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Home Is Where the HQ Is: Corporate Citizenship Following the Supreme Court's Decision in *Hertz v. Friend*

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**HOME IS WHERE THE HQ IS:
CORPORATE CITIZENSHIP FOLLOWING THE SUPREME COURT'S
DECISION IN *HERTZ v. FRIEND***

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I. INTRODUCTION

When a large, multi-state corporation is sued in state court, the defendant's counsel's first question is often whether there are grounds to remove the case to federal court. Federal courts, deservedly or not, are often seen as more "desirable" forums for corporate defendants. However, removal requires establishment of federal question or diversity jurisdiction.

For purposes of diversity jurisdiction, a corporation is deemed to be a citizen of the state of its incorporation as well as the state where it has its "principal place of business."¹ The proper understanding and interpretation of this phrase was at the heart of the Supreme Court of the United State's recent decision in *Hertz v. Friend*.² This article provides a history of the phrase and discusses the substance and implications of the Court's opinion.

II. DIVERSITY JURISDICTION

The federal courts are courts of limited jurisdiction. Article III of the United States Constitution restricts federal jurisdiction to claims based on a federal question and

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¹ 28 U.S.C. § 1332(c)(1).

² 559 U.S. ____ (2010), No. 08-1107.

claims that satisfy diversity jurisdiction.³ The Supreme Court has interpreted the latter narrowly, requiring complete diversity and a minimum amount-in-controversy.⁴

Federal jurisdiction is restricted to limit the volume of cases that federal courts hear and to protect the right of state courts to determine questions of state law. An additional concern over potential home-state bias, however, influenced the constitutional framers to allow diversity actions to be heard in federal court regardless of subject matter. While jurists and legal commentators debate whether such bias still exists today, diversity jurisdiction remains “to shore up confidence in the judicial system by preventing even the appearance of discrimination in favor of local residents.”⁵

Before 1958, the statute defining federal diversity requirements stated that a corporation was a citizen of its state of incorporation only. In practice, this led to instances where local businesses could avoid state courts simply by filing charters in other states. As a result, federal courts were often burdened with diversity cases involving state law claims and counter-parties that were not truly “foreign.” In an effort

³ See U.S. Const. art. III, § 2 (“The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution . . . [and] to Controversies . . . between Citizens of different States.”); 28 U.S.C. § 1331 (2006) (granting federal district courts original jurisdiction over all controversies that raise a question of constitutional or federal law); see also *id.* § 1332 (granting federal district courts original jurisdiction over cases where the amount in controversy exceeds \$75,000 and is between citizens of different states).

⁴ *Strawbridge v. Curtiss*, 7 U.S. 267, 267 (1806) (announcing a complete diversity rule); see also *Ruhrgas v. Marathon Oil Co.*, 526 U.S. 574, 580 n.2 (1999) (interpreting § 1332 to require complete diversity even though the Constitution permits federal courts to hear cases between citizens of different states).

⁵ John H. Beisner & Jessica Davidson Miller, *They’re Making a Federal Case Out of It . . . In State Court*, 25 Harv. J.L. & Pub. Pol’y 143, 146 (2001) (citing *Class Action Fairness Act of 1999: Hearing Before the Subcomm. on Admin. Oversight and the Courts of S. Comm. on the Judiciary*, 106th Cong. 100 (1999) (statement of Prof. E. Donald Elliot, Yale Law School)).

designed, in part, to reduce frauds and abuses on the courts, Congress added subsection (c) to Section 1332 in 1958 to provide that “a corporation shall be deemed a citizen of any State by which it has been incorporated *and* of the State where it has its principal place of business.” (Emphasis added.) Congress purposefully chose to allow multiple citizenships for a corporation -- utilizing the conjunctive “and” in listing both the place of incorporation and principal place of business. Allowing for additional states of citizenship is in tune with the original purposes of the statute -- to limit the number of cases being removed to federal court, thus limiting access to federal forum whenever there is a colorable basis to do so.

