

Recent Changes in Federal Jurisdiction

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be wise to utilize the corporate entity by having the stockholder sell his stock to the corporation and then buy stock that qualifies under section 1244 directly from the corporation.

A stockholder in a family corporation may be able to establish an ordinary loss on 1244 stock and still keep the stock within the family by selling to in-laws.⁶⁷ Needless to say, the sale must be bona fide.

In view of the benefits of section 1244 and other provisions of the Technical Amendments Act of 1958,⁶⁸ it would appear that the future trend in small business organization should be and will be towards conducting business in the corporate form.



RECENT CHANGES IN FEDERAL JURISDICTION

Introduction

Congress has recently passed an Act amending the statutory provisions in regard to jurisdiction of the federal courts. The amount in controversy in "federal question" and "diversity of citizenship" cases has been increased,¹ and for purposes of diversity jurisdiction corporations are now deemed "citizens" both of their state of incorporation and of the state in which they have their "principal place of business."² Also, workmen's compensation cases arising under

⁶⁷ IBP, Tax Planning § 2, at 5 (Aug. 27, 1958).

⁶⁸ For example, corporations may now elect more beneficial tax treatment under INT. REV. CODE OF 1954, subchapter S, §§ 1371-77.

¹ Passed July 25, 1958, this amendment provides for four significant changes in diversity jurisdiction provisions. The first stipulates that the "amount in controversy" in diversity cases be in excess of \$10,000, exclusive of interest and costs. Formerly, the amount was in excess of \$3,000, exclusive of interest and costs. This provision of the amendment is reinforced by the further provision that, if the plaintiff be adjudged entitled to recover less than \$10,000, without regard to any counterclaim, the district court may, in its discretion, deny costs to him or even, in addition, impose costs upon him. 72 STAT. 415 (1958), amending 62 STAT. 930 (1948), 28 U.S.C. §§ 1331-32 (1952). The amendment raises the amount in controversy in "federal question" cases to in excess of \$10,000 exclusive of interest and costs, but this provision is regarded by Congress as relatively minor. See S. REP. NO. 1830, 85th Cong., 2d Sess. 6 (1958): "While this bill applies the \$10,000 minimum limitation to cases involving Federal questions, its effect will be greater on diversity cases since many of the so-called Federal question cases will be exempt from its provision. This is for the reason that Federal courts are expressly given original jurisdiction without limitation as to the amount claimed in a great many areas of Federal Law. For example, regardless of the amount claimed, the Federal courts have jurisdiction in copyright, patent, and trademark cases."

² 72 STAT. 415 (1958), amending 62 STAT. 930 (1948), 28 U.S.C. §§ 1331-32 (1952).

state law cannot be removed to federal courts.³ The avowed purpose of this amendment is to reduce the case load in the federal courts, and so promote the efficient administration of justice.⁴ Such an enactment was vitally necessary—the federal courts are swamped with unfinished business, and this backlog of cases increases each year.⁵ One of the principal causes of congestion is the large number of cases involving state law which stream into the federal courts through the diversity of citizenship jurisdictional device.⁶ It is this source of calendar congestion which Congress has principally sought to diminish.

Diversity of Citizenship Jurisdiction

Jurisdiction based upon diversity of citizenship was conferred upon the federal courts because of the fear that state courts would exhibit prejudice toward non-resident litigants.⁷ As Justice Story said in *Martin v. Hunter's Lessee*:

The constitution has presumed (whether rightly or wrongly we do not inquire) that state attachments, state prejudices, state jealousies, and state interests, might sometimes obstruct, or control, or be supposed to obstruct or control, the regular administration of justice. . . . No other reason than that which has been stated can be assigned, why some, at least, of those cases should not have been left to the cognizance of the state courts.⁸

Perhaps the underlying cause of this presumption was the economic disparity between the various sections of the country: the Northeast was highly developed; the frontier and South were rather poor. It was felt that the Northeast, with its large accumulations of capital, would be the "creditor" section, and that the frontier and South would be "debtor" sections. Many feared that in these "debtor" sections, there would be hostility toward the "creditors," and that this hostility would give rise to discriminatory attitudes in state courts. Consequently, the flow of capital between the "creditor" and "debtor" sections would be inhibited because of fear on the part of investors that they would sustain losses through injustice. The economic development of large parts of the country would thereby be hindered.⁹ As Henry Friendly stated in his informative article:

³ 72 STAT. 415 (1958), amending 62 STAT. 939 (1948), 28 U.S.C. §1445 (1952). Texas, Alabama, and New Mexico had received a substantial number of such cases by removal, and Louisiana some of them. S. REP. No. 1830, 85th Cong., 2d Sess. 34 (1958).

