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Citizenship of LLCs and Subject Matter Jurisdiction in the Federal Courts: A Serious Concern Begging for Resolution

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Introduction

Despite the widespread use of the LLC form, many practitioners fail to understand key distinctions in the law between LLCs and corporations. In particular, as many commentators have warned, legal ''citizenship'' of an LLC is determined not from its state of organization or principal place of business, as with a corporation, but rather, like other unincorporated associations, turns on the citizenship of each of its members. Practitioners frequently fail to recognize this distinction when initiating federal lawsuits and these mistakes can have disastrous consequences. In many cases the result is a dismissal for lack of jurisdiction after years of wasted litigation. In this article, we address the implications of mispleaded LLC citizenship for the broader federal court system. Based upon a preliminary survey of federal court filings, we believe that a significant portion of the diversity-based, non-MDL lawsuits involving LLCs are premised on a complaint or notice of removal that does not properly set forth the LLC's citizenship, therefore calling into question the federal court's subject matter jurisdiction over the dispute. We believe that improperly pleaded cases involving LLCs account for thousands of cases filed in federal courts each year, representing a significant drain on limited judicial resources to the extent the federal courts are adjudicating claims that are not properly before them.

This issue calls for a legislative or judicial solution. We briefly review here some recent attempts by courts and academics to effect such a change, along with the Supreme Court's recent decision in *Americold Realty Trust v. ConAgra Foods, Inc.*, 136 S. Ct. 1012 (2016),

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which strongly suggest that such a change will require legislative intervention.

Background: Diversity Jurisdiction for LLCs

With respect to common business litigation including contract and tort disputes arising solely from state law, federal court jurisdiction is limited to ''civil actions where the matter in controversy exceeds the sum or value of $75,000, exclusive of interest and costs, and is *between. . . [c]itizens of different States*.'' 28 U.S.C. § 1332(a) (emphasis added); *see also id.* at § 1441 (permitting removal to federal court of cases that could have originally been brought in federal court including under § 1332); U.S. Const. art. III, § 2, cl. 1. The definition of a corporation's ''citizenship'' has evolved over time. *Compare Bank of U.S. v. Deveaux*, 9 U.S. 61, 92 (1809) (concluding that the citizenship of a corporation turned on the citizenship of a corporation's president, directors, and shareholders) *with Louisville, Cincinnati & Charleston R.R. Co. v. Letson*, 43 U.S. 497, 558 (1844) (holding that corporations doing business in their state of incorporation would be deemed citizens of that state regardless of where the individuals comprising the entity resided). In 1958, Congress resolved the issue by amending 28 U.S.C. § 1332(c) to read that ''a corporation shall be deemed to be a citizen of any state by which it has been incorporated and of the State where it has its principal place of business.'' Pub. L. No. 85-554, § 2, 72 Stat. 415 (1958).

In 1990, the Supreme Court held in *Carden v. Arkoma Associates* that the definition of corporate citizenship contained in 1332(c) does not apply to a general partnership; rather, the entity is a citizen of each of the states in which one of its members is a citizen. 494 U.S. 185, 195-96 (1990). *Carden's* analysis made clear that all unincorporated entities would be deemed citizens of the states of each of their members, regardless of how much the structure resembled that of a corporation. Nearly every federal court of appeals has subsequently applied the *Carden* reasoning to LLCs.

Improperly Pleaded LLC Litigation Constitutes a Substantial Portion of the Federal Civil Docket

