1969

Manufacturing Diversity Jurisdiction

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COMMENTS

MANUFACTURING DIVERSITY JURISDICTION

I. INTRODUCTION

Parties to civil suits have long recognized that there are procedural and tactical advantages to litigating in federal court. Examples of procedural factors deemed advantageous are the broader scope of federal discovery and the availability of federal interpleader. Tactical advantages, on the other hand, are less easily distinguished. They seem to stem from pre-conceptions, biases, and beliefs; examples are the belief that federal juries render higher verdicts, the greater confidence in the judicial temperament and independence of federal jurists, and the belief that nonresidents incur local bias in state courts. These differences between the state and federal forums coupled with the fact that plaintiff's suit may only permit access to the federal forum on diversity have thus caused parties to undertake the "manufacture" of diversity where it might not normally existed. The types of devices frequently employed include the assignment of a claim to an out-of-state resident; the temporary or permanent change of residence by a party; and the appointment of an out-of-state representative, such as an executor, administrator, guardian, trustee, receiver, or representative of a class.

1. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938), held that federal courts must apply state common law in diversity suits. Since substantive law is no longer a factor in an attorney's choice of forum, only tactical and procedural advantages remain. See Summers, Analysis of Factors That Influence Choice of Forum in Diversity Cases, 47 Iowa L. Rev. 933 (1962). On the other hand, there are advantages to litigating in the state courts: lower litigation costs; greater familiarity with judges; local prejudice against the opponent; and the greater participation by judges in trial. See Comment, The Choice Between State and Federal Court in Diversity Cases in Virginia, 51 Va. L. Rev. 178 (1965).

2. A Philadelphia Orphans' Court has made a study of personal injury cases and concluded that verdicts in the federal courts are generally higher than those rendered in similar state court cases. As a result this court appointed a nonresident guardian to create the requisite diversity to sue in federal court. Kaufmann Estate, 87 Pa. D&C 401 (C.P. Phila. Co., 1954).

3. Diversity jurisdiction is derived from 28 U.S.C. § 1332 (1964): (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest 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.

4. The corollary to the manufacture of diversity is the use of legal device to destroy diversity where it would normally have existed.

5. The legal representatives whose citizenship is generally considered controlling for purposes of diversity are executors or administrators, trustees, receivers, repre-
Judicial approaches to the problem of manufactured diversity have not been entirely consistent. The basic problem seems to stem from the fact that consistency is difficult to achieve when the underlying basis of a court's decision is policy. The policy involved is, of course, the particular view each federal judge holds on the basic issue of diversity of citizenship as a jurisdictional base. Those who feel diversity jurisdiction must be jealously guarded to prevent its abuse and who would therefore limit its scope or abolish it altogether find support in arguments which point out that diversity was originally based on speculative fears of prejudice which are not so apparent today. These courts would add that since the advent of *Erie R.R. v. Tompkins*, the adherence to diversity has reduced federal judges to the position of a "ventriloquist's dummy to the courts of some particular state." On the other hand, those courts which argue in support of maintaining diversity jurisdiction and who would sanction the manufacture of diversity posit that since state and federal courts would be forced to compete, diversity helps to promote better administration of justice by producing uniform development of


Several commentators trace the true fear of prejudice against out-of-state interests to the state legislatures rather than the state courts. See, e.g., Friendly, supra note 6, at 493-98. Others claim that the absence of controversy over the adoption of the diversity clause reflected an effort to avoid unnecessary attacks on the state judges. See Yntema & Jaffin, *Preliminary Analysis of Concurrent Jurisdiction*, 79 U. Pa. L. Rev. 869, 875 n.12 (1931). See also Warren, supra note 6, at 83.

7. 304 U.S. 64 (1938).


Others arguing similar positions claim: (1) that since the country is now economically national, business investments no longer need the diversity "creditor's court." Frankfurter, supra note 6, at 521-22; (2) congress has recognized that state courts are capable and on an equal footing with federal courts by raising the amount in controversy to $10,000 and prohibiting removal of F.E.L.A. and Jones Act cases. Doub, *Time for Re-Evaluation: Shall We Curtail Diversity Jurisdiction?*, 44 A.B.A.J. 243, 245 (1958); (3) legitimate state policies are thwarted when citizens are given the opportunity to escape state courts. Frankfurter, supra note 6, at 525; (4) the prestige of the federal courts can only be maintained by limiting its jurisdiction. Frankfurter, supra note 6, at 525. See also Wechsler, *Federal Jurisdiction and the Revision of the Judicial Code*, 13 Law & Contemp. Prob. 216, 240 (1948); (5) the federal courts are becoming congested with diversity suits. See ALI, *Study of the Division of Jurisdiction Between the State and Federal Courts* (Part I) 170-77 (Official Draft 1965) [hereinafter cited ALI Study]. This study of 1,000 cases filed between November 10, 1958 and July 7, 1959 in the Eastern District of Pennsylvania showed that 53% were based on diversity jurisdiction.
the law. However, irrespective of which viewpoint one is disposed to adopt, it must be admitted that there are certain types of "manufactured" cases which should not be heard in the federal forum. Those are the cases in which the creation of diversity of citizenship by assignment or appointment is almost wholly motivated by the desire to invoke federal jurisdiction, and also where it is the type of litigation state courts are equally adept at hearing. The following example describes the type of "sham" transactions which should not be heard in federal court:

Two Pennsylvania residents are involved in an automobile accident; plaintiff believes that he can obtain a larger judgment in federal court rather than in state court, and therefore he executes an assignment of his claim against the defendant for $1.00 consideration to a New Jersey resident. The "new" party similarly agrees that upon entry of judgment he will pay plaintiff 95% of the award.