⁴ See S. REP. No. 1830, 85th Cong., 2d Sess. 3 (1958).

⁵ *Ibid.* See also 1957 U.S. JUD. CONF. ANN. REP. 75.

⁶ See 1957 U.S. JUD. CONF. ANN. REP. 75.

⁷ *Martin v. Hunter's Lessee*, 3 U.S. (1 Wheat.) 304 (1816) (dictum).

⁸ *Id.* at 347.

⁹ See Brown, *The Jurisdiction of the Federal Courts Based on Diversity of Citizenship*, 78 U. PA. L. REV. 179, 180-83 (1929); Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483, 497-99 (1928).

Not unnaturally the commercial interests of the country were reluctant to expose themselves to the hazards of litigation before [the state courts]. . . . They might be good enough for the inhabitants of their respective states, but merchants from abroad felt themselves entitled to something better. There was a vague feeling that the [federal] courts would be strong courts, creditors' courts, business men's courts.¹⁰

But there are doubts as to the validity of the "debtor-creditor hostility" theory. Friendly observed that:

Only if we could find that the state judges had been notoriously unfair to foreigners, would we be in a position to place much faith in the genuineness of the classical theory.¹¹

He went on to state that there is no evidence available to support this position,¹² but other writers disagreed.¹³

However the question of the validity of the original basis for diversity jurisdiction be resolved, there still remains the question of the justification for its retention at the present time. One writer asserted in 1929 that there was still a large amount of "debtor-creditor hostility." He pointed out that sectionalism was still rampant, and that the economic disparity between the sections had not been eliminated.¹⁴ Hence, while federal district courts may well have judges and juries drawn from the locality, since these judges are federal officers there is a tendency to diminish the unfortunate effect of local prejudice.¹⁵ Brown had advanced another theory in support of diversity jurisdiction. He indicated that the doctrine of *Swift v. Tyson*¹⁶ tended toward the conformity of state law with federal law, and that this unifying force justified the retention of the jurisdiction.¹⁷ Whatever degree of validity this theory may have had, it has been moot since the decision in *Erie R.R. v. Tompkins*,¹⁸ which required adherence in federal courts to state decisional law as well as statutory law.

Mr. Justice Frankfurter, however, takes the position that fear of local prejudice is belied by the changes in our national economic

¹⁰ Friendly, *supra* note 9, at 498.

¹¹ *Id.* at 493.

¹² *Id.* at 493-97.

¹³ See Yntema & Jaffin, *Preliminary Analysis of Concurrent Jurisdiction*, 79 U. PA. L. REV. 869, 876-77 n.13 (1931).

¹⁴ Brown, *The Jurisdiction of the Federal Courts Based on Diversity of Citizenship*, 78 U. PA. L. REV. 179, 181-83 (1929). See also Newlin, *Proposed Limitations Upon Federal Courts*, 15 A.B.A.J. 401, 403-04 (1929); Parker, *The Federal Jurisdiction and Recent Attacks Upon It*, 18 A.B.A.J. 433, 437-39 (1932); Parker, *Dual Sovereignty and the Federal Courts*, 51 NW. U.L. REV. 407, 408-13 (1956). But see discussion in Wechsler, *Federal Jurisdiction and the Revision of the Judicial Code*, 13 LAW & CONTEMP. PROB. 216, 235-36 (1948).

¹⁵ Brown, *supra* note 14, at 183-86.

¹⁶ 14 U.S. (16 Pet.) 1 (1842).

¹⁷ Brown, *supra* note 14, at 191.

