Beware the Dissolved Corporation: Issues Affecting Diversity Jurisdiction

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All litigators know the general rule that a corporation is deemed a citizen of both its state of incorporation and the state in which the corporation has its principal place of business.[1] Where a plaintiff and a defendant are citizens of different states and the amount in controversy exceeds $75,000, a federal district court can exercise subject-matter jurisdiction over the case because there is complete diversity of citizenship between the parties.[2] But what happens when either the plaintiff or defendant corporation is defunct, inactive, or dissolved? The U.S. Supreme Court has yet to resolve a decades-long split of authority among the Circuit Courts of Appeals on this issue.

All states have enacted laws that allow for a dissolved corporation, limited liability company, etc., to exist for a certain amount of time (varying from state to state) following dissolution for purposes of engaging in all activities necessary to wind up the business and to sue or be sued. Thus, without question, an inactive or dissolved corporation remains a citizen of its state of incorporation for the statutory period prescribed in that state's law. But what happens to its principal-place-of-business citizenship is an issue that has not been resolved by the courts.

Both the Third and Eleventh Circuits have adopted a bright-line rule that an inactive or dissolved corporation has no principal-place-of-business citizenship and remains a citizen of its state of incorporation only.[3] In *Midlantic National Bank v. Hansen*, the Third Circuit defined inactive corporation as "a corporation conducting no business activities."[4] In holding that an inactive corporation has no principal place of business, *Midlantic* relied on the now-rejected "corporate activities" test, noting that because an inactive corporation does not engage in corporate activities, it cannot have a principal place of business.[5] Thus, an inactive corporation could only be a citizen of its state of incorporation.

After *Midlantic* was decided, however, the Supreme Court resolved a split among the Circuit Courts of Appeals regarding the test to be applied in determining a corporation's principal place of business. In *Hertz Corp. v. Friend*, the Court held that a corporation's principal place of business is where its "nerve center" is located—that is, "where the corporation's high-level officers direct, control, and coordinate the corporation's activities."[6] Notwithstanding that *Midlantic* was based on the "corporate activities" test that *Hertz* expressly rejected for determining principal place of business, the Eleventh Circuit adopted *Midlantic*'s holding, extending it to a dissolved corporation. In *Holston Investments Inc. B.V.I. v. LanLogistics Corp.*, the Eleventh Circuit held that a dissolved corporation is a citizen of its state of incorporation only.[7] Although the Delaware corporation had at all times maintained its corporate headquarters in Florida, it had dissolved in Delaware in December 2007, and the Florida Secretary of State had processed and filed documents withdrawing the corporation's authority to transact business in Florida in January 2008; the plaintiff sued the dissolved corporation four months later.[8] Although at the time the lawsuit was filed, the dissolved corporation was still winding down its affairs, the Eleventh Circuit held that the defendant had no principal place of business and was a citizen of its state of incorporation only, opting for the bright-line rule set forth in *Midlantic*:

> Considering the jurisdictional tests in the various circuits and the guidance of the Supreme Court in *Hertz*, we join the Third Circuit in holding a dissolved corporation has no principal place of business. This bright-line rule may open federal courts to an occasional corporation with a lingering local presence, but undeserved access to a fair forum is a small price to pay for the clarity and predictability that a bright-line rule provides. Moreover, in our opinion, the Third Circuit rule aligns most closely with the Supreme Court's analysis in *Hertz*.[9]

The Second Circuit Court of Appeals, on the other hand, has rejected this reasoning and held that an inactive or dissolved corporation must also have a principal place of business for determining citizenship. In *Wm. Passalacqua Builders Inc. v. Resnick Developers S. Inc.*, the Second Circuit held that an inactive corporation must have a principal place of business for purposes of diversity jurisdiction, which it determined is the place in which the corporation last transacted business.[10] This holding was reiterated by the Second Circuit in *Pinnacle Consultants Ltd. v. Leucadia National Corp.*, in which the court noted that the diversity statute was designed to preclude any argument that an inactive corporation has no principal place of business.[11] Rather, an inactive corporation must be a citizen of both its state of incorporation and its principal place of business, which will be the state where it last transacted business.[12]

The Fifth and Fourth Circuit Courts of Appeals have adopted a somewhat middle-ground approach, adopting a "facts and circumstances" test to determine whether an inactive or dissolved corporation has a principal place of business. In *Harris v. Black Clawson Co.*, the Fifth Circuit noted that "while the place of an inactive corporation's last business activity is relevant to determine its principal place of business, it is not dispositive."[13] Rather, "as a matter of law, where a corporation has been inactive in a state for a substantial period of time, … that state is not the corporation's principal place of business."[14] Because the defendant had been completely inactive in Louisiana for a substantial period of time—over five years—before suit was filed, the court determined that Louisiana was not the corporation's principal place of business and thus complete diversity existed.[15] The Fifth Circuit avoided ruling on whether an inactive corporation *must* have a principal place of business.[16]

The Fourth Circuit held in *Athena Auto. Inc. v. DiGregorio* that a dissolved corporation *can* have a principal place of business, expressly rejecting the Third Circuit's approach because it overlooked the reality that "[a] corporation's business does not usually end with the abruptness of closing its doors" and that even an inactive corporation can have a "continuing impact" in an area sufficient to preserve its local identity.[17] Adopting a test similar to that in *Harris*, the Fourth Circuit held that the inactive corporation did not have a principal place of business in Maryland as it had been inactive in that state for three years before suit was filed.[18] The Fourth Circuit did not need to decide whether the inactive corporation actually had a principal place of business but noted that, if it had to make such a finding, it would apply the nerve-center test.[19]