Upon brief analysis it can be seen that parties have joined together to invoke federal jurisdiction in an ordinary, but nevertheless prevalent, negligence action. The essential question is whether the federal courts should allow such actions to be heard at the whim of the plaintiff. On the other hand, an example of the type of case which might justifiably be presented in federal court — even where the motive is solely to create diversity — is a derivative suit brought on behalf of a class of shareholders by a representative. Where stock is publicly held throughout the United States, it is probable that "true" diversity could never be present if the representative's citizenship were not controlling. Irrespective of motive, this might be the type of litigation that should only be brought in federal court because national, even international, interests might be involved or affected. It is, therefore, mandatory that an adjudication be rendered without a particular state's interest affecting the rights of the parties. Though this might be considered a "manufactured" case, a compelling reason can be found for allowing courts to take jurisdiction.

It is the purpose of this Comment to plot the judicial and legislative undertakings which have attempted to achieve a balance between

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In further support of maintaining diversity, Yntema & Jaffin, supra note 2, at 887, list the basic arguments: (1) It helps promote the administration of justice; (2) It has its basis in the Constitution and is therefore a mandate of the federal system; See also Phillips & Christenson, The Historical and Legal Background of the Diversity Jurisdiction, 46 A.B.A.J. 959, 964 (1960); (3) Diversity has helped to produce the development of national enterprises and to now restrict that motivating force would weaken the financial structure of the nation; (4) It mitigates all possible prejudice to out-of-state litigants. Cf. Comment, The Choice Between State and Federal Court in Diversity Cases in Virginia, note 1 supra. See also Parker, Dual Sovereignty in the Federal Courts, 51 Nw. U.L. Rev. 407, 409 (1956), where it is posited that such prejudice denies a nonresident his right to a "fair and impartial jury;" (5) Diversity has worked well up to now so why do away with a good thing. See Frank, supra note 9; Moore & Wechstein, supra note 9; (7) To do away with it would offend Anglo-Saxon ideas of civil liberty by providing two sets of laws, one governing the rights of individuals and the other governing the rights of the government.
II. HISTORICAL LIMITATIONS ON THE MANUFACTURE OF DIVERSITY

At present, section 1359 of the Judicial Code represents Congress' attempt to limit the manufacture of diversity. It states:

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.10

Prior to the enactment of section 1359, there were two separate statutes aimed at restricting the ability of parties to create diversity. In order to prevent litigants from invoking federal jurisdiction by speciously assigning claims to citizens of other states, Congress first enacted section 11 of the Judicial Code of 1789.11 This section, popularly known as the anti-assignment clause, required that both the original assignor and the assignee bringing suit12 possess the requisite diversity of citizenship13 except in those cases where foreign bills of exchange and corporate bearer notes14 were assigned. The anti-assignment clause fell short of its intended purpose, however, for two reasons: firstly, its all-encompassing language prevented bona fide assignments15 and, secondly, the courts excluded from its scope the transfer of property interests,16 promises and duties implied in law,17 and assignments by operation of law.18

11. Nor shall any circuit or district court have cognizance of any suits to recover the contents of any promissory note, or other chose in action, in favor of an assignee, unless a suit might have been prosecuted in such court if no assignment had been made. Except in cases of foreign bills of exchange. Judiciary Act of 1789, ch. 20, § 11, 1 Stat. 78.
12. Mesne conveyances were disregarded. See Emshiemer v. New Orleans, 186 U.S. 33 (1902).
13. The section was constitutionally challenged as a limitation on diversity jurisdiction but was upheld. Sheldon v. Sill, 49 U.S. (8 How.) 441 (1850); Turner v. The President, Directors, and Co. of the Bank of North America, 4 U.S. (4 Dall.) 8 (1799).
15. Williams v. Nottawa, 104 U.S. 209 (1881); Consolidated Rubber Tire Co. v. Ferguson, 183 F. 756 (2d Cir. 1910); Cf. Bullard v. City of Cisco, 290 U.S. 179 (1933). It thus operated as an inflexible "wooden rule." Cohen & Tate, supra note 5, at 208.
17. Ambler v. Eppinger, 137 U.S. 480 (1890); Menasha Wooden Ware Co. v. Southern Ore Co., 244 F. 83 (9th Cir. 1917).
18. The appointment of executors, administrators, trustees, receivers, and guardians were therefore not within the purview of the anti-assignment clause. See, e.g., New Orleans v. Gaine's Adm'r, 138 U.S. 595 (1891). See generally Reviser's Note to 28 U.S.C. § 1359 (1964); Dobie, Jurisdiction of the United States District Court as Affected by Assignment, 6 VA. L. Rev. 533 (1920). See also Comment, Chaos of
Subsequently, in an effort to prevent litigants from misusing the jurisdictional base of the federal courts, Congress enacted section 37 of the Judicial Code in 1875. This statute supplemented the anti-assignment clause with language prohibiting "improper and collusive" transfers to create a case cognizable in federal court. The first case to interpret the statute's broad prohibition was *Williams v. Nottawa,* where the plaintiff assignee attempted to bring suit as owner of three bearer bonds and as a collection agent for citizens of Michigan who owned the remaining bonds. Since the obligor was a township located in Michigan, the assignors themselves could not satisfy the requirements of diversity jurisdiction. The Supreme Court held that since the transfers to the collection agent were never intended to change ownership, they were colorable assignments and must therefore have been undertaken for the purpose of creating federal jurisdiction. The Court concluded that the plaintiffs were collusively joined, and that under section 37, the circuit court should have dismissed the case on its own motion. In announcing that the test under section 37 would be one of colorability, the Court relied upon earlier assignment cases which were previously considered outside the scope of the anti-assignment clause. Thus the new section was to be based on standards previously announced in the area of assignments, but was not to be limited in application solely to transfers by assignment. The factors to be weighed by courts in deciding whether a particular transfer was bona fide or colorable were: (1) the amount
of consideration paid, (2) the completeness of the interest transferred, and (3) the possibility that the proceeds derived from suit would be reconveyed. If the transfer was bona fide, the motive behind it was irrelevant and could not render the transfer “improper and collusive.”