¹⁸ 304 U.S. 64 (1938).

structure, which "no longer allows the easy assumption that in the West and in the South state jurors and judges are economic Ishmaelites."¹⁹ This would seem to indicate that it is by no means clear that there is justification for retention of diversity jurisdiction. Conversely, its opponents have not conclusively demonstrated that it lacks justification. However the controversy may be resolved in the future, the present amendment does not abolish diversity jurisdiction; it merely modifies it.²⁰ Congress has not inquired into the *raison d'être* of the jurisdiction, but has simply endeavored to remove a few of its deleterious effects on the federal administration of justice.²¹

The federal court calendars have, in recent years, become seriously congested. The number of private civil cases rose from 33,519 in 1956 to 36,938 in 1957, an increase of ten per cent.²² In 1956, of the private civil cases, 20,525, or approximately two-thirds, were in the federal courts because of diversity of citizenship.²³ In 1957, the number of diversity cases rose to 23,223, accounting again for about two-thirds of the private civil business.²⁴

The huge increase in the case load of the federal courts has had its effect. In the Eastern District of New York in 1957, the average interval between filing a case and its disposition was more than forty-six months.²⁵ It is safe to state that if the number of diversity cases could be decreased, this interval would be shortened.

The Supreme Court held in *Marbury v. Madison*²⁶ that Congress may not extend the jurisdiction of the federal courts beyond the boundaries prescribed in the Constitution; however, it may refuse to vest in them the various types of jurisdiction enumerated.²⁷ The constitutional provisions for jurisdiction are permissive, and not mandatory.²⁸ As the Supreme Court stated in *Kline v. Burke Constr. Co.*:²⁹

The right of a litigant to maintain an action in a federal court on the ground that there is a controversy between citizens of different States is not . . . derived from the Constitution. . . . Only the jurisdiction of the Supreme Court is derived directly from the Constitution. Every other court created by the general government derives its jurisdiction wholly from the authority of

¹⁹ Frankfurter, *Distribution of Judicial Power between United States and State Courts*, 13 CORNELL L.Q. 499, 522 (1928).

²⁰ See 72 STAT. 415 (1958).

²¹ Cf. S. REP. No. 1830, 85th Cong., 2d Sess. 4-5 (1958).

²² 1957 U.S. JUD. CONF. ANN. REP. 75.

²³ *Id.* at 174.

²⁴ *Ibid.* Of these, only 6,059 were removed from state courts. The remaining three-fourths of the diversity cases were brought directly in federal courts by the plaintiffs. *Ibid.*

²⁵ 1957 U.S. JUD. CONF. ANN. REP. 115.

²⁶ 1 U.S. (1 Cranch) 137 (1803).

²⁷ See, e.g., *Sheldon v. Sill*, 17 U.S. (8 How.) 441 (1849); *U.S. v. Hudson & Goodwin*, 2 U.S. (7 Cranch) 32 (1812).

²⁸ See note 27, *supra*.

²⁹ 260 U.S. 226 (1922).

Congress. That body may give, withhold or restrict such jurisdiction at its discretion. . . .³⁰

Therefore, no constitutional problem should arise in regard to the amount in controversy provisions.

(a) *Dual Citizenship of Corporations*

There may be some doubt as to the constitutionality of the provision by which a corporation is deemed a citizen of the state in which it has its principal place of business, as well as of the state in which it is incorporated. It is a well settled doctrine that a corporation is deemed to be a citizen of the state of incorporation, for purposes of diversity of citizenship.³¹ However, this doctrine is but a statement of a fiction, since a corporation is not as a rule regarded as a citizen.³² The Supreme Court has held that Congress may extend diversity of citizenship jurisdiction to cases involving inhabitants of the District of Columbia and of the Territories,³³ in spite of the classic holding of Chief Justice Marshall that the District could not be considered a "state" within the terms of Article III of the Constitution.³⁴ By this amendment Congress seems to run counter to the long line of Supreme Court decisions holding that a corporation is only the creature of the state in which it was incorporated and deemed to be a "citizen" of that state alone.³⁵ Here a corporation may in effect be a citizen of more than one state. But this provision is for the purpose of limiting the jurisdiction of the federal courts in diversity of citizenship cases, and not for the purpose of extending it. It may, therefore, be legitimately contended that since Congress has the power to withhold or restrict such jurisdiction, the amendment is a valid one.

Under this amendment, a corporation created by the laws of state *A*, having its principal place of business in state *B*, cannot claim diversity of citizenship as a ground for federal jurisdiction if it sues a citizen of state *B*. Neither can a citizen of state *B* claim diversity of citizenship, wherever he may sue. Also, where a corporation is incorporated in more than one state,³⁶ it will be considered a citizen

³⁰ *Id.* at 233-34.

