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Milbank

Corporate Governance Group

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FEDERAL DISTRICT COURT APPLIES *HERTZ* CORPORATE “NERVE CENTER” TEST TO DETERMINE CITIZENSHIP OF LLC

Determines that single-member, manager-managed LLC’s “center of direction, control and coordination” is not state of incorporation of corporate member

Last year, in *Hertz Corp. v. Friend*,¹ the U.S. Supreme Court resolved a conflict among the Federal Circuits by establishing a uniform interpretation of the phrase “principal place of business” for determining corporate citizenship under the federal diversity jurisdiction statute (the “Diversity Statute”).² In *Hertz*, the Supreme Court ruled that a determination of corporate citizenship should be based on the specific location of a corporation’s “center of direction, control, and coordination.” This approach is aptly labeled the “nerve center” test. To eliminate potential “attempts at manipulation,” the *Hertz* Court made clear that a nominal principal office consisting of “nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat” will not suffice to establish a corporation’s nerve center.

Recently, in *Brewer et al. v. SmithKline Beacham Corporation d/b/a GlaxoSmithKline*,³ the United States District Court for the Eastern District of Pennsylvania applied *Hertz* in deciding the citizenship, for purposes of the Diversity Statute, of an operating entity organized as a limited liability company (“LLC”) within a corporate holding company structure. In a fact-specific ruling, the Court found that “for purposes of determining the citizenship of a limited liability company whose sole member is a holding company that does not direct or control the operations of the limited liability company, we look to the ‘nerve center’ of the limited liability company to which the holding company has delegated the operational decision-making.”

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¹ 130 S.Ct. 1181 (Feb. 23, 2010). For a detailed description of the *Hertz* decision, please see our Client Alert entitled “U.S. Supreme Court Simplifies Test for Determining State Citizenship of Corporations for Purposes of Diversity Jurisdiction” (March 25, 2010).

² Under the Federal Rules of Civil Procedure, diversity of citizenship exists when the respective litigants are citizens of different states. When faced with a claim brought in a state court by a citizen of that state, a diverse defendant has the option to remove the suit to federal court, thereby avoiding potential local prejudice.

³ Civ. Action No. 10-4443 *et seq.* (E.D. Pa., March 24, 2011).

Background

GlaxoSmithKline plc, the U.K.-incorporated global pharmaceutical and consumer healthcare giant, employs a multi-tiered holding structure to conduct its worldwide operations. GlaxoSmithKline LLC (“GSK LLC”) is “the entity through which [GlaxoSmithKline] conducts its pharmaceutical and consumer healthcare business in the United States.” For historical reasons relating to tax considerations and the protection of intellectual property rights, GSK LLC is a registered Delaware LLC. That, however, is its only real contact with Delaware, and its business address, books and records and most of its important “corporate functions” are located in Philadelphia.

The sole member of GSK LLC is GlaxoSmithKline Holdings (Americas) Inc., a Delaware corporation (“GSK Holdings”). GSK Holdings is for all intents and purposes a pure holding company, has only one person on payroll (who “works approximately 20 hours annually for the company”) and contracts with a Delaware corporate services company to accept mail, pay bills, provide two officers and a director and supply an “office” that is only “a 10’ x 10’ room furnished with a desk, file cabinets and an unused computer.”

Crucially, in its role as the sole member of GSK LLC, GSK Holdings has delegated management responsibilities for GSK LLC’s business and affairs to GSK LLC’s officers and directors. Consequently, GSK LLC is “manager-managed,” and its senior officers “direct and control the activities of the United States pharmaceutical business from Philadelphia.”

GSK LLC found itself the defendant in eight pharmaceutical liability cases relating to its Paxil product, all brought in Pennsylvania state court by individual citizens of that state. Initially, GSK LLC was successful in removing these cases from state court to federal court on the basis that GSK LLC, but none of the plaintiffs, is a citizen of Delaware. Plaintiffs subsequently moved to remand the cases back to state court, arguing that application of the *Hertz* test indicates that GSK LLC’s principal place of business is Philadelphia, thereby depriving the federal courts of diversity jurisdiction. GSK LLC, adamant that it should be considered a Delaware citizen, opposed remand.

The Court’s Analysis

The Court began by citing the principle, accepted “in the Third Circuit and in all other circuits that have considered the issue,” that “[a] limited liability company’s citizenship . . . is determined by the citizenship of its members.” Given that GSK LLC’s sole member is GSK Holdings, the Court, applying *Hertz*, turned to an examination of Holdings’s “center of direction, control and coordination in the context of its dual role as a holding corporation and as the sole member of [GSK] LLC.” The Court concluded that, in either regard, diversity jurisdiction was defeated because GSK Holdings’s principal place of business is, in fact, in Philadelphia.⁴ The Court therefore directed these cases back to state court.

GSK Holdings as GSK LLC’s Sole Member. The Court first sought to locate GSK Holdings’s “nerve center” in the context of its role as the sole member of GSK LLC. In light of GSK Holdings’s limited business activities and its delegation of the management of GSK LLC’s operations to Philadelphia-based GSK LLC officers and directors, the Court found that GSK Holdings “has effectively transplanted the vast majority of its ‘brain’ or ‘nerve center’ to its managers in Philadelphia” As such, the Court concluded that “[GSK] Holdings’s ‘nerve center’ is in Philadelphia.”

⁴ Although the Court emphasized that its ruling rested on the “nerve center” test, it did point out instances of purported “post-removal jurisdictional manipulation” on the part of GSK Holdings following the initiation of the Paxil lawsuits, including changes to corporate bylaw and government contract provisions that actually listed GSK Holdings’s business address as being in Philadelphia.

GSK Holdings as a Holding Corporation. Focusing on GSK Holdings’s limited activities *other than* its role as GSK LLC’s sole member, the Court nevertheless concluded that “[GSK] Holdings’s principal place of business is not in Delaware.” In this regard, the Court explained that GSK Holdings “does no more there than is necessary to preserve its corporate status as a Delaware corporation under Delaware law.” Its quarterly board meetings held in Delaware “do not direct, control or coordinate its real business activities,” and its Delaware operations are largely supplied by a corporate services company that provides an office “the size of a closet” where no business activities are conducted and a Delaware “‘rent-a-director,’ spending four hours per year on his duties.” In fact, in the Court’s opinion, GSK Holdings “fits the profile of a company described by the Supreme Court in *Hertz* as an artifice to manipulate jurisdiction.”

Conclusion

Brewer instructs how the U.S. Supreme Court’s *Hertz* test will be applied within complex, multi-tiered corporate holding structures that are prevalent in many large, international business enterprises. It is interesting to note that, in determining the citizenship of a manager-managed LLC for purposes of the Diversity Statute, the *Brewer* Court essentially disregarded the jurisdiction of incorporation of the LLC’s sole member. Moreover, while there may be other very good reasons for locating the citizenship of a business enterprise in a particular jurisdiction where it may not necessarily conduct significant business operations, *Brewer* demonstrates that, for purposes of a *Hertz* analysis, a federal court seeking to identify an entity’s *actual* center of direction, control and coordination might very well ignore what it views to be an effort to manipulate jurisdiction.

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