

# Supreme Court Simplifies Test For Federal Court Jurisdiction

The United States Supreme Court has ruled that a corporation's principal place of business is its corporate headquarters – its “nerve center” –

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rather than the state in which the corporation conducts the largest amount of business. This ruling provides a much simpler test for corporations to apply in determining whether litigation is likely to occur in state or federal court.

## Diversity Jurisdiction

Corporations often prefer to litigate in federal court rather than state court. Federal courts, however, are courts of limited jurisdiction, while state courts have broader jurisdiction. If the case does not involve a federal question and the United States is not a party, a party can establish federal court jurisdiction only by showing that “diversity of citizenship” exists, meaning that the plaintiff and defendant are not citizens of the same state, and that the amount in controversy exceeds \$75,000. 28 U.S.C. § 1332; *Ibeabuchi v. Arizona State Univ.*, No. 08-2270-PHX-JAT, 2009 WL 1804980, at \*1 (D. Ariz. June 24, 2009). Congress vested federal courts with diversity jurisdiction to help out-of-state parties avoid the local prejudice that might influence state court decisions. *Hertz Corp. v. Friend*, No. 08-1107, 2010 U.S. LEXIS 1897, \*17 (Feb. 23, 2010).

A corporation is a citizen of its state of incorporation and a citizen of the state where its principal place of business is located. 28 U.S.C. § 1332. Determination of the state of incorporation is straightforward, but there has been uncertainty about how to identify a corporation's principal place of business. Federal courts of appeal developed different tests to determine a corporation's principal place of business, often based on where the corporation conducted the most business. *Hertz*, 2010 U.S. LEXIS 1897, at \*23-28. In *Hertz Corp. v. Friend*, the Supreme Court adopted the rule that the location of the corporation's “nerve center” serves as the corporation's

principal place of business for purposes of diversity jurisdiction. *Id.* at \*28.

## The Hertz Case

The plaintiffs in *Hertz*, citizens of California, brought a class action in California state court against Hertz Corporation, alleging violations of California's wage and hour laws. Hertz removed the case to the federal court for the Northern District of California based on diversity jurisdiction, but the federal district court ruled that diversity of citizenship did not exist because Hertz's principal place of business was in California. *Friend v. Hertz Corp.*, No. C-07-5222 MMC, 2008 WL 7071465 (N.D. Cal. Jan. 15, 2008). In so ruling, the district court focused on where Hertz's business activities occurred rather than on the location of Hertz's corporate headquarters and found that Hertz conducted significantly more business in California than in any other state. *Id.* at \*1-3. The Court of Appeals for the Ninth Circuit upheld the district court's decision. *Friend v. Hertz Corp.*, No. 08-16963, 2008 WL 4750198 (9th Cir. Oct. 30, 2008).

Hertz argued to the United States Supreme Court that its principal place of business was where the company made its corporate decisions – at its corporate headquarters in New Jersey. The Supreme Court, in a unanimous opinion, agreed with Hertz and held that a corporation's principal place of business is “where a corporation's officers direct, control, and coordinate the corporation's activities,” also called the corporation's “nerve center,” which in practice should normally be the corporation's headquarters. 2010 U.S. LEXIS 1897, at \*28-29.

## The Court's Basis for Adopting the Nerve Center Test

The Supreme Court explained that the nerve center test, although “imperfect,” is better than other approaches for three reasons: (1) the statute's language supports this interpretation; (2) “administrative simplicity” is important in construing jurisdictional statutes; and (3) the statute's legislative history shows that a purpose of

the statute was to simplify the citizenship determination. *Id.* at \*29-33.

The Court noted that the diversity statute provides that a corporation is a citizen of “the State where it has its principal place of business.” *Id.* at \*29. The Court analyzed the text and determined that the language refers to a place within a state, not the state itself. *Id.* at \*29-30. The nerve center test identifies a specific place within a state as constituting the corporation’s principal place of business. *Id.* at \*30. A test based on the amount of business activity in each state, in contrast, incorrectly identifies a state itself rather than a specific place within a state. *Id.* The Court determined that the latter approach invites more litigation and could lead to “strange results”; for example, nearly every national retailer could be designated as a citizen of California because of the volume of the retailer’s business activities resulting from California’s relatively larger population. *Id.* at \*30-31.

The Court emphasized that simplicity is a “major virtue” in construing and applying a jurisdictional statute, and that a nerve center/corporate headquarters rule represents a simpler approach than an approach based on a corporation’s business activities. *Id.* at \*31-32. The Court stated that “[c]omplex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court is the right court to decide those claims,” and that “[j]udicial resources too are at stake.” *Id.* at \*31. In contrast, the Court reasoned, “[C]ourts benefit from straightforward rules under which they can readily assure themselves of their power to hear a case.” *Id.* at \*31-32. The Court pointed out the value that a simple rule would have for both parties: “Simple jurisdictional rules also promote greater predictability. Predictability is valuable to corporations making business and investment decisions” and “benefits plaintiffs deciding whether to file suit in a state or federal court.” *Id.* at \*32.

Finally, the Court noted that the legislative history of the diversity statute shows that the drafters intended to simplify the jurisdictional test by adding citizenship based on principal place of business. *Id.* at \*32-33. Indeed, the drafters considered and explicitly rejected an approach based on a numerical test analyzing the amount of income the corporation earned in a state. *Id.* at \*33. According to the Court, the nerve center rule provides an approach that more

closely achieves the drafters’ goal of simplicity. *Id.*

### Limitations of the Nerve Center Test

The Court acknowledged, however, that the approach it adopted will result in some “hard cases” and may produce some results that “cut against the basic rationale” of the diversity statute. *Id.* at \*33-34. It also stated that the test will be simple to apply “comparatively speaking” as opposed to other tests, not that it will always yield a straightforward result. *Id.* at \*32. The Court further qualified its ruling by stating that if a party attempts to manipulate the test – for example, by establishing a “headquarters” with “nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat” – courts should look to the true location of “actual direction, control, and coordination” to determine the principal place of business. *Id.* at \*36.

### Implications of the Nerve Center Test

The Court’s adoption of the nerve center test will simplify the determination of whether litigation will occur in state or federal court and will presumably save corporations money in avoiding litigation regarding whether diversity jurisdiction exists. Rather than having to analyze where its business activities occur or having to apply different tests depending on the state where a lawsuit was filed, a corporation will know that its principal place of business is where its officers “direct, control, and coordinate the corporation’s activities,” which will normally be corporate headquarters. As a result, the Supreme Court’s new rule establishing a corporation’s principal place of business at its “nerve center” has simplified the rule and made the determination of whether federal jurisdiction exists much more predictable for inside and outside counsel.

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