As noted previously, assignment by operation of law — the appointment of an executor, administrator, trustee, receiver, and guardian — was excluded from the scope of the anti-assignment clause. Therefore, contemporary courts, having the benefit of a strictly worded section 37, did not contemplate a prohibition against the appointment of those representatives. One case, Cerri v. Akron-People’s Telephone Co., did, however, find the appointment of such a representative “improper” or “collusive” under section 37. In Cerri, the plaintiffs secured the appointment of a nonresident administrator whose sole function was to institute a wrongful death action in federal court. There were no other assets in the estate except the cause of action, and the proceeds derived from suit would have gone directly to the beneficiaries and not come under the administrator’s supervision. Under these facts the court was able to analogize to the formation of a “naked trust,” and therefore conclude that no real and substantial controversy existed between the administrator and the defendants. The view expressed in Cerri was that the test of collusiveness was aimed at the substance of the transaction and therefore the legal form could be disregarded. Though Cerri was never expressly overruled, its holding was narrowly read into extinction by subsequent cases.

The case with which diversity could be treated under these old statutes is exemplified by the case of Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co. In that case, a Kentucky corporation sought to take advantage of federal common

24. In most cases these factors were not separately distinguished. See Southern Realty Investment Co. v. Walker, 211 U.S. 603 (1909); Miller & Lux, Inc. v. East Side Canal & Irrigation Co., 211 U.S. 293 (1908); Lehigh Mining & Mfg. Co. v. Kelly, 160 U.S. 327 (1895); Morris v. Gilmer, 129 U.S. 315 (1889); Central Paper Co. v. Southwick, 56 F.2d 593 (6th Cir. 1932).

25. Mecom v. Fitzsimmons Drilling Co., 284 U.S. 183 (1931). Mecom was concerned, however, with the ability of a party to destroy rather than create diversity. There is no legislative policy against the avoidance of diversity but since there is such a policy against its creation the considerations would seem to be different. See 3A J. MOORS, supra note 5, ¶ 17.05, at 152. See also Note, 96 U. PA. L. Rsv. 897 (1948). See note 81 infra.


29. Id. at 292.

30. Id.

31. It may, however, be suggested that it was effectively overruled sub silentio by Harrison v. Love, 81 F.2d 115 (6th Cir. 1936). See County of Todd v. Loegering, 297 F.2d 470, 474 (8th Cir. 1961); Jaffe v. Philadelphia & Western R.R. Co., 180 F.2d 1010, 1013 (3d Cir. 1950).


33. 276 U.S. 518 (1928).
law by conveying all its property to a newly created Tennessee corporation. After the conveyance was complete the Kentucky corporation was dissolved. Two months later its progeny instituted suit in federal court against a Kentucky defendant. In holding the transfer sufficient to create diversity the Supreme Court reasoned that since the transfer was complete, the motive behind it, even if solely to create diversity, was irrelevant and not fatal.

Though other corporations had attempted to create diversity through the use of such "interstate ballets" and had failed, the Court found Black & White clearly distinguishable. The Court reasoned that cases where section 37 prevented jurisdiction from attaching, the corporations involved had continued to transact business while transferring only the property involved in the suits to their subsidiaries. In Black & White, on the other hand, the Tennessee corporation dissolved after conveyance of all its assets. It was this dissolution that made the transfer "complete" because the parent corporation, by its mere non-existence, no longer had the ability to force a reconveyance of the proceeds realized from suit.

III. THE 1948 REVISION

Discontent with the operation of the anti-assignment section as an effective limitation on the manufacture of diversity ultimately led to the Congressional revision in 1948 in which both section 11 and section 37 were combined to form section 1359. The statute has not undergone further change and presently 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.

34. Prior to Erie R.R. Co. v. Tomkins, 304 U.S. 64 (1938), Swift v. Tyson, 41 U.S. (16 Pet.) 1 (1842), permitted forum shopping since federal courts were not bound to administer state substantive law. Therefore, a case similar to Black & White could not arise today. See Comment, 73 Yale L.J. 873, 883 (1964).

35. 276 U.S. 524-25 (1928).


Black & White may also be distinguished on the ground that the corporation was making an effective change of domicile by moving to the new state. It is settled law that the establishment of a new domicile, to the present exclusion of any other place, will also change a party’s citizenship for purpose of diversity. Gilbert v. David, 235 U.S. 561 (1915); Chicago & N.W.R. Co. v. O’Hle, 117 U.S. 123 (1886). See Note, Manufactured Federal Diversity Jurisdiction and Section 1359, 69 Colum. L. Rev. 706 (1969). The motive for the change is immaterial as long as there exists a present intention to remain permanently. Morris v. Gilmer, 129 U.S. 315 (1889).


A. Effect on the Manufacture of Diversity by Appointment

The reviser's notes indicate that no change in the prior law of section 37 — the section that prohibited "improper or collusive" joinder — was intended by the 1948 enactment. However, the revision did eliminate the words which granted the district court the power to dismiss a collusive case on its own motion. It was felt that this principle need not be stated within the newly revised statute since modern courts realized that they possessed the power to dismiss on their own motion.

