REPORT OF THE COMMERCIAL AND FEDERAL LITIGATION SECTION IN SUPPORT OF THE ABA RESOLUTION CONCERNING 28 USC § 1332

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SUPPORT FOR ABA RESOLUTION OF 28 USC § 1332

In 2015, the American Bar Association's Section on Litigation, Standing Committee on the American Judicial System presented the ABA House of Delegates with Resolution 103B, and an accompanying Report, for its consideration. The Resolution urged Congress to amend 28 USC §1332 such that any unincorporated business entity shall, for diversity purposes, be deemed a citizen of the state of its organization and the state where the entity maintains its principal place of business. The ABA's House of Delegates adopted the Resolution in August 2015. For the following reasons, the Federal Procedure Committee of the New York State Bar Association's Section on Commercial and Federal Litigation supports this resolution as well.

REASONS FOR THE RESOLUTION

The impetus for the ABA's Resolution is the wide array of business organizations available today that were simply not in existence the last time the diversity statute was amended in 1958. Many states have permitted the formation of limited liability partnerships (LLPs), limited liability companies (LLCs), and other unincorporated associations that, under current case law interpreting 28 USC §1332, require complete diversity of every single constituent member of such organizations. This requirement may prevent many organizations from being in federal courts. It also imposes a pleading burden and potentially an onerous one, as LLCs, for example, may not only be comprised of corporations, but limited partnerships as well, which in turn may include many individual partners.

In 1958, the primary unincorporated business entity was the partnership, which was a contract between and among individuals who both owned and controlled the business. Corporations were juridical entities that were a creation of state law. The 1958 amendments to 28 USC §1332, codifying the Supreme Court decision in *Louisville, Cincinnati & Charleston R.R. v. Letson,* 43 U.S. 497 (1844) (holding that companies were legal entities separate and apart from their members and owners) provided that corporations were both citizens of the state of incorporation and the state where they had their principal place of business.

However, since that time, many states have enacted the 1994 revisions to the Uniform Partnership Act which recognized that a general partnership was a separate entity and not merely an aggregation of its members. In addition, many states have enacted statutory schemes permitting hybrid business forms such as LLCs, limited partnerships, professional corporations, limited liability partnerships, and multi-state general partnerships.

The Supreme Court considered the diversity statute in the context of a non-corporate business entity in *Carden v. Arkoma Assocs.,* 494 U.S. 195 (1990). There, the Court resisted the invitation to expand 28 USC §1332(c) to unincorporated artificial entities and, instead, passed such potential revision of diversity jurisdiction to Congress. *Carden*, 494 U.S. at 189, 196. In this respect, the Court, in holding that every constituent member of a limited partnership needed to be considered for complete diversity to exist, followed its prior holding in *Steelworkers v. R.H. Bouligny Inc.,* 382 U.S. 145 (1965), which held that a labor union was not itself a citizen for diversity purposes, but that citizenship was to be determined on the basis of its individual members.

According to the ABA Report supporting Resolution 103B, every Court of Appeals that has considered the status of LLCs for diversity purposes has followed the example of the Seventh Circuit in *Cosgrove v. Bartolotta* 150 F.3d 729 (7th Cir. 1998), which held that, pursuant to *Carden*, members of a non-corporate business entity must be considered individually for diversity purposes until Congress provides otherwise and that, given the functional similarity between LLCs and LPs, *Carden* also applies to LLCs.[1] *Cosgrove*, 150 F.3d at 731.[2] *Accord*, *Zambelli Fireworks Mfg. Co.*

[1] The 10th Circuit has in the meantime also confirmed this approach. *See Siloam Springs Hotel, L.L.C. v. Century Sur. Co.*, 781 F.3d 1233, 1236-37 (10th Cir. 2015) (holding that LLCs are non-corporate artificial entities whose citizenship is determined by considering all of the entity's members).

[2] The Seventh Circuit also held, at approximately the same time as the decision in *Cosgrove,* that each name in a Lloyd's Syndicate needed to be considered to determine diversity. *Indiana Gas Co. v. Home Insurance Co.,* 141 F.3d 314 (7th Cir.), c*ert. denied*, 525 U.S. 931 (1998). The Second Circuit, applying a different analysis, came to the same conclusion as well, although it did suggest a path by which diversity jurisdiction could be maintained. *E.R. Squibb & Sons, Inc. v. Acc. & Cas. Inc. Co.* 160 F.3d 925 (1998).

v. Ward, 592 F.3d 412 (3d Cir. 2010).

Recent case law has underscored the necessity of Congressional action. In *Lincoln Benefit Life Co. v. AEC Life, LC*, 800 F.3d 99 (3d Cir. 2015), the Third Circuit ruled that a plaintiff need only allege federal diversity of a defendant LLC on "information and belief", and allege that the defendant LLC is not a citizen of the same state as the plaintiff. *Id.* at 106-07. However, the allegation must be based on a reasonable inquiry and be made in good faith. If the defendant mounts a factual challenge, the Third Circuit held that limited jurisdictional discovery would be permitted.[3]

In so holding, the Third Circuit took the unusual step of issuing a unanimous concurrence along with the unanimous decision. In the concurrence, the panel urged recognition of business entities such as LLCs to be the functional equivalent to corporations. The Third Circuit did not address this plea to Congress, but rather to the Supreme Court. It implored the latter to reverse the course it took in *Carden*, given the complexity of establishing jurisdiction for modern business organizations such as LLCs. *Id.* at 111-13.

