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Supreme Court Determines Your Principal Place of Business

By Rasheed A. Simmonds, Esq.

Your day is going just fine, but then you open your mail. There it is, one of those "dreaded" documents. This time it is a complaint filed in state court by a current or former employee against your company. One of the initial strategy questions you should ask yourself is whether you can (and should) remove the case to federal court. You already know that you cannot remove a case filed in a state where your company is incorporated or where your company has its "principal place of business," but what exactly does "principal place of business" mean? The Supreme Court just made the answer to that question a little easier. In a unanimous ruling on February 23, 2010, the Supreme Court held that a corporation's "principal place of business" often is its corporate headquarters or the place from where the control and direction of the corporation emanate. *Hertz Corporation v. Friend*, 2010 WL 605601 (U.S. 2010).

Soon after the founding of the nation and its judicial system, Congress created "diversity jurisdiction," which allows non-local defendants to remove certain state cases to federal court in order to escape local state courts that might be biased against non-local defendants. Generally speaking, federal courts have diversity jurisdiction over state law civil claims between citizens of different states when the amount in controversy is at least $75,000. *See* 28 U.S.C. § 1332(a)(1). Since the inception of diversity jurisdiction, Congress has struggled to find the best way to define the citizenship of a corporation. In 1958, a Congressional committee created the rule that a corporation is a citizen of both the state in which it is incorporated and the "State where it has its principal place of business." 28 U.S.C. § 1332(c)(1). Congress borrowed the phrase "principal place of

business" from bankruptcy law with the hope it would provide federal courts with a clear and predictable guide to a corporation's citizenship. Congress's plan had one small problem, however; bankruptcy courts throughout the country at the time did not agree on what "principal place of business" meant or how to apply it. Perhaps predictably, federal courts soon had the same disagreement.

By the time *Hertz* reached the Supreme Court, there were nearly as many tests for determining a corporation's "principal place of business" as there were federal circuits. The Seventh Circuit (covering Wisconsin, Illinois, and Indiana) looked to see from where the direction, control, and coordination of a corporation emanated, which typically was the physical location of a corporation's headquarters. This was known as the "nerve center" test. On the other hand, the Ninth Circuit (covering Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, Washington, Guam and the Northern Mariana Islands) first looked to see if a corporation's business activities were "significantly larger" in any one state as compared to any other state, and, if not, then to that corporation's "nerve center." The First Circuit (covering Maine, Massachusetts, New Hampshire, Rhode Island and Puerto Rico) looked to a corporation's "nerve center" ... but only if the corporation had "far flung" operations; otherwise, it would focus on a corporation's actual business activities like the Ninth Circuit. Still other circuits followed a "totality of the circumstances" test. And even should different circuits ostensibly follow the same test in name, the tests could be different in application. The result was such that one corporation could have a different "principal place of business" depending on where the lawsuit was filed. It was into this morass that the Supreme Court entered in *Hertz*.

Hertz began when a group of California citizens sued Hertz Corporation in California state court alleging violations of California's state labor laws. Hertz sought to remove the case to federal court on the basis of diversity jurisdiction, stating that it was a citizen of Delaware (where it was incorporated) and New Jersey (where it had its corporate headquarters), but not California. A California federal district court denied removal, applying the Ninth Circuit's "business activities" test and finding that a predominance of Hertz's business activities - namely a predominance of its employees and revenues - were in California, thus making Hertz's "principal place of business" California, not New Jersey. The Ninth Circuit upheld the decision, and Hertz appealed to the Supreme Court.

In a unanimous decision, the Supreme Court ended nearly 50 years of debate and held that a corporation's "principal place of business" is "the place where the corporation's high level officers direct, control, and coordinate the corporation's activities." 2010 WL 605601 at *3. In other words, the Court adopted the "nerve center" test.

The *Hertz* Court gave three reasons for adopting the "nerve center" test. First, the language of 28 U.S.C. Section 1332(c)(1) indicates that "principal place of business" refers to a single

physical location *within* a state. The statute's textual cues led the Court away from the Ninth Circuit test advocated by Ms. Friend, which did not look to a single location *within* a state, but rather looked at a corporation's business activities in relation to the state *as a whole*. Such an approach went against the language of the statute. "A corporation's 'nerve center,' [on the other hand,] usually its main headquarters, is a single place. The public often ... considers it the corporation's main place of business. And it is a place within a State." 2010 WL 605601 at *11. The second reason that the Supreme Court gave was that the "nerve center" test was the best test for purposes of administrative simplicity. Third, the Court noted that the legislative history of 28 U.S.C. Section 1332(c)(1) indicated that Congress rejected a calculation of business activities in favor of a physical location test.

Although listed as its second reason, administrative simplicity was the Court's overriding concern. A dominating theme of the Justices' questions during oral arguments (and of the Court's opinion) was a concern with finding a single rule that, although not perfect, offered the most predictability for parties and the easiest application for federal courts. The "nerve center" test, which was the most easily applied of all the potential tests, became the natural choice. And while the Court noted that the "nerve center" test will sometimes yield counterintuitive results that cut against the purpose of diversity jurisdiction (i.e., helping non-local defendant avoid biased state courts), such exceptions are a necessary evil that accompanies a clearer rule.

For corporations, the *Hertz* decision means greater predictability in removal efforts, which is important when a corporation faces a lawsuit in an unfriendly jurisdiction. Corporations and their attorneys should note, however, that the Court did not adopt the "nerve center" test without qualifications. Claims for and against the location of a corporation's "principal place of business" still need to be supported with proof, and "the mere filing of a form like the Securities and Exchange Commission's Form 10-K listing a corporation's 'principal executive offices' would [not], without more, be sufficient proof to establish a corporation's 'nerve center.'" 2010 WL 605601 at *14. Moreover, a corporation cannot attempt "gamesmanship" by claiming as its "principal place of business" a P.O. Box, an empty office, or a place used only once a year for annual board of director meetings. Still, the decision is beneficial to businesses, as corporations can now more easily plan the location of both their incorporation and their headquarters so as to avoid unfriendly jurisdictions.

During oral arguments, the Justices wondered aloud whether new technology and improving means of communication may one day render the traditional notion of a "nerve center" obsolete. Should that one day prove true, this latest attempt at simplifying diversity jurisdiction may prove as effective as the attempt that led to the *Hertz* decision in the first place.

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