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## In *Hertz v. Friend*, the U.S. Supreme Court Clarifies the Path to Federal Courts

By Jim E. Hart

By its unanimous decision in *Hertz v. Friend*,<sup>1</sup> the U.S. Supreme Court has made it more likely that a company sued in state court in a state other than where its headquarters and center of direction, control, and coordination are located, will be able to remove the case from state to federal court in that jurisdiction.

Removal of a case from its original location of filing in state court to federal court through so-called “diversity jurisdiction” was originally intended to protect those “who might otherwise suffer from local prejudice against out-of-state parties.”<sup>2</sup> To that end, when a plaintiff sues a defendant in state court who – at the time the action is filed - is not a citizen of the state in which the action is brought, the out-of-state defendant can “remove” the case from state court and have it litigated in the federal court in that jurisdiction. Some of the benefits of federal court jurisdiction for corporate defendants may include the requirement of a unanimous jury verdict, less crowded dockets with the same judge overseeing the case and deciding all dispositive motions, and automatic disclosure of evidence that generally requires a more cards-on-the-table approach than may be found in some state courts.

When a corporation is a party to litigation, a continuing source of controversy and confusion has been how to determine the corporation’s “citizenship.” The diversity jurisdiction statute provides that a corporation is deemed to be a citizen of its state of incorporation and the state “where it has its principal place of business.”<sup>3</sup> Determining the location of incorporation is for the most part clear. Defining a company’s “principal place of business,” however, has been less clear in the past. To determine a principal place of business, some courts have looked to the company’s “nerve center,” or, in other words, the place where “the corporation’s high level officers direct, control, and coordinate the corporation’s activities.”<sup>4</sup> Other courts, such as the U.S. Court of Appeals for the Ninth Circuit, have analyzed a corporation’s business activity on a state-by-state basis and determined the principal place of business based on the state in which the total activity is “significantly larger” or “substantially predominant.”<sup>5</sup> Where there is no

such predominant state, then courts have determined the principal place of business as the corporation's "nerve center," where "the majority of its executive and administrative functions are performed."<sup>6</sup>

### The Lower Courts' Analyses

It is within this context that, on February 23, 2010, the U.S. Supreme Court considered and clarified the concept of principal place of business in *Hertz v. Friend*. Hertz, like many other corporations, carries on operations in several states. When the company was sued in California state court by California citizens alleging wage and hour violations, the company removed the case to federal court citing diversity jurisdiction. The company argued that – although it operated in 44 states including California – it was not a citizen of California, but rather was a citizen of New Jersey.

Hertz offered a variety of evidence to establish that its principal place of business was New Jersey, not California. To show that Hertz did not have a disproportionate presence in California, the company offered evidence showing that, when comparing its California revenue, employees, transactions, and facilities to other states, it was not a California citizen.

Despite the showing by Hertz, when applying the "substantially predominant" test, the district court found that there was no diversity jurisdiction because the "plurality of each of the relevant business activities" was in California, and "the differential between the amount of those activities" in California and the amount in "the next closest state" was "significant" so that Hertz's "principal place of business" was California.<sup>7</sup> The U.S. Court of Appeals for the Ninth Circuit agreed with the district court's analysis.

## The Supreme Court's Reasoning

The Supreme Court disagreed with both lower courts, finding that Hertz was not a citizen of California. The Court noted that, where a company's corporate headquarters and a majority of operations are located in one state, determination of the principal place of business is fairly straight forward. Where, however, the corporate headquarters is in one state and corporate plants or centers of business activity are in other states, the answer is less clear. After reviewing the increasingly complex interpretations of a company's citizenship under the "business activities" test, the Court abandoned that test in favor of the "nerve center" test, hoping to "find a single, more uniform interpretation of the statutory phrase, [principal place of business]."<sup>8</sup> According to the Court, a corporation's principal place of business:

should normally be the place where the corporation maintains its headquarters provided that the headquarters is the actual center of direction, control and coordination, *i.e.* the "nerve center," and not simply an office where the corporation holds its board meetings.<sup>9</sup>

The Court found that the statutory language, administrative simplicity and predictability, and legislative history all supported its decision to adopt the "nerve center" test, while recognizing that the "nerve center" test was not perfect and could lead to anomalies, such as telecommuting's potentially problematic impact.

Practically speaking, this case resolves the thorny issue presented to companies (like Hertz) who conduct business in California, New York, or other states with relatively large populations. The Court recognized that one of the problems of using the "business activities" test is that corporations that do business in large states may be deemed to be citizens of those states based on the higher revenue, number of employees, transactions, and/or facilities generated solely by the higher population of the state. As the Court stated, if a "corporation may be deemed a citizen of California on the 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."<sup>10</sup>

In the past, companies seeking to remove state court cases to federal court in populous states have attempted to factor in state population by using census data to assess revenue, headcount, and other factors on a per capita basis. As the lower court opinion in *Hertz* demonstrates, however, this approach has met with mixed success. In addition, because the required showing of diversity and principal place of business must be established in the removal papers, companies have felt compelled to disclose information that the

company considers proprietary or confidential. With the new *Hertz* decision, the Supreme Court has at least made the path to the federal courts a more clear and manageable affair.

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<sup>1</sup> *Hertz Corp. v. Friend*, 08-1107, 2010 U.S. LEXIS 1897 (Feb. 23, 2010).

<sup>2</sup> *Hertz*, 2010 U.S. LEXIS 1897, at \*17.

<sup>3</sup> 28 U. S. C. §1332(c)(1).

<sup>4</sup> *Hertz*, 2010 U.S. LEXIS 1897, at \*28.

<sup>5</sup> *Friend v. Hertz Corp.*, 297 Fed. App'x 690, 691 (9th Cir. 2008); *Tosco Corp. v. Communities for a Better Env't*, 236 F. 3d 495, 500–02 (9th Cir. 2001) (per curiam).

<sup>6</sup> *Hertz*, 2010 U.S. LEXIS 1897, at \*11.(quoting *Friend v. Hertz*, 2008 U.S. Dist. LEXIS 111867, at \*4 (N.D. Cal. Jan. 15, 2008).

<sup>7</sup> *Hertz*, 2010 U.S. LEXIS 1897, at \*\*11-12.

<sup>8</sup> *Id.* at \*28.

<sup>9</sup> *Id.* (emphasis added).

<sup>10</sup> *Id.* at \*\*30-31. (internal quotations and citations omitted).