Our previous analysis of this issue addressed the troubling frequency with which counsel for an LLC pleads diversity jurisdiction as if the entity were a corporation, and highlighted some noteworthy instances in which courts discovered the lack of federal jurisdiction late in a litigation; in some instances, on appeal after a jury verdict. *See, e.g., Belleville Catering Co. v. Champaign Mkt. Place, L.L.C.*, 350 F.3d 691 (7th Cir. 2003) (dismissing case on appeal after trial and jury award of $220,000 and ordering both parties' counsel to perform any additional services necessary to bring the dispute to resolution at no charge to their clients). This problem persists in part because even where parties *are* aware that jurisdiction derives from the citizenship of an LLC's members, they may not realize that the citizenship rules are ''iterative,'' such that where a member of an LLC is itself an LLC, LLP, or partnership, citizenship for that entity is also determined by the citizenship of its members. *See, e.g., D.B. Zwirn Special Opportunities Fund, L.P. v. Mehrotra*, 661 F.3d 124, 126-27 (1st Cir. 2011); *see also Hart v. Terminex Int'l*, 336 F.3d 541 (7th Cir. 2003) (dismissing case for want of jurisdiction after eight years of litigation). Moreover, because the issue implicates subject matter jurisdiction, the citizenship of the parties generally must be affirmatively established in the pleadings and may not be pleaded negatively, *i.e.* by stating that the parties are *not* citizens of the same state. *D.B. Zwirn Special Opportunities Fund, L.P.*, 661 F.3d at 126; *see also Cameron v. Hodges*, 127 U.S. 322 (1888). These rules render some large multi-member LLCs citizens of every state and therefore non-diverse in any federal court. They also preclude certain *types* of litigation that necessarily include the business entity as a party, such as derivative actions, from utilizing diversity jurisdiction when they involve LLCs. *See* Carter G. Bishop and Daniel S. Kleinberger, *Diversity Jurisdiction for LLCs? Basically, forget about it*, Business Law Today, Sept./Oct. 2004, at 31.

A. Methodology

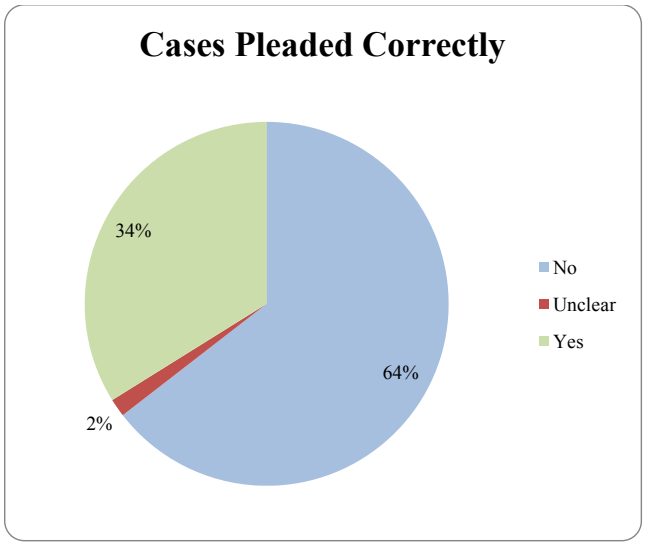
Given these potentially serious implications, we sought to determine the pervasiveness of the issue. We searched commercially available databases for diversity-based cases involving an LLC filed in 2013 (2013 was chosen as a recent year but one in which most of the cases filed will have terminated by now). We identified 26,765 such cases, representing just under 9% of the 292,212 civil cases and over a quarter of the 96,428 diversity cases filed in federal courts in 2013. This number, however, includes several large Multidistrict Litigation (''MDL'') matters, each consisting of hundreds or thousands of individual suits filed throughout the nation and transferred to an MDL docket for pretrial purposes. We identified several of these large MDLs and removed them from our dataset, resulting in 13,509 non-MDL diversity cases.

We then began a review of a random sample of the resulting cases to determine whether the citizenship of the LLC or LLCs is correctly pleaded in the initiating documents (*i.e.*, that the complaint and/or notice of removal adequately establish the citizenship of each of the LLC's members and, when those members are themselves LLCs or partnerships, that the citizenship of their members is identified).

B. Survey Results and Analysis

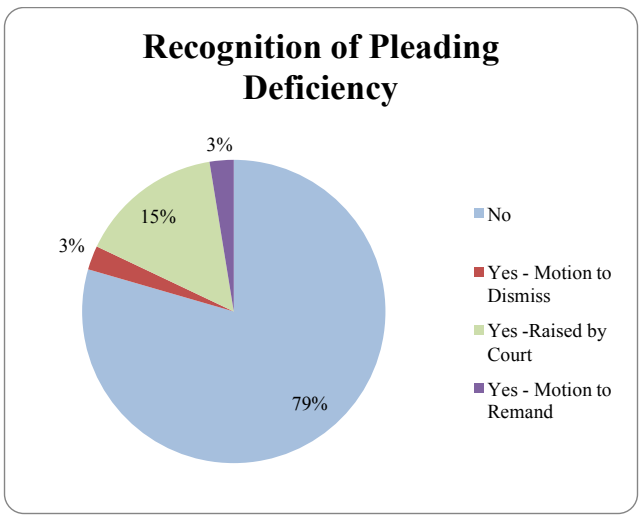
At present, we have surveyed the pleadings and dockets of 82 such cases; just under two-thirds of these cases were pleaded or removed improperly according to the criteria laid out above.