The first court to interpret section 1359, Jaffe v. Philadelphia & Western R.R. Co., agreed with the reviser's position that there was no substantial difference between the old and new statutes. The court held that if the appointed representative is the "real party in interest" under state law, his citizenship controls for purposes of diversity. The fact that the representative was appointed solely to create diversity was immaterial.

Shortly thereafter, the Third Circuit handed down Corabi v. Auto Racing Inc., a case frequently cited for its well reasoned opinion. In Corabi, the original administratrix resigned so that a nonresident administrator could be appointed to institute a wrongful death action in federal court. Though the appointment was sought solely for the purpose of creating diversity jurisdiction, the court held that the appointment was not "improper" or "collusive" within the meaning of section 1359. In so holding, the court found Corabi to be factually indistinguishable from Black & White. There existed a "real and substantial controversy"; the transfer and succession of interests was actual, not feigned or colorable since the administratrix was discharged and the administrator was appointed prior to the inception of the suit. Moreover, the real party in interest, the administrator, possessed the cause of action and was therefore entitled to prosecute. It is evident from the court's reliance on Black & White that Corabi demanded a transfer of interest amounting to a formal severance of all ties. Corabi has been criticized as reading Black & White too closely and therefore requiring only a severance of formal connections between transferor and transferee.
the severance extant in the fact that the original corporation dissolved subsequent to the transfer of assets while Corabi found the severance complete by emphasizing that the administratrix resigned prior to the inception of suit.

If Corabi is to be criticized, it is most easily attacked on its dictionary definition of "improper and collusive." With aid from Webster's New International Dictionary the court concluded that "improper" clearly connoted "impropriety." The court reasoned that creation of diversity through the means used in the Corabi case was not improper as defined by Webster and, further, that Congress could have prohibited such a situation by more direct means than use of the words "improperly or collusively." In interpreting "collusively", the court, quoting Webster, required "[a]n agreement between two or more persons to defraud a person of his rights by the forms of law, or to obtain an object forbidden by law." The use of state law to create diversity, with the object of securing a high verdict was not, in the court's opinion, within the meaning of collusive as so defined.

The court's attempt to define exactly what Congress envisioned as an abuse of diversity jurisdiction was in itself laudable, however, in basing the decision on dictionary definitions rather than on legislative history, the court seems to have offended the broadest mandates of statutory construction. Additional criticism may be directed at the Corabi court's finding that parties could only have been collusively joined to invoke diversity when there had been "an illegal agreement or understanding between opposing sides of a litigation rather than . . . an arrangement effected by one side of the sort at bar." This conclusion was clearly at odds with the purpose of the first congressional limitation on diversity jurisdiction — the anti-assignment clause — which restricted the possibility of collusion among plaintiffs by requiring both the assignor and assignee to be of diverse citizenship to the opposing party.

Although this dictionary interpretation of section 1359 was dicta, Corabi became well accepted authority for the proposition that the appointment of a representative, if considered the real party in interest under state law, was not improper or collusive within the meaning of section 1359 and was therefore a valid means of manufacturing diversity jurisdiction.
B. Effect on the Manufacture of Diversity by Assignment

The effect of the revision on section 11 — the anti-assignment clause — was more far-reaching. The reviser's notes indicate that the combination of the two old sections envisioned a product encompassing "the best of both worlds." The restrictions upon bona fide assignments and the exceptions built into section 11 had permitted only partial fulfillment of its purpose — to prevent the manufacture of jurisdiction by assignment. The limitations were therefore dropped in favor of the more direct approach taken by section 37. Where the anti-assignment section did fulfill its purpose, the reviser did not seem to contemplate a change from standards applied in the earlier cases. If the assignment was merely a sham or colorable, it could not be used to create diversity.

After the 1948 revision, assignment cases interpreting section 1359 took two basic approaches in determining whether the assignment was sufficient to create diversity. Some courts seem to have interpreted the revision as a rejection of the standards developed under the old anti-assignment section, and have adopted tests developed under the appointment cases — Black & White and Corabi. Courts adhering to this view held that if the assignment was lawful under state contract or statutory law, it was not prohibited by section 1359 as a means of creating diversity. The mere assignment of a claim for $1.00, without more, was sufficient to confer citizenship, for diversity purposes, on the assignee. The burden of proof was on the defendant to show collusion via a secret arrangement or fraud on the court. Only then would section 1359 have any effect. Although this approach succeeded in presenting uniform standards for both assignments and appointments under

Goos, 302 F.2d 421 (8th Cir. 1962); County of Todd v. Loegering, 297 F.2d 470 (8th Cir. 1961). Cf. Grady v. Irvine, 254 F.2d 224 (4th Cir. 1958); Rodriguez v. Wheeler, 16 F.R.D. 103 (S.D. Tex. 1954). But see Duffy v. Currier, 291 F. Supp. 810 (D. Minn. 1968). The court found the reasoning of McSparran v. Weist, 402 F.2d 867 (3d Cir. 1968), cert. denied, 395 U.S. 903 (1969), to be very cogent, but was unable to follow it since it was bound by previous Eighth Circuit decisions. For general guardians see Stephan v. Marlin Firearms Co., 217 F. Supp. 880 (D. Conn.), aff'd per curiam, 325 F.2d 238 (2d Cir. 1963). But cf. Brough v. Strathmann Supply Co., 358 F.2d 374 (3d Cir. 1966). Prior to McSparran only three cases purported to question the authority of Corabi: Martineau v. City of St. Paul, 172 F.2d 777 (8th Cir. 1949), was decided on the real party in interest question rather than section 37; Campbell v. Pacific Fruit Express Co., 148 F. Supp. 209 (D. Idaho 1957), was decided upon an heir being found to be an indispensable party to the suit under a wrongful death statute and therefore section 1359 was not raised; and Cerri v. Arkon-People's Telephone Co., 219 F. 285 (N.D. Ohio 1914). See p. 734 & note 30 supra.  

