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Client Alert

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Get In, Get Out: Federal Court More Corporation-accessible and Defendant-friendly

The United States Supreme Court has handed corporate defendants a potentially lethal one-two punch to knock out plaintiff's claims.

In May 2009, the Supreme Court decided *Ashcroft v. Iqbal*, a case that effectively gave federal district court judges much broader leeway to dismiss claims at the outset of a case if they do not think the plaintiff had set forth a "plausible" basis to prevail. Of course, defendants in state court received no benefit from that ruling, since the Supreme Court's decision only applies in federal court.

But in February 2010, the Supreme Court made it much easier for corporations operating in multiple states to transfer cases—or "remove" them—from state court to federal court. In *Hertz Corporation v. Friend*, the Supreme Court simplified the standard for establishing federal court jurisdiction based on "diversity of citizenship," thus making removal more available to defendants sued in state court and opening the door for wider application of the defendant-friendly *Iqbal* dismissal standard.

Before *Iqbal*, there were already many reasons why a corporate defendant might want to transfer a case from state court to federal court. Primarily, it is thought that federal judges—since they hold lifetime appointments and thus are not subject to re-election by local voters—are more independent of local interests. As a result, some lawyers believe federal judges are more likely to apply the law evenly and less likely to be swayed by local interest or emotions. Indeed, giving out-of-state parties greater protection against local prejudice is one of the principal reasons for the diversity statute that, under certain circumstances, allows a defendant who is a citizen of state "A" to transfer a case filed by a citizen of state "B" in the state courts of state "B."

The question that the Supreme Court had to decide in *Hertz* was how the federal courts should determine the citizenship, for diversity purposes, of a corporation operating in multiple states. A corporation always will be deemed a citizen of the state in which it is incorporated. In addition, the diversity statute provides that a corporation also will be deemed a citizen of any other state where it has its "principal place of business."

The *Hertz* case concerned how courts were to decide on a corporation's principal place of business when, for example, it has its corporate headquarters

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in one state, but has its major operations in another state or in several states. Before *Hertz*, federal courts applied a variety of standards, ranging from the "nerve center" test, i.e., where the executive offices were located; to the "business activity" test, i.e., where the corporation conducted most of its business operations; or a hybrid standard involving an analysis and weighing of both tests. Which standard was applied depended on which federal circuit the case was in, so that corporation "A" might be able to remove a state court case filed in New York, but not if the identical case was filed in Atlanta.

With its decision in *Hertz*, the Supreme Court put an end to use of the different tests. It decided that, from now on, the "nerve center" test would apply and that, as a result, most corporations would be deemed a citizen of the state in which its "corporation's officers direct, control, and coordinate the corporation's activities." In other words, courts will look to the location of the corporation's headquarters, so long as it is in fact the place where the corporation's activities actually are controlled and directed.

For a corporation with a true "headquarters" location in one state, but with operations, manufacturing plants, distribution centers and sales offices located throughout the country, *Hertz* will vastly expand and simplify the ability to exercise diversity jurisdiction and thus remove cases to federal court when the corporation is sued outside of its state of incorporation and, if different, its headquarters state.

If protection against local prejudice is not enough of a reason to exercise diversity jurisdiction when available, the 2009 Supreme Court decision in *Iqbal* added an entirely different—and important—reason to yank a case into federal court. The reason is a substantially-enhanced likelihood of having the case dismissed *before* being subjected to discovery.

In *Iqbal*, the Supreme Court did away with 50 years of precedent that allowed dismissal of a case on the pleadings only when the court concluded plaintiff could prove "no set of facts" that would allow it to prevail on its claim. If any possible set of facts could be conjured up that would permit the plaintiff to recover on a claim set forth in the complaint, the case would proceed to discovery. That means the defendant would have to go to the trouble and cost of producing written and electronic documents, answering written questions (interrogatories) under oath, and having officers and employees subjected to days of depositions—live testimony taken under oath in front of a court reporter.

The discovery process, with its goal of allowing parties to uncover every piece of evidence that may bear on a claim or defense, frequently makes a big difference in the outcome of a case by allowing the parties to uncover otherwise unavailable evidence supporting their claims and defenses. On the other hand, discovery abuse—the practice of making large and costly demands for discovery that have little or no likelihood of uncovering admissible evidence—is widely viewed as one of the major defects in the civil judicial system.

Iqbal changed all of that by allowing dismissal before discovery commences if the complaint does not allege sufficient facts to rise to the level of being "plausible," a term not defined in the opinion. Instead, federal judges were encouraged to use their "judicial experience and common sense" to determine if a lawsuit

meets the new test and, if not, to dismiss it. Usually, dismissal would be "without prejudice," meaning the plaintiff could file an amended complaint and attempt to allege sufficient facts to make the claim plausible.

Of course, alleging facts in an amended complaint also is subject to Rule 11 of the Federal Rules of Civil Procedure, which subjects the party and the attorney signing the pleading to sanctions if he or she fails to make reasonable inquiry before filing the pleading. In other words, frivolous allegations designed to overcome the *Iqbal* standard, but not supported by appropriate due diligence, could end up resulting in sanctions such as dismissal of the case or an award of attorneys' fees against the offending party or the lawyers who signed the pleadings. Many state courts do not have an equivalent rule, so this is another protection in federal court against frivolous complaints (or, for that matter, frivolous defenses).

It will take some time for the courts to sort out how the *Iqbal* standard will be applied, but early evidence is that all types of litigation—from antitrust claims to employment claims to contract claims—are being dismissed in the early stages of the case. Likewise, it will take some time to determine how many cases are removed to federal court under the new *Hertz* standard. But defense lawyers whose clients are sued in state court have a new one-two punch available in appropriate cases: (i) remove the case to federal court under *Hertz*, and then (ii) file a motion to dismiss under *Iqbal*.