III. THE CASE OF *HERTZ v. FRIEND*

A. Factual and Procedural History

In 2007, Melinda Friend and John Nhieu filed a putative class action in California state court against nationwide rental company The Hertz Corporation (“Hertz”), alleging that Hertz had violated California wage and hour laws. The proposed class was wholly comprised of California citizens. Hertz was incorporated in Delaware and has an established corporate headquarters in Park Ridge, New Jersey. Hertz therefore removed the case on the basis of diversity jurisdiction. Plaintiffs moved for remand, arguing a lack of diversity because all parties were California citizens. With no federal question at issue, federal jurisdiction turned on whether California was Hertz’s “principal place of business.”

Hertz is a national company, conducting business in 44 states. At the time of removal, California was home to 20.5% of Hertz’s employees, 17% of Hertz’s physical

rental locations and facilities, and was the source of 18.6% of Hertz's revenues.⁶

Plaintiffs cited these statistics to argue California was Hertz's principal place of business, relying primarily on the Ninth Circuit's holding in *Tosco Corp. v. Communities for a Better Environment*.⁷

In *Tosco*, the Ninth Circuit recognized two tests for determining a corporation's principal place of business. First, the "place of operations" test focused on the state where a "substantial predominance of corporate operations" occurred. To determine whether a corporation's operations "substantially predominate" in a given state, *Tosco* instructed lower courts to compare a corporation's business activity in the state at issue to its activity in other states, taking into account "the location of employees, tangible property, production activities, sources of income, and where sales take place."⁸ Second, the "nerve center" test identifies the principal place of business as the state "where the majority of [the corporation's] executive and administrative functions are performed."⁹ Rather than restricting analysis to one test over the other, the Ninth Circuit established a hierarchy between the tests, directing that the "nerve center" test should only be used when no state contains a "substantial predominance of the corporation's business activities."¹⁰

Here, Plaintiffs argued that since more of Hertz's employees, tangible property, and revenues could be found in California than in any other state, California was where a

⁶ The next closest state, Florida, was home to 14.3% of Hertz's employees, 9.7% of Hertz's property, and was where 11.6% of Hertz's revenues were generated.

⁷ *Tosco*, 236 F. 3d 495 (9th Cir. 2001) (per curiam).

⁸ *Tosco*, 236 F. 3d 495, 497, 500-02.

⁹ *Tosco*, 236 F. 3d 495, 500.

“substantial predominance” of Hertz’s business activities took place and, therefore, was Hertz’s “principal place of business” for the purposes of § 1332(c)(1). Plaintiffs further argued that Hertz, a well-known, national company, was not “the kind of litigant that diversity jurisdiction was intended to protect,” and that companies that have as large of a business presence within California, as Hertz does, are unlikely to be treated as outsiders or suffer local bias in state court.¹¹

In opposition, Hertz argued that the scope of its California business was merely reflective of the state’s size, and not a result of any deliberate attempt to concentrate its activities in California. Hertz also argued that, in the big picture, its business operations were not “substantially predominant” in California, or any other state; further, even though California was the location of more employees and rental locations, in absolute terms, that number is not disproportionately high when examined on a per capita basis. Hertz relied on *Ho v. Ikon Office Solutions, Inc.*¹² to support its position that a forum state’s large size can have a distorting effect on statistics regarding a company’s multi-state business activities. Specifically, Hertz emphasized the impropriety of the “place of operations” test in that its application would necessarily result in many national corporations being deemed California citizens based solely on the state’s size and population. This, Hertz argued, was both unfair and contrary to the underlying purposes of diversity jurisdiction. In addition, relying on pre-*Tosco* precedent, Hertz argued that

¹⁰ *Id.*

¹¹ Plaintiff’s Memorandum in Support of Motion to Remand at 3, No. 3:07-cv-05222 (N.D. Cal. Nov. 9, 2007) (quoting *Ghaderi v. United Airlines, Inc.*, 136 F. Supp. 2d 1041, 1043 (N.D. Cal. 2001)).