57. See p. 730 supra.  
60. 276 U.S. 518 (1928).  
61. 264 F.2d 784 (3d Cir. 1959).  
64. Id.
section 1359, its effect was to encourage the use of sham devices to create diversity rather than to restrict the creation of diversity by device.

The second approach adopted by courts after the 1948 revision was merely an affirmation of the test utilized by pre-revision courts. Rather than looking at the terms of the assignment to see whether it was a valid transfer under state law, the courts looked to the nature of the interest or claim conveyed. The minimum interest required was an independent interest — something other than the assignment itself — in the claim that predated the assignment. Other courts utilizing this same approach were more demanding in that they required not only a complete transfer of all interests in the dispute or claim but also a showing that sufficient consideration was given to insure that the assignee was not a mere collection agent. Thus in Ferrara v. Philadelphia Laboratories, Inc., the court held that the lawful assignment of a cause of action to a trustee had been "improper" or "collusive" within the meaning of section 1359 since the interest acquired under the revocable trust agreement merely directed the trustee to bring suit in federal court. The absence of payment for the management of the trust property together with an agreement to reimburse expenses was, in the court's opinion, only further evidence of the trustee's lack of interest in the res.

The approach adopted by the Ferrara court is clearly the most flexible, and, as such, better designed to handle the intricate fact situations which sometimes pervade the area. The Ferrara court was able to weigh "all the circumstances attending the transfer"; the nature of the interest retained by the transferor; the transferor's ability to force a reconveyance without valuable consideration; the motive or purpose behind the transfer; the solicitation of the plaintiff to bring suit coupled with a reimbursement arrangement for costs and expenses; and an examination of who actually controlled the litigation.

If the first approach to assignment transfers — validity of the assignment under contract law — was discounted as contrary in effect to the policy of restricting manufactured cases, then two other distinct tests appeared in determining whether there had been an "improper"

65. Dunham v. Robertson, 198 F.2d 316 (10th Cir. 1952); Rosenberg v. Platt, 229 F. Supp. 8 (E.D. Wis. 1964); Paper Makers Importing Co. v. City of Milwaukee, 165 F. Supp. 491 (E.D. Wis. 1958); C.F. Commerce Mfg. Co. v. Blue Jeans Corp., 146 F. Supp. 15 (E.D.N.Y. 1956). See also Bradbury v. Dennis, 310 F.2d 73, 76 (10th Cir. 1962), cert. denied, 372 U.S. 928 (1963), which Professor Moore refers to as utilizing the "common sense approach" since the court neither depended on the validity of the transfer under state law nor the completeness of the transfer but chose to look at the historical purpose of the section's "denial of diversity jurisdiction when it would operate to serve a purpose which is unsuited to the good order of federal court administration." See 3A J. MOORE, supra note 5, ¶ 17.05, at 159.


68. Id. at 1007.
or "collusive" joinder under section 1359. In cases involving the appointment of a legal representative, the question was whether the appointee was the real party in interest under state law. If, however, the case involved the assignment of a claim or interest, then it was a question of whether the assignment was "real" or "colorable." If the tests for determining the validity of an appointment and an assignment were completely different and there was no common ground, then one wondered whether the revision and combination of the two old statutes into section 1359 was not a useless and confusing act by Congress. However, this was the state of the law until recently.

IV. RECENT COURT DECISIONS

A. McSparran's Effect on the Appointment Test

Amidst the clamor for federal diversity reform, two courts refused to wait for legislative action and attempted to reinterpret section 1359 so as to give it "meaning."

The most notable action was taken by the Third Circuit in McSparran v. Weist. There, the plaintiff, an out-of-state resident, was appointed as an injured minor's guardian for the sole purpose of creating diversity of citizenship with the defendant, a Pennsylvania resident. The court, in applying a novel mode of construction to section 1359, expressly overruled Corabi and Jaffe holding that "a nominal party designated simply for the purpose of creating diversity of citizenship, who has no real or substantial interest in the dispute or controversy, is improperly or collusively named." In thus construing section 1359, the court relied on language no longer present in the statute. The "unnecessary" language omitted by the reviser in 1948 — that portion of section 37 which empowered the court to dismiss on its own motion — was now held to give "content" to the otherwise ambiguous wording of the statute.

The full scope of McSparran, is not, however, entirely clear. In the first instance, though the case itself involved the appointment of a general guardian, the holding is not merely limited to this one type of 69. See ALI Study supra note 8, at 170-77. The ALI proposes a change in the statutory language. See pp. 743-44 infra.

70. Professor Moore states that legislative reform is not needed, but the burden is on the courts to make section 1359 effective as a restriction on diversity manufacture. See 3A J. Moore, supra note 5, ¶ 17.05, at 166.


72. 264 F.2d 784 (3d Cir. 1959).

73. 180 F.2d 1010 (3d Cir. 1950). The McSparran court also disapproved Fallat v. Gouran, 220 F.2d 325 (3d Cir. 1955), since Fallat implied approval of "manufactured" diversity.


