Home Is Where the Nerves Are: What to Know About a Subsidiary's Principal Place of Business When Diversity Jurisdiction Is at Stake

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May 31, 2011

It goes without saying that it is vitally important to place your client in the most advantageous position at the outset of a lawsuit. For a defense attorney, the conventional wisdom is that federal court is often the best forum to defend a complex lawsuit against a corporate client. However, a defense attorney is well-advised to consider challenging federal court jurisdiction in appropriate cases. Diversity jurisdiction, of course, is a common and familiar gateway into the federal court system. However, in *Hertz Corp. v. Friend*, 130 S. Ct. 1181 (2010), the United States Supreme Court altered the landscape by establishing the "nerve center" test to determine a corporation's principal place of business. Although this test clarifies the often-confusing standards previously used by various courts across the country, a defense attorney needs to understand the impact this case has on its corporate client, especially a corporation with either a geographically decentralized management structure or a subsidiary that is closely controlled by an out-of-state corporate parent. This article discusses the latter type of corporate relationship and considers the tactical options for an attorney who either represents such a corporation or is defending against the claims brought by that corporation.

Defense attorneys are often hardwired to seek and defend federal court jurisdiction for a lawsuit which alleges state law causes of action. However, for many of these attorneys, the particulars of diversity jurisdiction have faded after their Civil Procedure or Federal Jurisdiction final exam in law school, and in practice, the focus is on a quick checklist: 1) does any plaintiff "reside" in the same state as any defendant, and 2) is more than $75,000 in controversy? However, after the Supreme Court's decision in *Hertz*, a deeper look is now necessary either to defend or defeat a claim to diversity jurisdiction.

Diversity Jurisdiction Basics

The following is a quick refresher on diversity jurisdiction: 28 U.S.C. § 1332 confers subject matter jurisdiction based on geographic diversity of the parties. Diversity jurisdiction pursuant to 28 U.S.C. § 1332 exists only where more than $75,000 is at issue and there is "complete diversity" among the parties, *e.g.*, where no plaintiff and no defendant are residents of the same state. *UMLIC Consol., Inc. v. Spectrum Fin. Services Corp.*, 665 F.Supp. 2d 528, 532 (W.D.N.C. 2009) (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 96 (1998)); *Jones v. Am. Postal Workers Union*, 192 F.3d 417, 422 (4th Cir. 1999); *Evans v. B.F.Perkins Co.*, 166 F.3d 642, 647 (4th Cir. 1999). These requirements are mandatory and if they are lacking in a lawsuit, the parties have no recourse—they cannot consent or waive the requirements of § 1332. *Wisconsin Dep't of Corr. v. Schacht*, 524 U.S. 381, 389 (1998). Importantly, courts have their own obligation to police subject matter jurisidiction and cannot turn a blind eye to an apparent jurisdictional defect. *Id.* Rather, a court "must raise the matter on its own." *Id.*

The law considers a corporation to be a resident of the state where it is incorporated and the state where it maintains its principal place of business. *Hertz*, 130 S. Ct. at 1194; *Athena Automotive, Inc. v. DiGregorio*, 166 F.3d 288, 290 (4th Cir. 1999). Determining the state of incorporation is a

rather straightforward task usually involving a search on the website of a secretary of state. Determining where a corporation maintains its principal place of business is more difficult where that corporation's business spans state lines. Many defense attorneys may have been taught by their Civil Procedure professors that a corporation's principal place of business may be either the state where its headquarters or "nerve center" is located, *or* the state where a majority of the corporation's business is conducted—where its "business activities" are carried out. *Hertz*, 130 S.Ct. at 1190-91. However, confusion for both law students and the Federal Circuit Courts of Appeal has ensued when trying to determine a corportation's principal place of business using these tests. *Id.* at 1191.

Hertz's Impact and Its Ramifications for Subsidiaries

To alleviate this confusion and to resolve the inconsistent approaches of the Circuit Courts of Appeal, the United States Supreme Court held in *Hertz* that the federal courts are to apply only the "nerve center" test to determine a party's principal place of business under 28 U.S.C. § 1332. *Hertz*, 130 S.Ct. at 1192. The Court explained the meaning of "nerve center" as "the place where a corporation's officers direct, control, and coordinate the corporation's activities." *Id.* The Court envisioned that the nerve center will often be the corporate headquarters, so long as the headquarters "is the actual center of direction, control, and coordination." *Id.* Importantly, the Supreme Court appeared to place more importance on the activities of the officers versus the directors of a corporation in its principal place of business analysis. *See id.* (cautioning that a headquarters cannot merely be the place where the board of directors meet). Finally, while tempting, one cannot merely rely on a corporation's entries on its Securities & Exchange Commission or secretary of state filings in determining that corporation's principal of place of business. The Supreme Court closed the door on such a shortcut, rejecting the argument that the listing of a "principal executive office," "principal office," or something similar in a regulatory filing without additional support is determinative of a corporation's principal place of business. *Id.* at 1195.