Instead of the approach taken in *Carden*, the Third Circuit urged the Supreme Court to return "to the path it started to mark for unincorporated business associations in *Puerto Rico v. Russell & Co.,* 288 U.S. 476 (1933)," a case that was decided contemporaneously with the

[3] Recent district court decisions handed down subsequent to *Lincoln Benefit Life* demonstrate the continuing complexities that plague allegations of federal diversity jurisdiction regarding LLCs. In *Bissell v. Graveley Bros. Roofing Corp.*, No. CV 15-04677, 2016 WL 3405455, at *7 (E.D. Pa. June 21, 2016) the court held that the plaintiff had conducted a reasonable investigation into the identities of a defendant LLC's members by *inter alia* consulting court filings and other public records and granted jurisdictional discovery. However, in *Plantation Bay LLC v. Stewart Title Guaranty Company*, 2015 U.S. Dist. LEXIS 165, 753 (D.N.J. Dec. 10, 2015), the District of New Jersey held that the relaxation for pleading standards in *Lincoln Benefit Life* did not extend to pleading jurisdiction on behalf of a plaintiff LLC, and the plaintiff's complaint was dismissed with permission to re-plead. Generally, courts will allow the plaintiff to amend even if the operative pleadings fail to provide any basis from which the court can infer the prerequisite good faith inquiry and even if plaintiff entirely fails to plead citizenship. *See Wright v. Chesapeake Appalachia LLC,* 2015 U. S. Dist. LEXIS 126690 (M.D. Pa. Oct. 7, 2015); *Miller v. Native Link Constr., LLC*, No. CV 15-1605, 2016 WL 4701454, at *7 (W.D. Pa. Sept. 8, 2016).

promulgation of the Federal Rules of Civil Procedure.[4] *Lincoln Benefit Life,* 800 F.3d at 111. In *Russell*, the Supreme Court analogized the Puerto Rican entity known as the *sociedad en comandita* to a corporation for jurisdictional purposes, even though the *sociedad en comandita* was an unincorporated business association. The Supreme Court reasoned that, under the Codes of Puerto Rico, the entity had a personality distinct from that of its members, and was therefore a juridical person. *Id.* at 112-113. Citing scholarly articles critical of *Carden's* refusal to employ a functional analysis of modern business entities, thereby foreclosing federal courts to a wide array of modern business organizations (many of these articles were also cited by the ABA Report), the Third Circuit urged the Supreme Court to return to *Russell's* approach. *Id.* at 113.

DEVELOPMENTS AFTER PUBLICATION OF THE RESOLUTION

In its most recent decision on diversity jurisdiction in the context of unincorporated entities, *Americold Realty Trust v. ConAgra Foods, Inc.*, 136 S. Ct. 1012 (2016), the Supreme Court reaffirmed *Carden*. At issue was the citizenship of a real estate investment trust ("REIT") organized under Maryland law. While diversity jurisdiction had not been challenged before the district court which ruled on the merits, the Tenth Circuit raised the question on appeal. It held that the REIT's citizenship, similarly to other unincorporated entities, should be determined by examining its members' citizenship and, since no such information was on record, found that subject-matter jurisdiction had not been established. *Id*. at 1017.

The Supreme Court affirmed by unanimous decision, holding that Maryland REITs, as unincorporated entities, possess the citizenship of all their members pursuant to *Carden*. *Americold*, 136 S. Ct. at 1016. For purposes of assessing diversity jurisdiction in this context, the Court considered REIT-shareholders to be members of the REIT, comparing them to shareholders of joint-stock companies or partners of limited partnerships. *Id*.

[4] The Third Circuit found that the Federal Rules had relaxed the stringent pleading requirements for jurisdiction previously established by Supreme Court precedent. *Lincoln Benefit Life*, 800 F.3d. at 106, n.24.

In its decision, the Court expressly rejected the National Association of Real Estate Investment Trusts' invitation, submitted by *amicus* brief, to treat non-corporate entities like corporations for jurisdictional purposes. *Id.* at 1017. Instead, the Court reaffirmed "that it is up to Congress if it wishes to incorporate other entities into 28 U.S.C. §1332(c)."

ANALYSIS

In light of the Supreme Court's decisions in *Carden* and *Americold*, congressional action is necessary to remedy the jurisdictional problems new forms of business organizations face under the diversity statute. We therefore concur with ABA Resolution 103B.

The only minority view in the ABA Report was that the change could lead to an increase in federal litigation. However, the Committee agrees with the ABA that the replacement of uncertainty with a more workable rule is far more desirable than any burden imposed by an increase in federal cases.[5]

The current differential treatment of corporations and LLCs for jurisdictional purposes is questionable. As the Supreme Court noted in *Carden*, it could "validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization." *Carden*, 494 U.S. 185, at 196.