75. See Reviser's justifications for omitting the relevant language at p. 734 supra.

76. That portion of section 37 upon which the court relied was the district court's ability to dismiss a suit "at any time . . . when such suit does not really and substantially involve a dispute or controversy properly within the jurisdiction of said court . . . " Act of March 3, 1875, ch. 137, § 5, 18 Stat. 472 (emphasis added).

appointment, but rather, purports to apply to the appointment of administrators and executors as well. Moreover, the court's interpretation of what is "collusive" joinder is subject to a number of interpretations. The court states that parties will henceforth be considered "collusively joined" when a representative is appointed who would not otherwise have been named but for the purpose of creating diversity. This broad language leaves many questions unanswered; for example, what factors are to be considered in determining the "purpose" of a given transfer, and how extensive an analysis will be required of district courts in making that determination. Clearly, the test proposed is a motive test. This is made evident by the fact that the court goes to great lengths to distinguish those cases which had taken the position that an exploration of motive was either unnecessary or irrelevant. Initially, the McSparran court challenged Mecom v. Fitzsimmons Drilling Co., a case which stood for the proposition that a court on review could not inquire into the motives of the parties in securing the appointment since to do so would be an admission that the parties had successfully perpetrated a fraud. In commenting on Mecom, the McSparran Court stated:

We do not impugn this decree collaterally by refusing to recognize the citizenship of a straw guardian. Guardian he remains, but since he is acting in the capacity of a straw party we refuse to recognize his citizenship for purposes of determining diversity jurisdiction.

Additionally, the Third Circuit easily distinguished Mecom since that case involved the destruction rather than the creation of diversity. Similarly, the McSparran court distinguished Black & White on the ground that when the Supreme Court concluded that an examination...
of motive was irrelevant, "it did so in the context of a real transaction which had significance beyond establishment of diversity jurisdiction."\(^{85}\)

Courts which follow \textit{McSparran} may select various approaches in applying the motive test. They may examine such factors as the ability and experience of the representative to manage the property.\(^{86}\) The relationship of the representative to the beneficiary\(^{87}\) will not only be relevant but also may be controlling. The sufficiency of the evidence required to find an "improper and collusive" joinder will thus be subject to various interpretations. In classifying a transaction as "improper" or "collusive" courts may require a showing that only one among several valid motives for the appointment of the nonresident be the creation of diversity, or they may require it to be the primary motive. Finally, courts may undertake to expose all the possible factors involved in the appointment, balance them, and find that when compared to the unexpressed\(^{88}\) desire to create diversity, the latter outweighs the former. The two elements that will most influence a court's choice are its view of diversity jurisdiction and the nature of the litigation itself. As noted earlier, a particular court's view on jurisdiction itself must influence its view on the propriety of a "manufactured" case. Irrespective of the approach adopted, a judicial conclusion that there has been an "improper" or "collusive" joinder, will result in the representative being treated as a straw party to the action.\(^{89}\) Even though the appointee is empowered to bring suit as the real party in interest under state law, his citizenship will not be determinative for purposes of diversity.\(^{90}\) He would, however, remain on the record as the party responsible for costs.

The application of the test adopted by the \textit{McSparran} court will not be free from difficulty. The test itself marks an abandonment of objective facts in favor of subjective criteria. This change may cause some to object that the new test will open the door to perjurious testimony and all but destroy predictability of result.\(^{91}\) The representative will no longer be able to obtain mere formal appointment and then use that appointment to invoke diversity jurisdiction in the federal courts. He must carry the burden of proving that there has not been an "improper and collusive" joinder of parties before jurisdiction will attach.\(^{92}\)

\(^{86}\) \textit{Id.} at 873.
\(^{87}\) \textit{Cf.} Fallat v. Gouran, 220 F.2d 325 (3d Cir. 1955).
\(^{88}\) Parties would no longer be as free to openly admit that the appointment was undertaken solely to create diversity.
\(^{89}\) "As a straw party he does not stand in the position of a true fiduciary whose involvement in litigation is incidental to his general duty to protect the interests of those for whom he is responsible." McSparran v. Weist, 402 F.2d 867, 873 (3d Cir. 1968), \textit{cert. denied}, 395 U.S. 903 (1969) (emphasis added).
\(^{90}\) See 3A J. \textit{MooRe}, supra note 5, \S 17.04, at 115; C. \textit{Wirght}, \textit{FEOERAL C0URTS} 81 (1963).
\(^{91}\) See Esposito v. Emery, 402 F.2d 878, 882-83 (3d Cir. 1968) (Judge Biggs dissenting in part and concurring in part).
\(^{92}\) The party seeking to invoke the jurisdiction of the federal courts has the burden of proving all the facts necessary to its sustenance. \textit{See}, \textit{e.g.}, \textit{McNutt v.}
In practice the plaintiff need only allege that diversity exists between the parties. On motion by the defendant to dismiss due to "improper" or "collusive" joinder, the plaintiff would probably incur the burden of moving forward with evidence to prove that the court has jurisdiction. It is not inconceivable that lengthy trials on the jurisdictional issue alone will develop, especially where the defendant is able to rebut the plaintiff's evidence by showing that the plaintiff had one or more equally well-qualified resident representatives from which to choose, but nevertheless selected a nonresident. The courts' examination of motive together with the plaintiffs' burden of proof on the issue of jurisdiction will then make section 1359 a most effective limitation on diversity suits.