But what happens where a corporation is a subsidiary that is closely controlled by its parent? It is clear that the principal place of business of the corporate parent is not automatically imputed to the subsidiary. *See, e.g.*, *Quaker State Dyeing & Finishing Co.v ITT Telephone Corp.*, 461 F.2d 1140, 1142 (3d Cir. 1972). Rather, courts following *Hertz* look at the "day to day control and coordination of the company's business operations" when considering a subsidiary's principal place of business. *Evernu Tech. v. Rohm and Hass Co.*, 2010 WL 3419892, *1 (E.D. Pa. Aug. 26, 2010). In *Evernu*, the plaintiff sought to claim the principal place of business of its corporate parent, which it argued dominated the plaintiff's decision-making. *Id.* at *3. The court rejected this argument, finding that the daily operations of the plaintiff were "conducted autonomously" by the plaintiff's officers who only in exceptional cases sought approval from the corporate parent. *Id.* at *4. This was sufficient for the court to find that the plaintiff's principal place of business was in a state other than the state of residence of the corporate parent. Indeed, the court held that if the "nerve center" was to be judged by where the highest level corporate policy was made, then every subsidiary's principal place of business would be the principal place of business of the parent. *Id.*

Evidence supporting the location of the principal place of business of a subsidiary may include factors such as where the public perceives a subsidiary's headquarters is located or where "the company purchases materials, arranges for transportation of materials and finished products,

handles personnel and human resources issues, manges the company's financials, and maintains nearly all the corporate records." *Cent. W. Va. Energy Co., Inc. v. Mountain State Carbon, LLC*, 2010 WL 1404470, *3 (S.D.W.Va. March 31, 2010) (finding that "[t]hese numerous and diverse activities certainly constitute the actual direction, control, and coordination of the company"). In *Evernu*, the court noted as evidence for a subsidiary's principal place of business "where all legal work, intellectual property licensing, information technology services, financial filings, and corporate governance services" were located. *Evernu*, 2010 WL 3419892 at *4. Even the fact that some corporate officers are located and some corporate decisions are made in another state than the purported principal place of business is not determinitive on this issue if outweighted by other factors. *Cent. W. Va. Energy Co.*, 2010 WL 1404470 at *2.

Of course, there may be circumstances in which a subsidiary will be found to have the same principal place of business as its parent. In *Astra Oil Trading NV v. Petrobras Am. Inc.*, 718 F.Supp.2d 805, 809-10 (S.D.Tex. 2010)("Astra Oil I"), *reversed on reconsideration*, 2010 WL 3069793 (Aug. 4, 2010), the court found that a subsidiary that did not "sell, trade in or provide any products[,]" did not have any employees or office, did not maintain a bank account in the United States, and was completely dominated by its parent had the same principal place of business as its foreign parent. The court found determinative that three out of four of the subsidiary's board members were also board members of the parent and that the CEO of the subsidiary, located in California, had no authority to make any decisions without approval from the chairman of the board of the corporate parent. *Id.* at 810. All corporate activities of the subsidiary took place in different cities throughout Europe, depending on the location of the board member who performed the operation. Therefore, the court found that the subsidiary's "nerve center" or principal place of business was the location of the board of directors and its chairman because those individuals "call[ed] the shots." *Id.* at 811. Simply put, based on Astra Oil I, a subsidiary's "nerve center" may likely be deemed the same as the corporate parent's nerve center where a subsidiary is a mere instrument of the parent's will with almost no ability to act independently or pursue a separate business purpose of its own.

However, the district court in *Astra Oil Trading NV v. Petrobras Am. Inc.*, 2010 WL 3069793, *1 (S.D.Tex. Aug. 4, 2010) ("Astra Oil II") reversed its ruling in Astra Oil I. The court found that additional evidence showed that the CEO had the "authority necessary to direct, control, and coordinate [the subsidiary's] *own* activities." *Id.* at *6. The Court found that the CEO negotiated large contracts for the subsidiary, investigated merger and acquisition opportunities, "'monitor[ed]'" employees of the subsidiary's subsidiaries, was involved in strategic decision making for the subsidiary, and "supervised" the subsidiary's finances. *Id.* at *7. Therefore, the court found that the subsidiary's principal place of business was in California because "while the [parent] board makes major decisions and sets policies for its subsidiary. . . , the management, direction, control and implementation of [subsidiary's] business activities are effectuated . . . in California." *Id.* at *8. Astra Oil II suggests that a very high degree of control by a corporate parent may be insufficient to render a subsidiary's principal place of business and the parent's as one in the same when the subsidiary retains some degree of management discretion and control.

Tactical Considerations

While somewhat esoteric, the issue of a subsidiary's principal place of business does pose significant tactical problems for a defense attorney. First, a defense attorney may want to raise this

issue as a part of a motion to dismiss for lack of subject matter jurisdiction. While cognizant of the benefits of a federal forum, striking an initial blow to the plaintiff's case may be worth remanding the case to a state court. In some cases, a state court may be preferable. State courts in relatively urban jurisdictions that may be located in a primarily rural federal judicial district may provide a preferable jury pool, for example. A plaintiff may file in federal court first because it believes it is better off in federal court than state court, and a defense attorney may want to deny that favorable forum. Further, as an ancillary benefit, a motion to dismiss for lack of subject matter jurisdiction may allow a defense attorney to learn details about another party's business, how it is run, and its key players before discovery officially begins. In any event, if a significant issue regarding a corporate party's residence arises which may destroy diversity jurisdiction, a defendant may be well-advised to raise the issue rather than expend considerable resources in federal court only to have the case dismissed for lack of subject matter jurisdiction at a later stage. Finally, a defense attorney seeking to remove a case to federal court should know and prepare the landscape for what is considered a principal place of business so that he or she can craft the best arguments regarding residence for diversity jurisdiction purposes on a motion to remand.

All in all, well armed with the clear direction of *Hertz*, a defense attorney will be able to navigate around the issues of a subsidiary corporation's principal place of business and use this newly articulated test to influence the forum where the case is tried to his or her client's advantage.

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