

Supreme Court's 'nerve Centre' Test Simplifies Corporate Citizenship For US Federal Court Jurisdiction

Gilda R. Turitz, May 2010

Ending 50 years of US federal courts' disagreements over how to define a corporation's 'principal place of business' in order to determine whether 'diversity of citizenship' exists between the litigants for jurisdictional purposes, the Supreme Court's ruling in *Hertz Corp. v. Friend*, No. 08-117, 2010 WL 605601 (23 February 2010), will give corporations – particularly those with widely varied activities conducted in different states – more certainty and control in defining their corporate citizenship and exercising their preference for federal court as the forum to defend and prosecute lawsuits. Federal court jurisdiction is often favoured because of perceived bias in state courts toward out-of-state corporations.

By federal statute (28 U.S.C. §1332(c)(1)), "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business". In a unanimous decision authored by Justice Stephen G. Breyer, the Supreme Court clearly articulated a 'nerve centre' test to determine a corporation's 'principal place of business', for purposes of federal diversity jurisdiction, which in most cases will be corporate headquarters. In so ruling, the Supreme Court reversed the Ninth Circuit Court of Appeals' decision utilising a 'place of operations' test, eliminated a 'totality of a corporation's activities' test applied in five circuits, and rejected a 'centre of activity' test applied in another circuit. Aside from their difficulty in application by measuring business activities and operations, those tests have sometimes yielded inconsistent results by different courts as to a single corporation's 'principal place of business'.

Drawing on legislative history, judicial decisions and interpretations, and a desire to find a single, more uniform interpretation of the statutory phrase, the Supreme Court adapted the 'nerve centre' approach from the Seventh Circuit and concluded that 'principal place of business' is best read as referring to the place where a corporation's officers direct, control and coordinate the corporation's activities. The Supreme Court observed that, in practice, this should normally be the place where the corporation maintains its headquarters. Judge Breyer's opinion cautioned, however, that the headquarters must be the actual centre of direction, control and coordination. A 'nerve centre' will not be established merely by filing required government forms stating a principal place of business (for example, SEC Form 10-K), or by attempts at manipulation such as reliance on a bare office with a computer, an annual executive retreat location, or a mail drop box. The Supreme Court recognised that hard cases may be presented in this era of telecommuting where command and control functions may be decentralised among officers in different locations, but the trial court must focus its 'nerve centre' inquiry on the place of the company's overall direction, control and coordination, and not on weighing corporate functions, assets or revenues as the rejected business activities tests required.

Despite uncertainties even under the 'nerve centre' test that may be presented by modern corporations with far-flung business activities or non-traditional operations, the test's pragmatic approach will cut down on the potentially inconsistent results to which corporations were previously exposed under the former business activities tests. The circumstances in *Hertz* illuminate the fact-intensive inquiry into a corporation's business the courts made in order to apply such tests. In *Hertz*, two former employees who were California citizens brought a class action against Hertz in a California state court, alleging violations of state wage and hour laws. Hertz invoked diversity jurisdiction in removing the case to a federal district court in California, asserting that its principal place of business was in New Jersey, and therefore the plaintiffs and Hertz were citizens of different states. The plaintiffs contended that there was no diversity of citizenship because under the applicable test, Hertz was a California citizen.

As factual support for its position, Hertz submitted evidence to the district court that its leadership was located at Hertz's 'corporate headquarters' in Park Ridge, New Jersey, and that such location (and to a lesser extent an Oklahoma City, Oklahoma location) was the location of its 'core executive and administrative functions' and where its 'major administrative operations' were performed. Hertz's evidence also included factual data about its revenues and facilities operations in 44 states and that California, with about 12 percent of the nation's population, accounted for 273 of its 1606 car rental locations, about 2300 of its 11,230 full-time employees, about 3.8 million of its approximately 21 million rentals, and about \$811m of its \$4.371bn in annual revenue. The district court applied Ninth Circuit precedent requiring identification of a corporation's 'principal place of business' by first determining the amount of its business activity state by state to see if the amount of activity was 'significantly larger' or 'substantially predominates' in one state. The district court held on Hertz's facts that the 'plurality of each of the relevant business activities' to be in California and a significant 'differential' between the amount of activities in California and those in the 'next closest state'. The district court therefore concluded that Hertz's principal place of business was California, and diversity jurisdiction was lacking. In vacating the Ninth Circuit's judgment, which had affirmed the district court, the Supreme Court noted that the unchallenged evidence suggested that Hertz's centre of direction, control and coordination, its 'nerve centre', and its corporate headquarters were one and the same, and located in New Jersey, and remanded the case to allow the plaintiffs a fair opportunity to litigate their case in light of the holding.

Applying *Hertz's* more straightforward 'nerve centre' test should bring greater predictability to judicial findings as to a corporation's citizenship based on its principal place of business, and eliminate the prior risk that different courts could find the same corporation to have its principal place of business in different states. This inconsistent result occurred with respect to United Airlines. Under the Ninth Circuit test rejected in *Hertz*, one district court had found that United Airlines was a citizen of California, while another found that it was a citizen of Illinois.

A significant impact of *Hertz* is that litigants will benefit from streamlined jurisdictional rules which will avoid diverting resources from litigating the merits of their claims and defences to litigating issues over complex jurisdictional tests. Particular impact may be felt in California, due to its relatively high percentage of the nation's population and with corresponding prevalence of corporate business activities and revenue generation in that state, as was the case in *Hertz*. A corporation that does not have its headquarters and 'nerve centre' in California will have greater certainty – of which Hertz could not be assured at the outset of the plaintiffs' wage and hour class action – that it will not be declared a citizen of California which is perceived to have plaintiff-friendly state courts, and that it therefore would be unable to invoke federal diversity jurisdiction to defend itself. Under the clear *Hertz* holding, corporations will enjoy greater predictability in making business and investment decisions, as the Supreme Court expressly recognised, by setting the 'nerve centre' test as the definitional rule for a corporation's 'principal place of business'.

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