¹² 143 F. Supp. 2d 1163 (N.D. Cal. 2001).

the “nerve center” test was the more appropriate analysis for a corporate party as operationally diverse as Hertz.¹³

In granting Plaintiffs’ Motion to Remand, the District Court noted that “a plurality” of each of Hertz’s *Tosco*-relevant business activities were in California. Specifically, the district court compared Hertz’s employee head count, property ownership and revenue, in absolute terms, between California and the state where Hertz had its next-largest presence, Florida.¹⁴ Applying this analysis, the district court held California was Hertz’s “principal place of business.”

Hertz appealed, but the Ninth Circuit, in a short, unpublished opinion, affirmed.¹⁵ The Ninth Circuit found that the district court had correctly applied the “place of operations” test and that Hertz’s relevant business activities were “significantly larger” in California than in any other state.¹⁶ Like the district court, the Ninth Circuit refused to consider “the comparative population of states in which a corporation operates to determine whether activities are significantly larger in one state than another.”¹⁷ Finally, the court also noted that Hertz’s extensive California contacts relieved it of any danger of being mistreated in a California state court.

¹³ Defendant’s Brief in Opposition to Plaintiff’s Motion to Remand at 4, 3:07-cv-05222 (N.D. Cal. Nov. 9, 2007).

¹⁴ Order Granting Plaintiffs’ Motion to Remand; Vacating Hearing at 4, no. 3:07-cv-05222-MMC (N.D.Cal. Jan. 15, 2008).

¹⁵ *See* 297 F. Appx. 690, 2008 WL 4750198 (9th Cir. 2008)

¹⁶ *Id.* at 691.

¹⁷ *Id.*

B. The Circuit Split

In its petition for a writ of certiorari, Hertz demonstrated the presence of “a deep four-way split” among the Circuit Courts of Appeal regarding the various tests for determining a corporation’s “principal place of business.”¹⁸ As discussed, the Ninth Circuit applied the “place of operations” test, in the first instance, with the “nerve center” test as a fallback. Alternatively, the Seventh Circuit relied solely on the “nerve center” test, directing courts to identify “the corporation’s brain,” which is most often found “where the corporation has its headquarters.”¹⁹ Similar to the Seventh Circuit’s test, the Third Circuit’s “center of corporate activities” test focused on a corporation’s “headquarters of day-to-day corporate activity and management.”²⁰ Finally, the “total activities” or “totality of circumstances” test, adopted by the Fifth, Sixth, Eighth, Tenth and Eleventh Circuits, sought a broader examination of the corporation and its business, considering a list of factors, including: the corporation’s nerve center, the locations of its

¹⁸ Petition for Writ of Certiorari at 2, *Hertz Corp. v. Friend*, 559 U.S. ____ (2010) (No. 08-1107), 2008 U.S. Briefs 1007 at *2, 2009 U.S. S. Ct. Briefs LEXIS 1633.

¹⁹ *Wisconsin Knife Works v. National Metal Crafters*, 781 F. 2d 1280, 1282 (7th Cir. 1986); *Metropolitan Life Ins. Co. v. Estate of Cammon*, 929 F.2d 1220, 1223 (7th Cir. 1991)(“this court follows the ‘nerve center’ approach to corporate citizenship: a corporation has a single principal place of business where its executive headquarters are located.”). In *Wisconsin Knife*, the Seventh Circuit openly acknowledged that other courts use “vaguer” standards and look to other factors besides a corporation’s headquarters to determine where the “principal place of business” is located, but believing that diversity jurisdiction “ought to be readily determinable,” it deliberately chose to go with the “simpler” nerve center test, and refused to consider factors such as location of employees, tangible property or sales in its determination. 781 F. 2d 1280, 1282

²⁰ *Kelly v. U.S. Steel Corp.*, 284 F. 2d 850, 854 (3d Cir. 1960). Unlike the “nerve center” test, however, the Third Circuit also considered the location of the corporation’s plants and employees, though the Court acknowledged that these considerations are “elements of lesser importance.” *Id.*; see also *Mennen Co. v. Atlantic Mut. Ins. Co.*, 147 F. 3d 287, 291 (3d Cir. 1998).

business operations, as well as the totality of surrounding circumstances, including the character and purposes of the corporation, and the kind of business in which it is engaged.²¹ The remaining circuits -- the First, Second, and Fourth -- have applied some or all of the tests described above without formally adopting any one of them; however, these Circuits' approaches have most closely resembled the multi-factor approach of the "total activities" test.