Thus, the current statute may result in diversity jurisdiction being destroyed by an LLC's nominal member (or sub-member) in an otherwise completely diverse case. The Second Circuit's assessment in *Bayerische Landesbank, New York Branch v. Aladdin Capital*, 692 F.3d 42 (2012), shows how a court, at the very least, must expend resources to determine if diversity jurisdiction exists when an LLC is a party. In that case, the court had to determine whether federal diversity jurisdiction existed between plaintiff Bayerische Landesbank, a German corporation, and defendant Aladdin Capital Management, a Delaware LLC with a principal place of business in

[5] In addition, the issue of diversity jurisdiction may arise on appeal, after substantial litigation. *See, e.g., Catskill Litig. Trust v. Park Place Entm't Corp.*, 169 F. App'x 658, 659 (2d Cir. 2006) (case remanded to District Court on appeal after it had not properly addressed diversity jurisdiction).

Connecticut. Aladdin's sole member, Aladdin Capital Holdings LLC, in turn was made up of ten members, of which only one—a company incorporated in Delaware, with a principal place of business in Tokyo, Japan—had non-domestic ties. *Id.* at 48-49.

Orchid Quay, LLC v. Suncor Bristol Bay, LLC, 178 F. Supp. 3d 1300 (S.D. Fla. 2016), was dismissed for lack of subject-matter jurisdiction because of one of the plaintiff LLC's many sub-members. Plaintiff's sole member was a limited partnership whose partners included several unincorporated entities which, in turn, were made up of numerous members or partners, including further unincorporated entities. *Id.* at 1302. Since one of the numerous sub-members, the California Public Employees' Retirement System, was an arm of the state of California and thus stateless, complete diversity between the parties was destroyed. *Id.* at 1305. The court held that while courts should generally disregard a nominal party's citizenship, "the Supreme Court's decision in *Carden* forecloses any argument that the citizenship […] of a member of an unincorporated entity can be ignored." *Id.*

Both *Bayerische Landesbank* and *Orchid Quay* are illustrative of the general disconnect between the jurisdictional framework of 28 U.S.C. §1332 and modern business realities. When the Supreme Court held in *Russell*, 288 U.S. 476, that the Puerto Rican *sociedad en comandita*, like the U.S. corporation, was an independent juridical person, it relied on a number of criteria inherent to the *sociedad*, *e.g.,* the ability to contract, own property and transact business, to sue and be sued in its own name and right, its creation through articles of association, as well as the fact that its members are not primarily liable for the *sociedad's* acts and debts. *Id.* at 448-49. These criteria also apply to LLCs. By focusing on the citizenship of sub-members who are entirely disconnected from the action at hand, the current jurisdictional framework disregards who the true litigants are. The ABA's proposed amendment of 28 USC §1332(c) would remedy these deficiencies.

Under the current 28 U.S.C. §1332, complications frequently arise in litigation involving foreign entities, where it is often not readily apparent whether such entities should be classified as incorporated or unincorporated under U.S. law. By way of example, *White Pearl Inversiones S.A.*

(Uruguay) v. Cemusa, Inc., 647 F.3d 684 (7th Cir. 2011), concerned a Uruguayan S.A. that had initially pled citizenship as if it were a U.S. corporation. The Seventh Circuit criticized both parties' counsel for simply assuming corporate equivalency and wrote that, "[i]f it is hard to determine whether a business entity from a common-law nation is equivalent to a 'corporation, it can be even harder when the foreign nation follows the civil-law tradition." *White Pearl*, 647 F.3d at 686. Although the Seventh Circuit, after a thorough analysis, determined that complete diversity was established, it also noted that the attorneys "took needless risk, and wasted a lot of the judges' time, by ignoring the proper treatment of foreign business entities until the case reached the court of appeals." *Id.* at 687.

While some Courts have relied on common characteristics between foreign and US corporate forms when determining diversity jurisdiction,[6] there is no clear or uniform analytic paradigm by which to assess whether a foreign entity should be treated as incorporated or unincorporated for purposes of diversity jurisdiction. The ABA's proposed amendment of 28 USC §1332(c) would alleviate substantial uncertainties in that regard and ensure a federal forum for the growing amount of international business disputes in this new era of globalization.

CONCLUSION

Accordingly, the Committee supports the ABA Resolution calling for Congress to amend 28 USC §1332(c) and extend to unincorporated associations the same citizenship test as corporations for diversity purposes.

[6] *See*, e.g., *BouMatic, LLC v. Idento Operations, BV*, 759 F.3d 790 (7th Cir. 2014) (Dutch B.V. was found to be similar to a close corporation, taking into account "standard elements of personhood" and the ability to hold and sell shares); *InStep Software, LLC v. InStep (Beijing) Software Co.*, No. 1:11-CV-03947, 2012 WL 1107798 (N.D. Ill. Mar. 29, 2012) (the citizenship of partners to a sino-foreign equity joint venture was irrelevant for purposes of diversity jurisdiction because the entity was regarded as an independent juridical person under Chinese law).