B. Caribbean Mills' Effect on the Assignment Test

Although not quite as notable as the McSparran decision, the Fifth Circuit's decision in Caribbean Mills, Inc. v. Kramer,93 is nevertheless important in that it helps to clearly establish a unified view on the creation of diversity jurisdiction by assignment. In Caribbean Mills the plaintiff, for $1.00 consideration, was assigned a claim for breach of contract. On the same day, he reassigned to the assignors 95% of any proceeds that he might receive.94 Shortly thereafter, the plaintiff brought suit against the defendant asserting jurisdiction based on diversity of citizenship.95 On appeal, the Fifth Circuit held the assignment to be colorable since it did not divest the assignors of their interest in the lawsuit. The court determined that the assignee was obviously a collection agent chosen solely for the purpose of creating diversity jurisdiction. In view of this determination the court suggested that a review of the "relevant" authority demonstrated that the parties had been "improperly" or "collusively" joined under section 1359.96 Although the holding is not startling, of great import is the fact that during the course of its analysis the court admitted that it was unable to distinguish City of Eufaula v. Pappas,97 a case standing for the general proposition that an assignment, if valid under state contract or statutory law, is not prohibited by section 1359. The Caribbean Mills court found no material distinction between the two cases; both assignments were exe-
cuted for $1.00, both were valid under state contract law, and the assignee in each case had agreed to divide the proceeds derived from suit with the assignors.\textsuperscript{98} Even so, the court refused to follow City of Eufala — a rejection of great significance since that case was decided in a district court within the jurisdiction of the Fifth Circuit.\textsuperscript{99}

On appeal Caribbean Mills was affirmed by the Supreme Court. In speaking for a unanimous Court, Mr. Justice Harlan made it very clear that the legality of the assignment under state law was a question separate and distinct from any determination of federal jurisdiction:

[Petitioner] suggests that the undisputed legality of the assignment under Texas law necessarily rendered it valid for purposes of federal jurisdiction. We cannot accept this contention. The existence of federal jurisdiction is a matter of federal, not state, law. . . . [T]his Court several times [has] held that an assignment could be “improperly or collusively made” even though binding under state law. . . . [T]o accept [Petitioner’s] argument would render § 1359 largely incapable of accomplishing its purpose. . . .\textsuperscript{100}

The Supreme Court’s position on the collateral issue of motive in assignment cases such as Caribbean Mills is equally clear — the motive behind the assignment is not a consideration carrying weight in such cases. Having found a “total lack of previous connection with the matter . . . [the Court decided there was] little doubt that the assignment was for purposes of collection.”\textsuperscript{101} Hence, the Court was able to distinguish those cases which hold that where the transfer of a claim is absolute, i.e., where the transferor retains no interest in the subject matter, then the transfer is not “improperly or collusively made,” regardless of the transferor’s motive.\textsuperscript{102} In further justifying its position on motive the Court also distinguished earlier appointment cases where motive to create diversity jurisdiction was held to render an appointment of an out-of-state representative “improper” or “collusive.”

Cases involving representatives vary in several respects from those in which jurisdiction is based on assignments: (1) in the former situation, some representative must be appointed before suit can be brought, while in the latter the assignor normally is himself capable of suing in state court; (2) under state law, different kinds

\textsuperscript{98} In City of Eufala a formal agreement of reassignment between the assignee and assignors was never executed but the parties did have an understanding to that effect. Caribbean Mills found that the lack of a formal agreement to reconvey was inconsequential where the facts indicate that the assignment was not “real” and the assignee was a collection agent. See Caribbean Mills, Inc. v. Kramer, 392 F.2d 387, 394 n.6 (5th Cir. 1968).

\textsuperscript{99} The appellee, Kramer, noted that the decision in City of Eufala was written by Judge Johnson who now sits with the circuit court. See Brief for Appellee at 27, Caribbean Mills, Inc. v. Kramer, 392 F.2d 387 (5th Cir. 1968).


\textsuperscript{101} Id. at 827.

\textsuperscript{102} Id. at 828 n.9; citing Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co., 276 U.S. 518 (1928); Williamson v. Osenton, 232 U.S. 619 (1914); South Dakota v. North Carolina, 192 U.S. 286 (1904); Cross v. Allen, 141 U.S. 528 (1891).
of guardians and administrators may possess discrete sorts of powers; and (3) all such representatives owe their appointment to the decree of a state court, rather than solely to an action of the parties. It is not necessary to decide whether these distinctions amount to a difference for purposes of § 1359.103

In rejecting the proposition that an assignment, if valid under state law, is also sufficient to create diversity, the Supreme Court has eliminated the confusion emanating from the type of reasoning which originated with Carabi. The question of whether the transfer was “real” or “colorable” is now controlling.104 However, even after the McSparran and Caribbean Mills decisions two separate tests remain under section 1359 — one governing appointments and another governing assignments.

V. RECOMMENDATIONS

Among the commentators advocating change in diversity jurisdiction is the American Law Institute.105 The ALI has recommended two legislative proposals which affect “manufactured cases.” The proposal which has provoked the most controversy is section 1301 (b) (4). It provides:

An executor, or an administrator, or any person representing the estate of a decedent or appointed pursuant to statute with authority to bring an action because of the death of a decedent shall be deemed to be a citizen only of the same State as the decedent; and a guardian, committee, or other like representative of an infant or incompetent shall be deemed to be a citizen only of the same State as the person represented.106

Thus, the ALI recommends that the representative be deemed to be a citizen of the represented's state when placed in certain fiduciary positions. The section is clearly “designed to prevent either the creation or the defeat of diversity jurisdiction by the appointment of a representative having a different citizenship from the infant, incompetent, or decedent he is appointed to represent.”107 It is based upon the assumption that these particular suits are essentially local contests between co-citizens and therefore do not properly belong in the federal courts.108

What is actually reflected, however, is the basic substance of the suit at

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Though it may be viewed as dicta, the Court mentions that it need not consider as relevant appointment cases where a motive to create diversity is present. The words are thus couched in terms of a or any (singular) motive. It might be surmised that the Supreme Court thus views the holding in McSparran as requiring a showing of this one factor — all other factors being ignored. Compare page 740 and notes 86-88 supra.