This percentage extrapolates to roughly 8500 cases filed in the federal courts in 2013 potentially relying on legally deficient statements of subject matter jurisdiction. Due to the small sample size included in our survey, this figure is subject to a relatively large margin of error of +/- 11% at the 95% confidence interval (a standard threshold used in assessing statistical significance). Even with this caveat, however, it is clear that a substantial portion of such cases are deficiently pleaded. In fact, our findings suggest that approximately 3% percent of all cases filed 2013 and roughly one in ten diversity cases may be based on deficient initiating documents. While these numbers may seem small compared to the entire federal docket, 8,500 cases exceeds the total number of civil cases filed in the district courts of the First Circuit in 2013 (6,685); in fact, only six federal districts had more civil cases filed that year. *See* United States Courts, Statistical Tables for the



Federal Judiciary – December 2013, Tbl C-1 *available at* http://www.uscourts.gov/statistics-reports/statistical-tables-federal-judiciary-december-2013. Another way to conceptualize the impact on the federal judiciary is that, nationwide, the average district court judge oversaw 594 cases; thus these mispleaded LLC cases account for more than the entire caseload of fourteen federal judges. *See* UNITED STATES COURTS, FEDERAL COURT MANAGEMENT STATISTICS, *Federal Court Management Statistics – Profiles* (Dec. 31, 2013), *available for download at* http://www.uscourts.gov/statistics-reports/federal-court-management-statistics-december-2013. At a time when most analysts recognize the dangers caused by our overworked and understaffed judiciary, the removal of this quantity of possibly erroneously filed cases represents an obvious step to potentially reduce the overall federal docket.

While it is possible that many of these cases could ultimately be adequately repleaded, in nearly four-fifths of the deficiently pleaded cases we reviewed, there was no evidence that the deficiency was ever identified or resolved.



This analysis suggests that over the last several years, federal courts have resolved many of thousands cases that they lacked clear jurisdiction to adjudicate. A related concern is the possibility that final judgments obtained in these cases would be subject to attack as void under Fed. R. Civ. P. 60(b)(4). While the issue is beyond the scope of this article, collateral attack on the potentially thousands of judgments rendered in absence of subject matter jurisdiction would present serious challenges to the finality of federal judgments and further clog federal dockets.

Potential Solutions for the Widespread Mispleading of LLC Cases

There are two principal ways to address the consequences of this all too frequent error: police LLC jurisdiction more tightly or amend the law to conform to practitioners' (presently incorrect) understanding of LLC pleading requirements. As noted above, the former approach, *i.e.*, better screening of judicial dockets for improperly filed cases, would have a salutary effect on the overloaded federal docket, which may counsel in favor of that approach.

As we have detailed in prior work, parties may be unwilling or even unable to voluntarily disclose the citizenship of their members and similarly unwilling to draw a court's attention to deficient pleadings. Thus, individual districts and judges are best positioned to take immediate steps to ensure that the citizenship of LLCs is properly pled in all diversity cases. Some districts have adopted local rules or standing orders that specifically require that LLCs in diversity cases disclose the citizenship of their members. *See, e.g.*, U.S. DIST. COURT, DIST. OF CONN., Form 26(f) Report, *Standing Order on Removed Cases* (corrected Jan. 12, 2012), http://ctd.uscourts.gov/sites/default/files/Revised%20Local%20Rules%204-1-16.pdf; D. Or. L.R. 7.1 (requiring ''In diversity actions, any party that is a limited liability corporation (L.L.C.), a limited liability partnership (L.L.P.), or a partnership must, in the disclosure statement required by Fed. R. Civ. P. 7.1, list those states from which the owners/members/partners of the L.L.C., L.L.P., or partnership are citizens. If any owner/member/partner of the L.L.C., L.L.P., or partnership is another L.L.C., L.L.P., or partnership, then the disclosure statement must also list those states from which the owners/members/partners of the L.L.C., L.L.P., or partnership are citizens.''); D. Mo. L.R. 3-2.09(B) (similar). Clear local rules, forms, or orders can be readily adopted by all districts and courts as a means to reduce the burden imposed by the presence of improperly pleaded cases in federal court. Of course such procedures are only helpful if the courts are willing to enforce compliance.

