South Carolina Law Review

Volume 23 | Issue 3 Article 6

1971

Civil Procedure--Attempt to Defeat Diversity Jurisdiction

David R. Gravely

COMMENTS

CIVIL PROCEDURE—ATTEMPT TO DEFEAT DIVERSITY JURISDICTION*

I. INTRODUCTION

This comment will examine the often used practice of assignment of a portion of one's claim to a citizen of the defendant's state for the purpose of destroying the required complete diversity of citizenship[1] and thus preventing the defendant's attempt to remove[2] his case to a federal court. Since the ability to bring suit in a federal court and to exercise the right of removal from a state court are dependent upon the citizenship of the parties involved, it has long been the practice to add or subtract parties in order to reach the court of plaintiff's choosing. Therefore, this device of assignment rests the choice of forum solely with the plaintiff and defendant's statutory right to remove becomes "illusory".[3]

There is a statute which prevents the collusive invoking of federal jurisdiction,[4] but there is no legislative policy against the avoidance of federal jurisdiction. However, in the South Carolina federal district

---

* Carter v. Seaboard Coast Line R.R., 318 F. Supp. 368 (D.S.C. 1970).

1. Diversity jurisdiction is derived from 28 U.S.C.A. § 1332 (1966) which states:
(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum value of $10,000, exclusive of interests and costs and is between (1) citizens of different states; (2) citizens of a state, and foreign states or citizens or subjects thereof; and (3) citizens of different states and in which foreign states or citizens or subjects thereof are additional parties.

Complete diversity was established in Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806).

2. The right of removal is derived from 28 U.S.C.A. § 1441 (a) (1950) which states:

> [A]ny civil action brought in a state court of which the district courts of the United States have original jurisdiction, may be removed by the defendant . . . to the district court of the United States . . . where such action is pending.

3. Note, *The Assignment Device in Diversity Cases: The Illusory Right of Removal*, 35 U. CIN. L. REV. 33, 45 (1966).

4. 28 U.S.C.A. § 1359 (1962) reads:

> A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court.

courts and other jurisdictions, there seems to be a judicial trend developing which would also prevent collusion to avoid federal jurisdiction.

II. BACKGROUND

Three early Supreme Court decisions laid the foundation for and explained the rationale of allowing the plaintiff to defeat diversity jurisdiction. The first decision on this issue was *Provident Savings Life Assurance Society v. Ford*[5] in which the federal court's assumption of jurisdiction was challenged. In this case the plaintiff had assigned his entire claim in order to prevent the defendant's removal to the federal court. The defendant's contention that the assignee was not the real party in interest was dismissed by the Court which reasoned that the assignment was not fraudulent, but merely colorable.[6] The Supreme Court, in refusing to assume federal jurisdiction,[7] stated:

> We know of no instance where the want of consideration in a transfer, or a colorable transfer, of a right of action from a person against whom the defendant would have a right of removal to a person against whom he would not have such right, has been held a good ground for removing a cause from a state to a federal court. . . . [I]t may, perhaps, be a good defense to an action in a state court to show that a colorable assignment has been made to deprive the United States Court of jurisdiction; but, as before said, it would be a defense to the action, and not a ground of removing that cause into the federal court.[8]

The second case, *Oakley v. Goodnow*,[9] went one step further in holding that the federal statutory scheme gave the court no jurisdiction to evade a colorable assignment made to defeat diversity.

> [N]o authority has as yet been given them [the courts of the United States] to take jurisdiction of a case by removal from a state court when a colorable assignment has been made to prevent such a removal. Under the law as it now stands, resort can only be had to the state courts for protection against the consequences of such an encroachment on the rights of a defendant.[10]

---

5. 114 U.S. 635 (1885).
6. *Id.* at 640-41.
7. *Accord,* Carson v. Dunham, 121 U.S. 421 (1887); Leather Manufactures' Bank v. Cooper, 120 U.S. 778 (1887).
8. 114 U.S. at 641.
9. 118 U.S. 43 (1886).
10. *Id.* at 45.