C. The United States Supreme Court's *Hertz* Decision

In light of the circuit split, the Supreme Court granted Hertz's petition for writ of *certiorari*, and on February 23, 2010, issued its written decision. Justice Breyer, writing for a unanimous Court, directed that the phrase "principal place of business" referred to "the place where the corporation's high level officers direct, control, and coordinate the corporation's activities," otherwise known as the corporation's "nerve center . . . [which] will typically be found at a corporation's headquarters."²² The Court placed "primary weight" upon "the need for judicial administration of a jurisdictional statute to remain as simple as possible."²³

The Court began by tracing the development of corporations as legal parties -- following them from non-entities to artificial persons to full-fledged corporate citizens. As with any statutory analysis, the Court began its inquiry with the plain language of the statute, noting that "principal place of business" was adopted rather than a citizenship test

²¹ See, e.g., *Gafford v. General Elec. Co.*, 997 F.2d 150, 161 (6th Cir. 1993); *Amoco Rocmount Co. v. Anschutz Corp.*, 7 F.3d 909, 915 (10th Cir. 1993).

²² 559 U.S. ____ (2010), no. 08-1107, slip op. at 1.

²³ 559 U.S. ____ (2010), no. 08-1107, slip op. at 1.

based on “gross income” because it was a “simpler and more practical formula.”²⁴ The Court acknowledged that this language was not as simple to apply as the drafters had intended.²⁵ Rather, the Circuits had divided in their approaches, with some courts adopting the multi-factor “business activities” tests that are fundamentally “at war with administrative simplicity.”²⁶ Finding these complex tests “unusually difficult to apply” and in some cases “imprecise[ly]” articulated, the Court noted that it is unsurprising that “different circuits (and sometimes different courts within a single circuit) have applied these highly general multifactor tests in different ways.”²⁷

Despite diversity jurisdiction’s origins in protecting against party-bias by local courts, the Court gave little weight to this argument. The Court observed that less quantifiable factors such as a corporation’s image, history, and advertising can more often influence prejudice against an out-of-state party than factors such as plant location, or sales and employment statistics, which “sometimes bear no more than a distant relation to the likelihood of prejudice.”²⁸

In holding that a corporation’s “nerve center” is its jurisdictional “principal place of business,” the Court emphasized three considerations. First, under the plain language of the statute, the word “place” in 28 U.S.C. 1332(c)(1) indicates a singular, “main,

²⁴ 559 U.S. ____ (2010), no. 08-1107, slip op. at 8.

²⁵ 559 U.S. ____ (2010), no. 08-1107, slip op. at 9 (quoting *Hearings on H.R. 2516 et al. before Subcommittee No. 3 of the House Committee on the Judiciary*, 85th Cong., 1st Sess., 37 (1957)).

²⁶ 559 U.S. ____ (2010), no. 08-1107, slip op. at 13.

²⁷ 559 U.S. ____ (2010), no. 08-1107, slip op. at 11.

²⁸ 559 U.S. ____ (2010), no. 08-1107, slip op. at 13.

prominent or leading” location.²⁹ The Court read this as the corporate headquarters, finding “the ‘place’ is a place *within a* State. It is not the State itself.”³⁰ Second, jurisdictional statutes demand rules that are easy to administer and promote judicial efficiency. Finding that multifactor “business activities” tests were often complicated, unnecessarily costly and timely to litigate, and encouraged gamesmanship among litigants, the Court favored the “nerve center” test.³¹ Third, the Court found the “nerve center” test best met the goals of simpler administration and predictability of outcomes that both Congress and the Court favor.³²

Cognizant of the impact a jurisdictional decision may have on a case, the Court recognized the potential for abuse under the “nerve center” test. Thus, the Court instructed the lower courts to scrutinize those litigants who may seek to create “sham” headquarters solely for jurisdictional purposes. Emphasizing practical substance over mere formality, the Court directed that a company’s “principal place of business” is the place from which it actually directs and manages its business, regardless of where the corporation indicates it is headquartered. Since the burden of persuasion for establishing diversity jurisdiction remains on the party asserting it, that corporation must have “competent proof” to support jurisdiction.³³ Such proof must be more than a designation on its public agency or tax filings nor can a location qualify if it solely serves as the

²⁹ 559 U.S. ____ (2010), no. 08-1107, slip op. at 14.