³¹ *Puerto Rico v. Russell & Co.*, 288 U.S. 476 (1933); *Doctor v. Harrington*, 196 U.S. 579 (1905); *Thomas v. Board of Trustees*, 195 U.S. 207 (1904); *Blake v. McClung*, 172 U.S. 239 (1898); *Marshall v. Baltimore & O.R.R.*, 21 U.S. (16 How.) 314 (1853); *Louisville, Cincinnati & Charleston R.R. v. Letson*, 15 U.S. (2 How.) 497 (1844). See also Green, *Corporations as Persons, Citizens, and Possessors of Liberties*, 94 U. PA. L. REV. 202, 205-28 (1946).

³² See McGovney, *A Supreme Court Fiction*, 56 HARV. L. REV. 853, 861 (1943).

³³ *National Ins. Co. v. Tidewater Co.*, 337 U.S. 582 (1949).

³⁴ *Hepburn v. Ellzey*, 1 U.S. (2 Cranch) 445 (1804).

³⁵ See note 31, *supra*.

³⁶ *Jacobson v. New York, N.H. & H.R.R.*, 206 F.2d 153 (1st Cir. 1953), *aff'd per curiam*, 347 U.S. 909 (1954). Cf. 28 U.S.C. 1348 (1952): "All

of the state in which it has its principal place of business as well as of the states (however numerous) in which it is incorporated. Actions cannot be removed from state courts to federal courts in diversity cases when the state court action is laid in the state where the foreign corporation has its principal place of business.

(b) *The "Principal Place of Business"*

The cases construing the Federal Bankruptcy Act will very probably be determinative in the construction of the "principal place of business" provision, according to the Report of the Senate Committee on the Judiciary.³⁷ The Bankruptcy Act provides that the district court of the district wherein the bankrupt has its "principal place of business" has jurisdiction of the bankruptcy.³⁸

Under the Bankruptcy Act, the question of the location of a corporation's principal place of business is one of fact.³⁹ Many cases have dealt with this problem,⁴⁰ and consequently a substantial body of decisional law is available on the subject.

Among these cases is *Dryden v. Ranger Refining and Pipe Line Co.*⁴¹ Involved there was a Delaware corporation, whose purpose was to produce, refine, and sell petroleum and petroleum products. Its "principal" office, according to its certificate of incorporation, was in Delaware, where its stock books were kept. However, its "general office" was in Kansas City, where its executive offices were located and all contracts were approved. There were some small oil wells in Kansas, and one refinery, seven gas stations and some wells in Missouri. The principal facilities of the company were in Texas: two refineries, some of its pipe lines, and several wells. These facilities contributed the bulk of the company's production. The value of its Texas property was five times as great as that in Missouri. Its Texas sales were more than four times as great as its Kansas sales. The court held that the corporation's "principal place of business" was in Texas.

national banking associations shall, for the purposes of all . . . actions by or against them, be deemed citizens of the States in which they are respectively located."

³⁷ S. REP. No. 1830, 85th Cong., 2d Sess. 5 (1958).

³⁸ 66 STAT. 420, 11 U.S.C. § 11 (1952).

³⁹ *Chicago Bank of Commerce v. Carter*, 61 F.2d 986 (8th Cir. 1932); *In re Diamond Star Timber Corp.*, 64 F. Supp. 849 (N.D.N.Y. 1946); *In re DeSoto Crude Oil Purchasing Corp.*, 35 F. Supp. 1 (W.D. La. 1940); *In re American & British Mfg. Corp.*, 300 Fed. 839 (D. Conn. 1924). Cf. *In re Pusey & Jones Co.*, 286 Fed. 88 (2d Cir. 1922), *cert. denied*, 261 U.S. 623 (1923).

⁴⁰ See note 39, *supra*. See also *Continental Coal Corp. v. Roszelle Bros.*, 242 Fed. 243 (6th Cir. 1917); *Home Powder Co. v. Geis*, 204 Fed. 568 (8th Cir. 1913); *In re Tygarts River Coal Co.*, 203 Fed. 178 (N.D.W. Va. 1913).

⁴¹ 280 Fed. 257 (5th Cir.), *cert. denied*, 260 U.S. 726 (1922).

*Burdick v. Dillon*⁴² involved a somewhat different situation. There, the "principal" office of a New Jersey corporation was in Boston, Massachusetts, and most of its sales were transacted through that office, while its quarries and mills were in Vermont and New York. The court held that the "principal place of business" was in Massachusetts, where the office was located. The test was the "ordinary understanding" of the principal place of business.

