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SUPREME COURT ADOPTS "NERVE CENTER TEST" TO DETERMINE A COMPANY'S "PRINCIPAL PLACE OF BUSINESS" IN DIVERSITY JURISDICTION MATTERS

After decades of dissonance between the Circuit Courts of Appeals, the US Supreme Court finally stepped in and unanimously ruled that, for purposes of federal diversity jurisdiction, a company's "principal place of business" is where the corporation's high level officers "direct, control, and coordinate the corporation's activities." This decision will inevitably hinder forum shopping by making it more difficult for plaintiffs to file suit against national or international companies in state courts.

This ruling, handed down on February 23, 2010 in *Hertz Corp.* v. *Friend*,[1] is an endorsement of the Seventh Circuit's "nerve center" test and a rejection of the "center of activity" test employed by the Third Circuit and the "totality of corporate activity" test employed in various forms by the Fifth, Sixth, Eight, Ninth, Tenth, and Eleventh Circuits. The ruling finally provides greater predictability to corporations as to whether a case will be heard in state or federal court. Courts will now look to the place where the majority of a corporation's executive and administrative functions are performed to determine diversity jurisdiction.

HERTZ CORP. v. *FRIEND*

In *Hertz*, plaintiffs, who were California citizens, filed a class action in California state court against Hertz Corporation, alleging that the company had violated state wage and hour laws. Hertz, incorporated in Delaware with its corporate headquarters in New Jersey, removed the action under federal diversity grounds, claiming that the parties were citizens of different states. Applying Ninth Circuit precedent,[2] the Northern District Court of California found that California was Hertz's principal place of business because a large amount of Hertz's business activities was conducted in California and the amount of those activities compared to the next largest state was "significant." It remanded the case to state court. Hertz appealed, the Ninth Circuit affirmed, and the Supreme

1 *Hertz Corp.* v. *Friend*, ---S. Ct. ----, 2010 WL 605601 (U.S.), *available at:* http://www.supremecourtus.gov/opinions/09pdf/08-1107.pdf.

2 The "place of operations" test that evolved in the Ninth Circuit instructed courts to identify a corporation's "principal place of business" by first determining the amount of a corporation's business activity state by state. If the amount of activity is "significantly large" or "substantially predominates" in one state, then that state is the corporation's principal place of business. If there is no such state, then the principal place of business is the corporation's "nerve center," or the place where the majority of its executive and administrative functions are performed.

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Court granted certiorari.

After analyzing the divergent and increasingly complex interpretations of the federal diversity jurisdiction statute, the Court's ruling rested on three considerations. First, the Court noted that the statute deems a corporation a citizen of the "State where it has its principal place of business."[3] Given that "place" is singular and follows the words "State where," then the place must be a singular place (such as a company's headquarters) within a state. The fact that a company may have operations in numerous locations throughout the state will not be determinative. Second, administrative simplicity is favored over complex jurisdictional tests in interpreting a jurisdictional statute. Courts benefit from straightforward rules under which they can assure themselves of their power to hear a case, and parties benefit from predictability. Finally, the Court resorted to legislative history for the proposition that Congress intended the words "principal place of business" to be a simpler alternative to a previously considered—and rejected—suggestion that courts should look at where a company generates half of its gross income. The Court then held that the "nerve center" test meets all of these considerations because: (1) a company's nerve center is a single place, (2) the test is relatively simple to apply, and (3) the test does not rely on reference to numbers or calculations.

The Court recognized that there likely is no perfect test, and there still will be difficult cases to decide under the nerve center test. Nevertheless, the test's simplicity guides courts in more easily determining the center of a company's overall direction, control, and coordination without having to weigh corporate functions, assets, or revenues of different kinds. Finally, the Court noted that the burden of persuasion for establishing diversity jurisdiction remains on the party asserting it, and that courts must take care to determine that a company's nerve center is indeed the place of "actual direction, control, and coordination," and not an attempt at manipulation, such as an empty office or the location of an annual executive retreat.

3 28 U.S.C. § 1332(c)(1).

IMPACT OF DECISION

Although this case has not received as much media attention as other recent US Supreme Court decisions, its significance and impact should not be overlooked. *Hertz* fundamentally changes how lower courts in most Circuits will determine corporate citizenship—and hence removability—in diversity cases. The decision will have the most impact on corporations that have their largest operations in states like California, merely due to the state's size. The concern prior to *Hertz* was that if a "corporation may be deemed a citizen of California on th[e] basis" of "activities [that] roughly reflect California's larger population…nearly every national retailer—no matter how far flung its operations—will be deemed a citizen of California for diversity purposes."[4] While the Ninth Circuit's old test was an obstacle to removal to federal court for any company that had significant operations in California, such companies with nerve centers outside of the state will now have an easier path to removal from California state courts.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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4 *Davis* v. *HSBC Bank Nev., N. A.*, 557 F.3d 1026, 1029-1030 (9th Cir. 2009).