³⁰ 559 U.S. ____ (2010), no. 08-1107, slip op. at 14.

³¹ 559 U.S. ____ (2010), no. 08-1107, slip op. at 15-16.

³² 559 U.S. ____ (2010), no. 08-1107, slip op. at 16-17.

³³ 559 U.S. ____ (2010), no. 08-1107, slip op. at 18.

location for board meetings or corporate retreats.³⁴ For jurisdictional purposes, a corporation’s headquarters is the place from which the actual direction, control or coordination of the corporation emanates.

The Court acknowledged the bright-line “nerve center” test is imperfect, and that “anomalies will arise.”³⁵ For example, the Court described a hypothetical where “the bulk of a company’s business activities” took place in New Jersey, but “its top officers direct those activities just across the river in New York.”³⁶ Despite the inconsistency with the goals upon which diversity jurisdiction was created, the Court acknowledged that New York would be this hypothetical company’s “principal place of business” and any claim against it in New Jersey could be removed to federal court.³⁷ Further, the Court acknowledged that the influence of modern communications technology and/or decentralized management structures could also create seemingly unplanned results. However, the Court determined that “[a]ccepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system.”³⁸ No test is perfect, certainly, but in the majority of instances, the “nerve center” test effectively “points courts in a single direction, towards the center of overall direction, control and coordination.”³⁹

³⁴ 559 U.S. ____ (2010), no. 08-1107, slip op. at 18.

³⁵ 559 U.S. ____ (2010), no. 08-1107, slip op. at 17.

³⁶ 559 U.S. ____ (2010), no. 08-1107, slip op. at 17.

³⁷ 559 U.S. ____ (2010), No. 08-1107, slip op. at 17.

³⁸ 559 U.S. ____ (2010), No. 08-1107, slip op. at 18.

³⁹ 559 U.S. ____ (2010), No. 08-1107, slip op. at 17.

IV. PRACTICAL IMPLICATIONS OF THE *HERTZ* DECISION

For corporate citizens, and the attorneys who defend them, the *Hertz* decision provides clarity to what was once a murky area of the law. In addition to “administrative simplicity” for the courts, the “nerve center” test makes predictions regarding a company’s citizenship more reliable. Provided that a company has an established headquarters from which its management exerts practical control over its operations, the company can be reasonably confident it will be a citizen of that state.

For corporations without an established headquarters, they could be well-served by establishing one. Establishment of a corporate headquarters allows a corporation to preemptively forum shop -- in the most legitimate, non-nefarious meaning of the term -- for a desirable jurisdiction. Even those corporations with a decentralized management structure should consider the advantages of establishing a headquarters in anticipation of future litigation. So long as corporations can be “haled into court” in jurisdictions within which they have minimum contacts, corporate-defendants cannot often choose, in the first instance, the forum within which a plaintiff may elect to sue them; however, the *Hertz* opinion grants companies the ability to establish citizenship and obtain a clearer picture of where more of those suits may arise as well as the ability to predict where such suits may be removed.

V. CONCLUSION

The United States Supreme Court’s holding in *Hertz* established the “nerve center” test for determining a corporation’s “principal place of business” and, thus, its citizenship, for purposes of diversity jurisdiction under 28 U.S.C. §1332(c)(1). The Court found the “nerve center” test to be the most administratively simple to apply, for most cases, while providing the least potential for incongruous results. The Court’s

ruling in *Hertz* provides welcomed guidance to litigants faced with diversity jurisdiction disputes and will benefit judicial economy overall.