The most recent revisions to the Federal Rules of Civil Procedure have deprived the judiciary for one avenue of addressing this problem on a national scale. Prior to the 2015 amendments, Rule 84 established certain exemplar forms to be published in an appendix to the Federal Rules to assist parties in complying with the pleading and motion requirements. Form 7 purported to describe a legally adequate statement of jurisdiction; that form, however, addressed natural persons and corporations and failed to advise parties of the appropriate manner for pleading jurisdiction of LLCs. While the forms were decidedly precatory, a revised form might have reinforced the means of adequately pleading an LLC's citizenship (indeed, the form's failure to address LLC citizenship may well have led to some of the confusion we see now). Regardless, these forms were eliminated after 2015, due in part to the ''many excellent al-

ternative sources for forms, including the website of the Administrative Office of the United States Courts, the websites of many district courts, and local law libraries that contain many commercially published forms.'' Fed. R. Civ. P. 84 advisory committee's note to 2015 amendment. The Administrative Office of the United States Courts currently has no analog to former Form 7, but the creation and promotion of such a form addressing LLC citizenship requirements could help ameliorate the problem of deficient pleading of citizenship in diversity cases and alleviate some of the burden of jurisdictionally deficient cases.

The alternative approach is to amend the statutory definition of citizenship for LLCs to match that of corporations. While this change would not alleviate the burden on the federal dockets, it would avoid situations in which lack of jurisdiction is discovered late in a litigation. Thus, as this issue has grown in prominence, so too have calls to amend the applicable rules to define LLCs (like corporations) as citizens of their states of organization and principal place of business.

As described above, the Supreme Court's citizenship jurisprudence has evolved over the years. Thus, while *Carden* currently embraces a formalist approach requiring that any changes in the definition of citizenship be effected through legislation, this has not always been the case. *See People of P.R. v. Russell & Co.*, 288 U.S. 476, 480-82 (1933) (adopting a functional approach to conclude that a ''sociedad en comandita'' should be treated as a corporation for purposes of diversity citizenship). This history has led at least one appellate court to explicitly request that the Supreme Court reconsider and reject its *Carden* jurisprudence and adopt a functional test that would render LLCs subject to the same citizenship test as corporations. *Lincoln Benefit Life Co. v. AEI Life, LLC*, 800 F.3d 99, 113 (3d Cir. 2015). Recently, however, the Supreme Court likely foreclosed this possibility in *Americold Realty*. There, Justice Sotomayor, speaking for a unanimous Court, reaffirmed the *Carden* approach, concluding that ''it is up to Congress if it wishes to incorporate other entities into 28 U.S.C. § 1332(c)'s special jurisdictional rule.'' *Americold Realty*, 136 S. Ct. at 1017. Thus, revision of the law, if any, will need to come from Congress.

At its 2015 Annual Meeting, the American Bar Association House of Delegates called for just such a change, urging Congress to amend the diversity statute to provide that unincorporated entities be treated like their corporate analogues. Aveni, Litigation News October 30, 2015 ABA House of Delegates Urges Change to Diversity Statute. available at https://apps.americanbar.org/litigation/litigationnews/top_stories/103015-diversity-unincorporated-business.html. Given the findings of our review, coupled with the lack of any likely relief from the Supreme Court itself, a legislative change along these lines warrants serious consideration.

Conclusion

Many analysts have noted that the citizenship standards for LLCs are poorly understood by practitioners and operate as a potential trap for the unwary. Our own preliminary findings suggest that the problem operates as a potentially significant drain on scarce judicial resources. The seriousness of this problem strongly counsels for individual federal districts and judges to pay close attention to the pleading of LLC citizenship to eliminate erroneously filed cases. Furthermore, these findings provide support to those concerned about the divergence between parties' expectations and the operation of federal procedure to push for a legislative remedy.