Without expressly ruling whether an inactive or dissolved corporation must have a principal place of business, the Tenth Circuit in *Coffey v. Freeport McMoran Copper & Gold* affirmed a district court's finding that a defendant's business activities were substantial enough to constitute "transacting business" and thus established principal-place-of-business citizenship.[20] In that case,

the defendant corporation had been acquired by another company but had engaged in environmental remediation activities in response to legal claims from its prior operations.[21] The Tenth Circuit—also applying the now-rejected "total activities" test for determining principal place of business—affirmed the district court's ruling that the remediation activity sufficed to establish Oklahoma as the defendant's principal place of business.[22]

Similarly, the D.C. Circuit Court of Appeals, while not expressly addressing the issue, has acknowledged the possibility that an inactive or dissolved corporation can have a principal place of business. The D.C. Circuit in *Ripalda v. American Operations Corp.* held that a corporation continues in existence after dissolution if the state of incorporation allows its continued existence to sue or be sued.[23] The circuit court left open the question of whether a dissolved corporation must have a principal place of business, noting only that the dissolved corporation had formally withdrawn from Virginia more than a year before suit was filed and thus—absent any contrary evidence in the record—the court could "presume" that "if it still had any principal place of business it was not in Virginia."[24]

The conflicting circuit court opinions have generated much confusion among the district courts about whether an inactive or dissolved corporation must have a principal place of business and, if so, how to determine that place. This issue is particularly problematic where a corporation has withdrawn its certificate of authority to transact business in a state but is still conducting necessary activities to wind down its business and still exists under the applicable state statute for purposes of suing or being sued.

While the law is in flux, some guidance with respect to dissolved corporations can be gleaned from the Supreme Court's decision in *Hertz* and from the diversity statute itself. In holding that a corporation's principal place of business is "where the corporation's high level officers direct, control, and coordinate the corporation's activities" (*i.e.*, the "nerve center"), the Supreme Court did not distinguish between active or dissolved corporations or focus on the types of activities being conducted to determine a corporation's principal place of business.[25] Instead, *Hertz* expressly recognized the reality that corporations exist in various forms to conduct many different kinds of activities and adopted the nerve-center test to accommodate this reality:

> Perhaps because corporations come in many different forms, involve many different kinds of business activities, and locate offices and plants for different reasons in different ways in different regions, a general 'business activities' approach has proved unusually difficult to apply.[26]

It is not the type of business that is being conducted that determines a corporation's principal-place-of-business citizenship; rather, it is the "place of actual direction, control, and coordination" that is dispositive.[27] Following this reasoning, it should not matter whether a corporation is engaged in active business practices, such as sales or marketing, as opposed to business activities necessary for winding down a corporation's affairs. Instead, it should only matter where the "place of actual direction, control, and coordination" of those activities is located (whether winding-down business activities or otherwise).

The plain language of the diversity statute further supports the theory that a dissolved corporation should have a principal place of business for diversity purposes. As the statute makes clear, a corporation is deemed to have dual citizenship and is a citizen of both its state of incorporation *and* its principal place of business.[28] The statute makes no distinction between active, inactive, or dissolved corporations. Nor should it. A dissolved corporation does not lose its character as a corporate body after dissolution. Indeed, every state extends the life of a corporation after dissolution for a definite time so that the corporation can prosecute and defend lawsuits and otherwise settle its affairs. Section 1332(c)(1)'s requirement for dual citizenship takes into account the reality that corporations exist after dissolution. Thus, the statute requires a determination, for every corporation, of a principal place of business, which is the place of actual direction and control under *Hertz*. The fact that the corporation has dissolved and is winding up its affairs does not mean it has no place of direction and control and thus no principal place of business. Rather, because the corporation exists and can sue or be sued, it must have a principal place of business—a nerve center—from which, at a minimum, any litigation is directed.

Until the Supreme Court resolves the conflict among the Circuit Courts of Appeals, however, litigators must be conscious of the problems that can arise when seeking (or attempting to avoid) federal court subject-matter jurisdiction under the diversity statute where one of the parties is an inactive or dissolved corporation. **SB**

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Endnotes

[1]28 U.S.C. § 1332(c)(1).
[2]28 U.S.C. § 1332(a)(1).
[3]48 F.3d 693 (3d Cir. 1995).
[4]*Id.* at 696.
[5]*Id.*
[6]559 U.S. 77, 80-81 (2010).
[7]677 F.3d 1068, 1071 (11th Cir. 2012).
[8]*Id.* at 1070 n.1.
[9]*Id.*
[10]933 F.2d 131, 141 (2d Cir. 1991).
[11]101 F.3d 900, 907 (2d Cir. 1996).
[12]*Id.*
[13]961 F.2d 547, 551 (5th Cir. 1992).
[14]*Id.*
[15]*Id.*
[16]*Id.* at 551 n.12.
[17]166 F.3d 288, 291 (4th Cir. 1999).
[18]*Id.* at 291-92.
[19]*Id.* at 292.
[20]581 F.3d 1240, 1245–46 (10th Cir. 2009).
[21]*Id.* at 1246.
[22]*Id.*
[23]977 F.2d 1464, 1468 (D.C. Cir. 1992).
[24]*Id.* at 1469.
[25]559 U.S. at 90-91.
[26]*Id.*
[27]*Id.* at 97.
[28]28 U.S.C. § 1332(c)(1).