Thirdly, the case of *Mecom v. Fitzsimmons Drilling Co.*[11] dealt with the appointment of an out-of-state administrator, which is another method often used to defeat diversity. In this case the deceased's widow, as administratrix, brought an action against the defendant, a Louisiana corporation, in an Oklahoma probate court under a wrongful death statute. The defendant removed to the district court whereupon the plaintiff dismissed the action. Subsequently, she resigned as administratrix and had Mecom, a citizen of Louisiana, appointed as administrator by the Oklahoma court. Mecom then brought the action, but defendant was again allowed to remove and plaintiff's motion to remand was denied. The Supreme Court, in reversing this denial stated:

> [T]here was no right of removal to the federal court; and it is immaterial that the motive for obtaining his appointment and qualification was that he might thus be clothed with a right to institute an action which could not be so removed on the ground of diversity of citizenship.[12]

There have been no United States Supreme Court cases dealing with the use of a partial assignment for the purpose of destroying diversity. The first[13] court to consider the partial assignment device did so in the case of *Ridgeland Box Mfg. Co. v. Sinclair Refining Co.*[14] The assigned amount in this action was only one one-hundredth of plaintiff's claim, but the South Carolina Supreme Court held that this assignment was not an evasion but an avoidance of federal jurisdiction.[15] The *Ridgeland* court further stated:

> [E]ven if the parties were joined for the purpose of defeating removal, if they really be proper parties and have legitimate standing in the court the attempt of removal may be defeated irrespective of the intent and purpose of the plaintiff.[16]

Another South Carolina case[17] has gone even further in discussing

11. 284 U.S. 183 (1931); *See* 45 HARV. L. REV. 743 (1932); 41 YALE L.J. 639 (1932).

12. 284 U.S. at 190.

13. 2 S.C.L.Q. 89, 90 (1949).

14. 82 F. Supp. 274 (D.S.C. 1949); *accord*, Heape v. Sullivan, 233 F. Supp. 127 (D.S.C. 1964); Doremus v. Atlantic Coast Line R.R., 242 S.C. 123, 130 S.E.2d 370 (1963).

15. 82 F. Supp. at 276.

16. *Id.*

17. King v. McMillan, 252 F. Supp. 390 (D.S.C. 1966).

the plaintiff's ability to defeat federal jurisdiction by assignment of one one-hundredth of his claim.

> This court cannot, will not, on the facts and pleadings now before it, invade the sanctity of the approval Order, or pierce the veil of authority erected by the signature thereon. If any fraud or collusion exists in connection with the assignment, the state court is the proper forum for pursuit of same.[18]

III. THE NEW TREND

Although the practice of assignment to defeat diversity jurisdiction seems accepted, many legal scholars have questioned the fairness of allowing the plaintiff absolute choice of his forum. The protection, which those who question the fairness of assignments believe the state courts should have afforded the defendant, has been proposed by section 1307(b) of the American Law Institute's federal legislation which reads:

> Whenever an object of a sale, assignment, or other transfer of the whole or any part of any interest in a claim or any other property has been to enable or to prevent the invoking of federal jurisdiction . . . jurisdiction of a civil action shall be determined as if such sale, assignment or other transfer had not occurred. The word 'transfer' as used in this section includes the appointment of a trustee, receiver, or other fiduciary, or of any other person to hold or receive interests of any kind, whether made by private persons or by a court of any other official body.[19]

In the American Law Institute's commentary for section 1307 the following thought provoking proposals are noted:

> So long as federal diversity jurisdiction exists, however, the need for its assertion may well be greatest when the plaintiff tries hardest to defeat it. The plaintiff who chooses to sue a non-citizen defendant in a state court may be motivated by the hope that the out-of-state defendant will be at a substantial disadvantage in that court, and the likelihood of such motivation increases with the lengths to which the plaintiff will go to prevent removal to a federal forum. Although the magnitude of the problem cannot be determined, the cases leave no doubt that it exists, and the enactment of remedial legislation may not only resolve particular

18. *Id.* at 391-392.

19. ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 21-22 (Official Draft, Sept. 25, 1965).

