WILLKIE FARR & GALLAGHER LLP

CLIENT MEMORANDUM

U.S. SUPREME COURT ADOPTS "NERVE CENTER" TEST FOR DIVERSITY JURISDICTION

Yesterday the U.S. Supreme Court issued a noteworthy ruling simplifying the test for determining a corporation's principal place of business for diversity jurisdiction. *See Hertz Corp. v. Friend,* No. 08-1107, 559 U.S. ____ (Feb. 23, 2010). For diversity purposes, "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business …." 28 U.S.C. § 1332(c)(1). In a unanimous decision, the Court held that a corporation's principal place of business is found where its high-level officers direct, control, and coordinate the corporation's activities — its "nerve center" — typically its corporate headquarters.

Factual and Procedural Background

Hertz arose from a class action commenced in California state court by California citizens who alleged that Hertz had violated California's wage and hour laws. The putative class was limited to employees in California. Hertz removed to federal district court pursuant to the Class Action Fairness Act, which provides that class actions may be removed to federal court when there exists minimal diversity and an amount in controversy of over $5 million. Hertz claimed that plaintiffs and the defendant were citizens of different states and therefore the federal court possessed diversity jurisdiction. In support of its position, Hertz submitted a declaration by an employee relations manager that sought to show that Hertz's "principal place of business" was in New Jersey, not in California. The declaration stated that Hertz's leadership and corporate headquarters were in Park Ridge, New Jersey, where its "core executive and administrative functions . . . are carried out." The declaration also explained that Hertz operated facilities in 44 states, and that California accounted for 273 of Hertz's 1,606 car rental locations, about $811 million of its $4.371 billion in annual revenue, and about 3.8 million of its approximately 21 million annual rentals.

The District Court of the Northern District of California accepted all of these facts as undisputed, yet held that under the Ninth Circuit's "substantial predominance" test, California was Hertz's "principal place of business." Under the "substantial predominance" test, courts examine a corporation's business on a state-by-state basis to determine if the amount of activity in one state "substantially predominates" or is "significantly larger" than other states. If there is such a state, 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" — *i.e.*, the place where "the majority of its executive and administrative functions are performed." Because the difference between Hertz's business activities conducted in California and the amount in the next closest state was "substantial," the District Court held that Hertz's principal place of business was California and remanded the action to California state court. The Ninth Circuit affirmed in a short memorandum opinion.

Hertz petitioned for certiorari, arguing that the circuits are employing four different tests for determining a corporation's principal place of business. For instance, in addition to the Ninth Circuit's approach, some circuits utilize the "nerve center" test, which emphasizes the location of the corporation's "brain," others focus on the corporation's center of activity, while still others look at the totality of the corporation's activities. The Supreme Court granted Hertz's petition on June 8, 2009, and oral argument was heard on November 10th.

The Decision

Writing for the Court, Justice Breyer stressed the need for simplicity. Complex 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." The Court therefore placed "primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible."

The Ninth Circuit's "business activities" analysis, under which a corporation's citizenship is determined by where it conducts most of its business activities, is difficult to apply. The difficulty lies in allocating degrees of significance among the multitude of factors that may enter into such a determination — including the variety of forms that corporations may take, the multiplicity of business activities in which corporations engage, and the complex of strategic decisions about locations of plants and headquarters that corporations may make.

Apart from its difficulty of application, the business activities approach would lead to the result that corporations with far-flung operations would almost always be deemed to be citizens of states with larger populations (like California) simply because they conduct business in that state proportionately with its larger population. "Why award or decline diversity jurisdiction," the Court asked, "on the basis of a State's population, whether measured directly, indirectly (say proportionately) or with modifications?"

By contrast, the "nerve center" approach (which ordinarily equates that "center" with a corporation's headquarters) "is simple to apply *comparatively speaking*." While there will still be "hard cases," the nerve center test "points courts in a single direction, towards the center of overall direction, control and coordination." Courts do not have to "try and weigh different corporate functions, assets, or revenues different in kind, one from the other." Moreover, while the nerve center approach might sometimes yield results that seemingly cut against the rationale for the diversity rule, "in view of the necessity of having a clearer rule, we must accept them." Accepting "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."

Implications

The Court's adoption of the nerve center approach will promote greater predictability and reduce jurisdictional disputes, an obvious benefit to the business community. But as the Court made clear, the party asserting diversity jurisdiction bears the burden of persuasion and attempts at

jurisdictional manipulation will not be countenanced. A corporation's nerve center is not "simply an office where the corporation holds its board meetings," the location of an "annual executive retreat" or even the "principal executive offices" listed on a corporation's Form 10-K. Rather, the "nerve center" is the *actual* place of direction, control, and coordination. Corporations should therefore continue to consider carefully where to locate their headquarters, and in the case of a corporation with offices in different states, what functions should be carried out at which offices.

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If you have any questions about this alert, or would like a copy of the *Hertz* opinion, please call or email Mary Eaton (212-728-8626, meaton@willkie.com), Roger Netzer (212-728-8249, rnetzer@willkie.com), or the Willkie Farr & Gallagher attorney with whom you regularly work.

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