104. There is some variation within “colorability” on the type of interest the assignee need have for the assignment to be “real.” See pp. 736-37 and notes 64-65 supra.

105. ALI STUDY, note 8 supra.

106. ALI STUDY, note 8 supra, at 8.

107. ALI STUDY, note 8 supra, at 63.

108. ALI STUDY, note 8 supra, at 64.
bar. It would seem that the ALI is taking the position that there can never be a valid justification for such litigation in federal court. Therefore, the motive behind the choice of a representative need not even be considered. The proposal is similar in effect to the 1966 congressional amendment of the basic diversity statute, which made the citizenship of an insured controlling for purposes of diversity, even in cases where the insurance company is the only party sued and the insured is not joined.

The second ALI proposal to affect "manufactured cases" is section 1307. It provides as follows:

(a) A district court shall not have jurisdiction of a civil action in which any party has been made or joined improperly, or collusively, or pursuant to agreement or understanding between opposing parties, in order to invoke the jurisdiction of such court.

(b) 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 under this chapter or chapter 158 of this title, 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 or any kind, whether made by private persons or by a court or any other official body.

A cursory examination of subsection (b) reveals that the ALI is clearly proposing a motive test for assignments and for those appointments which do not fall within the mandate of section 1301. The reasoning employed in proposing section 1307 is much the same as the underlying basis for section 1301. It is again, a recognition of the true nature of the transaction involved. The assignment of a claim or interest and the appointment of a trustee, receiver, or other similar fiduciary may often occur for reasons other than the creation or defeat of diversity jurisdiction. The section thus contemplates the existence of valid business reasons for the assignment or appointment. Where, however, it appears that the party did not enter the transaction for valid business reasons, but did so with "an object" of creating or defeating diversity jurisdiction, then the transaction will not be determinative for purposes of jurisdiction. But, with the burden of proof on the assignee, a showing that there has been a "real" assignment — absolute transfer of property for valuable consideration — would ordinarily negate the conclusion that "an object" of the assignment was to create diversity jurisdiction.

110. ALI Study, note 8 supra, at 23.
111. Id.
112. Id.
113. Id.
Section 1307 has several laudable features. Firstly, it seems to dis-regard the form of an assignment transfer. In doing away with the objective test of "real" versus "colorability" it examines the motive for the entire transaction. It is a further recognition that assignments and appointments in certain cases, may not be actually legally and factually distinguishable.\(^{114}\) Secondly, in proposing a motive test for trustees, receivers, and similar fiduciaries it builds into the test of jurisdiction the necessary flexibility that must accompany an area plagued with policy arguments.\(^{115}\) But apart from these redeeming features, the motive test, as proposed, seems to have one serious drawback. It would deny a party access to federal court where "an object" of the assignment or appointment was the desire to create or defeat diversity. This does not take into account the fact that there may be many objects surrounding the transfer. Its rigidity therefore seems to belittle the ability of courts to apply a true motive test as it has traditionally been able to do in, for example, criminal cases. The only difference is that in examining subjective states of mind in such criminal cases, such examination goes to the merits of the case. Now courts will be asked to examine the same subjective state of mind shrouded in the nature of procedural and dilatory questions. As previously noted, whole trials may thus occur merely on these procedural issues.\(^{116}\) Delay may then be a natural by-product of the motive test, but the fact that some cases may take longer to reach the actual merits will be offset by the fact that more than a few cases will not even survive the motive test. Therefore, the number of cases reaching the merits will be reduced and the total amount of time spent in litigating cases as a whole may actually be lowered.

VI. Conclusion

The two ALI proposals tacitly recognize that there are factual distinctions between the appointment of a fiduciary in certain situations. In some situations it may be unnecessary to indulge in a motive test because the basic appointment is of the type that should never be cognizable in federal court; while, on the other hand, those appointments which could be cognizable in federal court should be subjected to a motive test. Though the test proposed seems to be valid in principle, it would probably be too rigid if applied as contemplated. It provides for little, if any, flexibility and would seriously hinder the judicial process of examining the facts to see if a case is of the type that should be properly heard in federal court. Additionally, it seems to require severance of a court's view on the basic grant of diversity jurisdiction from its view of "manufactured" diversity jurisdiction — an impossible task.

\(^{114}\) See p. 743 & note 103 supra.
\(^{115}\) See p. 728 & notes 6, 8 supra.
\(^{116}\) See p. 741 supra.
The Third Circuit's decision in *McSparran* is certainly indicative of the more realistic approach that must be adopted by courts in assignment and appointment cases. It seems that the Third Circuit would apply this motive test to the appointment of all types of representatives — presumptively finding that there might be valid justifications for the appointment of an out-of-state representative in any, and all, types of appointment cases. The difference between the *McSparran* and the ALI proposals is therefore a difference in scope, not philosophy.

The Supreme Court's position in *Caribbean Mills* is no doubt correct. However the holding must be read narrowly in light of the facts of the case. In those cases where the facts indicate that there has been a "real" assignment, courts must not be satisfied with merely chanting that the assignment was not "colorable" and therefore was sufficient to create diversity jurisdiction. An examination of "all the circumstances attending the transfer"\(^{117}\) — including motive behind it — is the only approach which faces the reality of the transfer.

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