> cases when they arise but may also tend to discourage resort to such devices at the time that suit is brought.[20]

Professor James W. Moore discussing the foregoing American Law Institute proposed federal legislation comments: "The proposals . . . are good ones. But we respectfully suggest that the federal courts should not await legislative action to cure an erroneous doctrine which has been evolved by the federal courts."[21] Another comment by Professor Moore states: "[I]f the federal courts will not protect their jurisdiction from fraudulent evasion it it not likely that state courts will do it for them."[22] The recent Supreme Court case of *Kramer v. Caribbean Mills, Inc.*[23] gave force to professor Moore's warning by holding that "the existence of federal jurisdiction is a matter of federal, not state law."[24]

The first court to break with precedent and follow the views stated above was a district court of Maine in the case of *Gentle v. Lamb-Weston Inc.*[25] In this case a one one-hundredth of the plaintiff's claim was assigned to a law school classmate of the plaintiff's attorney for the sole purpose of destroying diversity jurisdiction. The district court did not allow the plaintiff to remand to the state court and held such an assignment did not destroy federal diversity jurisdiction. The *Gentle* court stated that *Provident*[26] did not apply because it dealt with assignment of an entire claim whereas in *Gentle* only a partial assignment was made.[27] The court also distinguished *Mecom*[28] by stating that *Mecom* involved, not a colorable assignment, but the appointment of an administrator.[29] The district court of Maine concluded its decision with this statement by Judge Gignoux:

> [T]he essential diversity of citizenship of the parties at bar has not been vitiated by plaintiff's sham transaction. Were the Court to hold otherwise, it could be by acquiescence a party to the

20. *Id.* at 104-105.
21. 3A J. MOORE, Federal Practice § 17.05[2], at 156 (2d ed. 1969).
22. *Id.* at 154.
23. 394 U.S. 823 (1969).
24. *Id.* at 829.
25. 302 F. Supp. 161 (D. Me. 1969); *See* 83 HARV. L. REV. 465 (1969); 15 VILL. L. REV. 497 (1970).
26. 114 U.S. 635 (1885).
27. 302 F. Supp. at 164.
28. 284 U.S. 183 (1931).
29. 302 F. Supp. at 164. This distinction was stated in Kramer v. Caribbean Mills, Inc., 394 U.S. 823, 827 (1969).

> fraudulent avoidance of its jurisdiction and the substantial frustration of defendant's constitutional and statutory rights. This it declines to be.[30]

The *Gentle* court obviously took this strong position in a belief that allowing partial assignments to defeat diversity jurisdiction was fraudulent and should no longer be condoned by the federal courts. It seemed, however, that other federal courts were not so willing to correct this erroneous doctrine.

In the South Carolina case of *Arant v. Stover*,[31] decided five months after *Gentle*, the district court was presented with a factual situation which again involved the assignment of one one-hundredth of the plaintiff's claim for the purpose of avoiding federal jurisdiction. District Judge Hemphill in failing to accept the *Gentle* rationale stated:

> The conclusion is that the Fourth Circuit now frowns on the forum shopping practiced by invoking federal jurisdiction through artificial or collusive means. Whether the brows of that mighty court will, at some later date, be furrowed by concern over forum avoidance by the same practices this court does not predict. . . . When it is used to defeat diversity jurisdiction, the motive will not be inquired into, and absent some Act of Congress not presently foreseeable, the federal court will not look behind the appointment for the purpose of grasping jurisdiction. This, of course, in no way preempts the state courts.
>
> . . . .
>
> After all, it is rather old-fashioned, but this court is a court of *stare decisis*.[32]

IV. THE CARTER DECISION

Almost one year from the date of the decision in *Arant*, the South Carolina district court was presented with another opportunity to follow the *Gentle* decision in the case of *Carter v. Seaboard Coast Line Railroad Co.*[33] This time, with Judge Russell deciding the case, the district court chose to accept the *Gentle* rationale and became a leader in the trend for protection of federal jurisdiction based upon diversity of citizenship.

30. 302 F. Supp. at 166-167.
31. 307 F. Supp. 144 (1969).
32. *Id.* at 151-152.
33. 318 F. Supp. 368 (D.S.C. 1970).

The action arose in a tort claim against the defendant railroad, a Virginia company, for injuries sustained in a railroad collision. In the application of the plaintiff, guardian *ad litem* of his minor son, for authority to execute the assignment, he stated that his purpose was "to retain jurisdiction in Colleton County" because he believed "that a more favorable verdict might be rendered by a jury composed of citizens of the home county of your Petitioner and the said minor."[34] Shelton, a resident of Virginia, was offered and accepted one one-hundredth interest in plaintiff's cause of action in order to defeat federal jurisdiction. The plaintiff than mailed Shelton the proper form of assignment and a check for one-hundred dollars which the letter explained was "for your assistance in this matter."