The court in the *Dryden* case, commenting on the *Burdick* case, stated that:

The [*Burdick*] case sustains the view that the place where the corporation conducts the greater part of its dealings with the public will be considered the principal place of business of the corporation rather than an office for the general control of its intra-corporate affairs.⁴³

The court stated further that:

Where a corporation conducts its business in a number of places, no one of which is plainly the place where its business is principally conducted, one of such places, where a substantial business is transacted, and from which general supervision of all of its business is exercised, may be properly held to be the principal place of business of such corporation.⁴⁴

Three factors were considered significant: the amount of production, volume of sales, and value of property. The court also stated that no general, set rule could be laid down.⁴⁵

It would seem that the three main factors mentioned in the *Dryden* case will aid in determining the principal place of business. However, where a corporation's facilities, conduct of operations, and dealings with the public are distributed evenly in several states, as may be the case with a railroad corporation, the location of the administrative office may be determinative.

Conclusion

The amendment will reduce the business of the federal courts, but the extent is yet to be determined. The probable effect of the provision by which a corporation is deemed to be a citizen both of the state where incorporated and of that in which it has its principal place of business is not known.⁴⁶ In the Report of the Senate Committee on the Judiciary it is pointed out that corporations are parties in sixty-two per cent of diversity cases.⁴⁷ However, corporations

⁴² 144 Fed. 737 (1st Cir. 1906).

⁴³ *Dryden v. Ranger Refining & Pipe Line Co.*, 280 Fed. 257, 262 (5th Cir.), cert. denied, 260 U.S. 726 (1922).

⁴⁴ *Id.* at 262-63.

⁴⁵ *Id.* at 263. See also *Continental Coal Corp. v. Roszelle Bros.*, 242 Fed. 243 (6th Cir. 1917); *Home Powder Co. v. Geis*, 204 Fed. 568 (8th Cir. 1913); *In re Tygarts River Coal Co.*, 203 Fed. 178 (N.D.W. Va. 1913).

⁴⁶ S. REP. No. 1830, 85th Cong., 2d Sess. 14 (1958).

⁴⁷ *Id.* at 13.

were not required to state their principal place of business prior to this amendment; consequently, it is not possible to estimate accurately the number of cases which will be affected by this provision, other than to speculate, as did Congress, that the number will be small but substantial.⁴⁸ The basis afforded for this speculation is a tabulation, by clerks in five district courts, of cases involving corporations chartered outside the state where the district is located but with their principal place of business in the state.⁴⁹ The results of the tabulation almost defy interpretation.⁵⁰

The provision raising the minimum amount in controversy to an amount in excess of 10,000 dollars, exclusive of interest and costs, will have some effect in reducing the workload of the federal courts, but this effect will not be great. As was stated in the Report of the Senate Committee on the Judiciary:

The number of diversity of citizenship cases, excluding tort actions, filed during the 2 periods surveyed in which the amount in controversy did not exceed \$10,000 constitutes almost 40 percent of the total of such cases. This is important because the suits in this grouping are time consuming. However, a reduction of 40 percent in the number of diversity of citizenship cases, other than tort suits, filed in the district courts during the fiscal year 1956 would have amounted to a reduction of only 6 percent in the total civil caseload. A reduction of 5.5 percent in the number of diversity of citizenship personal injury, motor-vehicle cases plus a reduction of 10 percent in all other diversity of citizenship tort suits would have amounted to a decrease of about 2 percent in the total civil caseload. Jones Act suits are not numerous so that a decline of 2 to 3 percent in the number filed would not effect a significant change in the overall civil caseload.⁵¹

The Committee concludes that:

On the basis of the available information it is therefore estimated that an increase in the jurisdictional amount requisite to invoke the jurisdiction of the United States district courts under diversity of citizenship or a Federal question from \$3,000 to \$10,000 would have reduced the 1956 load of work in the 86 districts which have only Federal jurisdiction by approximately 8 percent.⁵²

⁴⁸ *Id.* at 5, 14.

⁴⁹ *Id.* at 14.

⁵⁰ The percentage of diversity cases involving corporations affected ranged from none to 23%. Perhaps significant is the fact that a district in Michigan had the highest percentage—23%. On the other hand Connecticut had 6%, Texas 3%. Delaware and Kentucky had none. *Ibid.* Can it be said that this provision will have its greatest effect in States with the highest degree of industrial development?

⁵¹ S. REP. NO. 1830, 85th Cong., 2d Sess. 15 (1958).

⁵² *Ibid.*