ASSOCIATION OF BUSINESS TRIAL LAWYERS

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LOS ANGELES

SPRING 2018

TAKEAWAYS FROM THE NINTH CIRCUIT'S RECENT OPINION ON THE CORPORATE CITIZENSHIP OF A HOLDING COMPANY

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For purposes of establishing diversity jurisdiction, a corporation is deemed to be a citizen of the state in which it was incorporated and the one state where it has its principal place of business. 28 U.S.C. § 1332(c)(1) (2012). Courts have long grappled with the question of what constitutes a corporation's "principal place of business"—an inquiry governed by the "nerve center" test set out in *Hertz Corp. v. Friend*, 559 U.S. 77, 81 (2010). The Supreme Court in *Hertz* held that a corporation's principal place of business is "the place where the corporation's high level officers direct, control, and coordinate the corporation's activities"—typically the corporation's headquarters. *Id*. at 80-81.

The "nerve center" test is apt where a corporation actually engages in activities that the court can assess. But, as the Ninth Circuit recently asked, "[W]hat of a corporation that has few, if any, activities?" *3123 SMB LLC v. Horn*, 880 F.3d 461, 463 (9th Cir. 2018).

On January 17, 2018, the Ninth Circuit answered this question as to a holding company, an entity with minimal corporate activities beyond passively owning and supervising the management of other companies. Its answer: "[A] recently-formed holding company's principal place of business is the place where it has its board meetings, regardless of whether such meetings have already occurred, unless evidence shows that the corporation is directed from elsewhere." *Id*. at 468.

A court evaluating the existence of diversity jurisdiction looks at "the state of things" at the time a lawsuit is filed. *Id*. at 467 (citation omitted); *see also* 28 U.S.C. § 1332. The holding company at issue in *3123 SMB*, Lincoln One, was formed less than a month before litigation commenced. 880 F.3d at 471. Its only act during these twenty-five days was to incorporate in Missouri. *Id*. The entire business of Lincoln One was to own and direct the operations of its wholly-owned subsidiary, 3123 SMB LLC—a limited liability company that managed a Santa Monica property. *Id*. at 464. Lincoln One does this exclusively at annual board meetings that take place in Missouri, according to its owner, Anthony Kling. However, at the time the lawsuit was filed, Lincoln One had not yet held a board meeting. *Id*. Nevertheless, the Ninth Circuit held that Lincoln One's principal place of business was the place where it has its board meetings—i.e., Missouri—regardless of the fact that no such meeting had yet occurred when the lawsuit was filed. *Id*. at 463.

In reaching its conclusion, the Ninth Circuit relied on *Johnson v. SmithKline Beecham Corp.*, 724 F.3d 337 (3d Cir. 2013), the only circuit case that has applied the "nerve center" test to a holding company. *3123 SMB*, 880 F.3d at 465. The Ninth Circuit noted that in *Johnson*, the Third Circuit held "the Supreme Court's dictum [in *Hertz*] that a corporation's nerve center is 'normally . . . not simply an office where the corporation holds its board meetings,' . . . inapplicable to holding companies." *Id*. at 466 (quoting *Hertz*, 559 U.S. at 93). The Third Circuit explained that "relatively short, quarterly board meetings may well be all that is required to direct and control [a holding company's] limited work." *Johnson*, 724 F.3d at 354. The business that takes place at a holding company's board meetings "is straightforward and takes little time, yet constitutes [the holding company's] primary activity: managing its assets." *Id*. Therefore, "[t]he location of board meetings is . . . a more significant jurisdictional fact here than it was in *Hertz*, and the meetings' brevity does not necessarily reflect an absence of substantive decision-making." *Id*.

As the Ninth Circuit noted, the district court determined that Lincoln One's principal place of business was in California based in part on the fact that "Lincoln One's sole officer, Mary Kling, resided in California," and that "it found 'no evidence that any of the operations of Lincoln One are directed, controlled, or coordinated from Missouri or anywhere else other than California' . . . because Lincoln One's single board meeting in Missouri 'occurred well after this case was filed.'" *3123 SMB*, 880 F.3d at 468-69.

The Ninth Circuit in *3123 SMB* pointed out several faulty assumptions on which the district court had based its decision. First, the assumption that a holding company's principal place of business is by default in the state where its officers live is untenable given a corporation's principal place of business is "a place within a [s]tate" rather than the state itself, and corporations often have multiple decision-makers residing in multiple states, which could become an issue considering a corporation's nerve center must be a "single place." *Id*. at 469. Second, the assumption that a holding company's principal place of business can shift over time—even without any change to the corporation's structure or operation—as the company holds a sufficient number of board meetings at its "true nerve center" is unworkable, given the anomalous results and gamesmanship that could result if, unlike here, the corporate subsidiary is the defendant rather than the plaintiff. *Id*. The Ninth Circuit also rejected the idea that a holding company's nerve center is where its subsidiary's management is based, noting that the district court had "conflated 3123 SMB's management of its lawsuit, which the court reasonably assumed would be directed from California, where the Klings reside, with Lincoln One's management of 3123 SMB at its annual meetings, which had not yet occurred and would take place in Missouri." *Id*. at 467.

Given the many advantages of litigating in federal court, some may be concerned that the majority's approach in *3123 SMB* creates an opportunity for parties to manufacture diversity jurisdiction by manipulating the ownership structure of entities before litigation commences. The dissent in *3123 SMB* articulated this concern, noting that "a newly formed corporation is entitled, in the absence of other activity, to a presumption that its state of incorporation is also its principal place of business." *Id*. at 473 (Hurwitz, J., dissenting). While the Ninth Circuit instructed courts to be "alert to the possibility of jurisdictional manipulation," it dismissed the dissent's criticism that the "decision gives rise to the very dangers of jurisdictional manipulation that *Hertz* eschews." *Id*. at 470, 471 n.8 (majority opinion); *id*. at 473 (Hurwitz, J., dissenting). Nevertheless, the Ninth Circuit remanded the case to the district court so that it could consider in the first instance the question of whether 3123 SMB and Lincoln One were alter egos, or whether Lincoln One's owners created Lincoln One for purposes of jurisdictional manipulation. *Id*. at 463, 471.

The Ninth Circuit's opinion illustrates the jurisdictional consequences of a holding company's decision on where to hold its board meetings. And although the Ninth Circuit's opinion narrowly addresses a recently-formed holding company, the court's reasoning can be applied when determining the citizenship of other passive or newly-formed corporate entities with minimal activities.

Thus, for those setting up a holding company or other passive corporate entities, decisions about where to incorporate, where to hold board meetings, and whether to designate the location of board meetings in its bylaws may have real jurisdictional consequences. In *3123 SMB*, although no board meeting had yet occurred at the time litigation commenced, Lincoln One was registered in Missouri, which, like many states, allows a corporation to specify in its bylaws the location of annual meetings and, if none is designated, provides that the meetings by default will be held at the corporation's registered office. *Id*. at 470. As Lincoln One had not specified a meeting location in its bylaws, the default rule under Missouri law applied and lent additional support to the expectation that Lincoln One would hold its annual meeting at its registered office in Missouri (along with Anthony Kling's uncontradicted testimony that they are in fact held in Missouri). *Id*. Thus, for newly-formed companies that have not yet held a board meeting, corporate documents can serve as important evidence in establishing the location of board meetings and thus the location of the entity's principal place of business. If permitted, it may be wise for those setting up holding companies to prescribe in the bylaws the place where board meetings will be held—especially for those who intend to hold meetings in a state other than the one in which the company is incorporated or registered.

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