoning witnesses, taking charge of the jury, preserving order in court, serving writs, carrying out judicial sales, and executing judgments. The *marshals* of the United States perform these duties in the federal courts. In county courts not of record, such as the courts of justices of the peace, these duties, when appropriate, are performed by a *constable*. Some of the duties of the sheriff are now performed by persons known as *court criers*; or by deputy sheriffs, known as *bailiffs*.

(b) **The Jury.** The *jury* is a body of citizens sworn by a court to try to determine by verdict the issues of fact submitted to them. A trial jury consists of not more than twelve persons. The first step in forming a jury is to make a *jury list*. This involves the preparation by the proper officers or board of a list of qualified persons from which a jury may be drawn.

A certain number of persons drawn from the jury list constitute the *jury panel*. A trial jury is selected from members of the panel.

§ 1:9. Federal Courts. The Supreme Court of the United States is the highest court in the federal system. The courts of appeals are intermediate courts. The district courts and special courts are the lower courts.

(a) **Supreme Court of the United States.** The Supreme Court is the only federal court expressly established by the Constitution. Congress is authorized by the Constitution to create other federal courts.

The Supreme Court has original jurisdiction in all cases affecting ambassadors, other public ministers, and consuls, and in those cases in which a state is a party. Except as regulated by Congress, it has appellate jurisdiction in all cases that may be brought into the federal courts in accordance with the terms of the Constitution. The Supreme Court also has appellate jurisdiction of certain cases that have been decided by the supreme courts of the states. Thousands of cases are filed with this court in a year.

(b) **Courts of Appeals.** The United States, including the District of Columbia, is divided into 12 judicial circuits. Each of the circuits has a court of appeals. These

courts are courts of record.

A court of appeals has appellate jurisdiction only and is empowered to review the final decisions of the district courts, except in cases that may be taken directly to the Supreme Court. The decisions of the courts of appeals are final in most cases. An appeal may be taken on certain constitutional questions. Otherwise, review depends on the discretion of the Supreme Court and, in some cases, of the court of appeals.

(c) **District Courts.** The United States, including the District of Columbia, is divided into a number of judicial districts. Some states form a single district, whereas others are divided into two or more districts. District courts are also located in the territories.

The district courts have original jurisdiction in practically all cases that may be maintained in the federal courts. They are the trial courts for civil and criminal cases.

Civil cases that may be brought in these district courts are (a) civil suits brought by the United States; (b) actions brought by citizens of the same state claiming land under grants by different states; (c) proceedings under the bankruptcy, internal revenue, postal, copyright, and patent laws; (d) civil cases of admiralty and maritime jurisdiction; (e) actions against national banking associations; (f) cases between citizens of different states or between citizens of one state and a foreign state involving \$10,000 or more; and (g) cases that arise under the federal Constitution, or laws and treaties made thereunder.

(d) **Other Federal Courts.** In addition to the Supreme Court, the courts of appeals, and the district courts, the following tribunals have been created by Congress to determine other matters as indicated by their titles: Customs Court, Court of International Trade, Court of Claims, Tax Court, Court of Military Appeals, and the territorial courts.

§ 1:10. State Courts. The system of courts in the various states is organized along lines similar to the federal court system, although differing in details, such as the number of courts, their names, and jurisdiction.

(a) **State Supreme Court.** The highest court in most states is known as the Supreme Court. In a few states it may have a different name, such as "Court of Appeals" in New York. The jurisdiction of a supreme court is ordinarily appellate, although in a few instances it is original. In some states the supreme court is required to render an opinion on certain questions that may be referred to it by the legislature or by the chief executive of the state. The decision of a state supreme court is final in all cases not involving the federal Constitution, laws, and treaties.

(b) **Intermediate Courts.** In some states, intermediate courts have original jurisdiction in a few cases but, in the main, they have appellate jurisdiction of cases removed for review from the county or district courts. They are known as superior, circuit, or district appellate courts. As a general rule, their decisions may be reviewed by the highest state court.

(c) **County and District Courts.** These courts of record have appellate jurisdiction