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Supreme Court's Decision Opens Doors to Lawsuits Under the Federal Class Action Fairness Act

On February 23, 2010, the United States Supreme Court settled confusion and inconsistent holdings throughout the land on the test for "principal place of business" to determine citizenship for corporations. In *Hertz Corp. v. Friend*, the Supreme Court unanimously adopted the "nerve center" test for determining a corporation's citizenship for purposes of whether an action may be removed to federal court based on diversity of citizenship under 28 U.S.C. section 1332.¹ Under the "business activities" test that many circuits previously followed, a corporation could be deemed a "citizen" of a state simply because it conducted substantial business in that state. Now, a corporation will not be deemed a citizen of a state simply by virtue of the amount of business conducted in that state. Instead, courts will look to the place of the corporation's "nerve center" – where its officers direct, control and coordinate the corporation's activities to determine the corporation's principal place of business.² The simpler "nerve center" approach adopted by the Supreme Court was established to avoid the complications, costs, and impact on judicial resources that complex jurisdictional tests created.³ It will also have an effect on the number of class action cases filed in state court that may be removed to federal court, which is perceived as less "plaintiff-friendly" than many state courts.

Because the test for citizenship is now clearly based on the corporation's decision-making or "nerve" center, corporations doing business in larger states, such as California, will not be deemed citizens of that larger state based on the extent of their business activities. This will allow more corporations to take advantage of the Class Action Fairness Act of 2005 (the "Act") when they are named in state court class action lawsuits. The Act amends federal diversity and removal statutes to provide for federal jurisdiction over class actions that do not satisfy the traditional "amount in controversy" and "complete diversity" (each plaintiff must be a citizen of a different state than the state of each defendant) requirements. Under the Act, a federal court has jurisdiction over a

class action where any one member of the class has diverse citizenship from any one defendant, where the aggregate amount in controversy exceeds \$5 million.⁴

In *Hertz Corp. v. Friend*, two California citizens sued Hertz Corporation in California state court, alleging violations of California's wage and hour laws.⁵ Hertz filed a notice seeking removal to federal court, claiming plaintiffs and Hertz were citizens of different states. To support its removal, Hertz submitted a declaration by a manager that sought to show that Hertz' "principal place of business" was in New Jersey, not in California. The declaration stated that Hertz conducted operations in 44 states, and that California, which had about 12 percent of the nation's population, had 273 of Hertz' 1606 car rental locations.⁶ The declaration stated that Hertz' leadership was located at its headquarters in New Jersey, and that its core executive and administrative operations were carried out in New Jersey and to a lesser extent in Oklahoma City.⁷

Under the Ninth Circuit Court of Appeals' precedent for determining "principal place of business," the District Court of the Northern District of California determined that Hertz was a citizen of California. The District Court found that the "plurality of each of the relevant business activities" was in California and that the "differential between the amount of those activities" in California and the next closest state was insignificant.⁸ The District Court thus found that diversity of citizenship was lacking, and remanded the case back to the state court.⁹

Prior to the *Hertz Corp. v. Friend* decision, the federal district court decisions were split on the test for determining a corporation's "principal place of business." For example, one court found that the place of a corporation's principal office, rather than a factory or mine, was the principal place of business, whereas another court found that the place of a corporation's mining activities, rather than the principal office, was the corporation's principal place of business.¹⁰ As businesses became more wide-

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spread and complex in terms of their places of operation and management, courts struggled with how to determine “principal place of business” for diversity purposes. For example, what if corporate headquarters and executive offices were in one state, but corporate plants and other centers of business activities were located in other states?¹¹ Courts considered different factors, and the number of factors considered grew as courts combined aspects of the “nerve center” and “business activity” tests to look at a corporation’s total activities, sometimes referred to as the corporation’s “center of gravity.”¹² As a result, case law was becoming more and more complex, resulting in different and often multifactor tests around the country.

The Supreme Court adopted the “nerve center” test (where a corporation’s officers direct, control, and coordinate the corporation’s activities) for determining “principal place of business” under 28 U.S.C. section 1332(c)(1), noting the statute’s word “place” is singular, and a corporation’s “nerve center” is usually located in a single place.¹³ The Supreme Court criticized the “business activities” test as wrongfully leading some courts to measure the total amount of business activities that the corporation conducts in a state to determine whether the amount is significantly larger than other states. This led to greater litigation and what the Court described as “strange” results in that a corporation could be deemed a citizen of a state such as California simply because it conducted substantial business activities in California. Based on California’s population, “nearly every national retailer – no matter how far flung its operations – will be deemed a citizen of California for diversity purposes.”¹⁴

Previously, corporations such as major retailers that were deemed citizens of a large state due to their business activities in those states would routinely be precluded from removing lawsuits to federal court because they could not satisfy the “diversity of citizenship” requirement. Corporations will now be able to establish citizenship in the state in which their “nerve center” is located even if they do substantial busi-

ness in another state. The effect of this decision will be that state court lawsuits will be more easily removed to federal court.

Endnotes

- 1 *Hertz Corp. v. Friend*, __ U.S. __ (Feb. 23, 2010) slip opinion (“Opinion”) at 14.
- 2 *Id.*
- 3 *Id.* at 15
- 4 28 U.S.C. § 1332(d)(2).
- 5 *Hertz Corp. v. Friend*, at 2.
- 6 *Id.*
- 7 *Id.*
- 8 *Id.* at 3.
- 9 *Id.*
- 10 *Id.* at 10.
- 11 *Id.*
- 12 *Id.* at 12.
- 13 *Id.* at 14.
- 14 *Id.* at 15 (citing *Davis v. HSBC Bank Nev., N.A.*, 557 F.3d 1026, 1029-1030 (2009).)

About the Author

Karen R. Palmersheim is a litigation partner in the Los Angeles office of Locke Lord. Ms. Palmersheim is a member of the firm’s class action practice group and she represents health care entities, insurers and other companies in complex business and reimbursement litigation, class actions and related regulatory matters.