Judge Russell relied on the *Kramer*[35] decision for the propostion that the question of federal jurisdiction would not be bound by the state court's determination of the validity of the assignment.[36] Having determined to investigate the basis of the assignment, the *Carter* court noted that *Gentle* was a well-reasoned opinion that had been approved by the commentators.[37] The court then stated language from the case of *Wecker v. National Enameling and Stamping Co.*[38] which was also quoted in the *Gentle* decision:

> While the plaintiff, in good faith, may proceed in the state courts upon a cause of action which he alleges to be joint, it is equally true that the federal courts should not sanction devices intended to prevent a removal to a federal court where one has that right, and should be equally vigilant to protect the right to proceed in the federal court as to permit the state courts, in proper cases, to retain their own jurisdiction.[39]

Accepting this power to look behind the assignment, the *Carter* court determined that "the motive of the transferor is an important consideration in determining whether the transfer actually was real, complete and bona fide."[40] Six factors were outlined by the court which

34. *Id.* at 370.

35. 394 U.S. 823 (1969).

36. 318 F. Supp. at 371-372.

37. 318 F. Supp. at 372 *citing* 83 HARV. L. REV. 465 (1969); 15 VILL. L. REV. 499 (1970); 3A J. Moore, Federal Practice § 17.05 [2], at 156 (2d ed. 1969).

38. 204 U.S. 176 (1907).

39. *Id.* at 185-186.

40. 318 F. Supp. at 373 *citing* Amar v. Garnier Enterprises, Inc., 41 F.R.D. 211, 216 (C.D. Cal. 1966). *See* 83 HARV. L. REV. 465, 473 (1969) which suggests that "it might be preferable to ignore the citizenship of the transferee only when the transferor would not have made the transfer *but for* its effect on federal jurisdiction."

led them to the finding of a sham assignment and joinder, they were: (1) no present consideration for the assignment; (2) the assignee acquired no real rights in the cause of action; (3) the assignee was not to be consulted about a settlement; (4) the assignee expected no control over the action; (5) the assignee expressed complete indifference to the subject; and (6) the assignee was actually being employed and paid to permit the use of his name as a co-plaintiff.[41] The *Carter* court found that it would be "inconceivable" to allow such a sham when its stated purpose was to deny the defendant "the very right which the diversity jurisdiction of this court was intended to secure."[42]

V. CONCLUSION

Judge Russell concluded his opinion in *Carter* by noting the conflict of decisions on the avoidance of federal diversity jurisdiction in the various federal courts. He contended that, in order to resolve this conflict, an interlocutory appeal[43] would be granted and because of the importance of the issue involved, such appeal would be allowed without the prepayment of fees and costs. The plaintiff chose, however, not to exercise this granted privilege to take an interlocutory appeal and therefore the conflict will have to be finally determined at some later date.

The effect of the *Carter* decision on the practicing attorney may have been predicted by Professor Field in his discussion of the American Law Institute's proposed federal legislation:

> To those of you who habitually represent plaintiffs in, for example, personal injury cases, it must come as a *shock* even to suggest that you be deprived of a choice which you always have

41. 318 F. Supp. at 374.
42. *Id.*
43. 28 U.S.C.A. § 1292 (b) (1966) states:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided, however,* that application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

> had, and have tried to exercise, as I always did, in a particular case in the way best calculated to aid your client's cause.[44]

Perhaps before the *Carter* decision the attorney who has attempted to choose his forum by a sham assignment would be "shocked" if his forum were denied him, but he no longer should express such sentiment after *Carter*. It is this writer's opinion that the *Carter* court is to be commended for its attempt to correct an erroneous doctrine. The United States Supreme Court will eventually have to balance the theory that the *Carter* decision represents against the possibility of overburdening the federal courts dockets and make the final determination of this issue.

DAVID R. GRAVELY

44. Field, *Proposals on Federal Diversity Jurisdiction*, 17 S.C.L. REV. 669, 672 (1965) (emphasis added).