

CITIZENSHIP OF LLCs AND SUBJECT MATTER JURISDICTION IN THE FEDERAL COURTS: A TRAP FOR THE UNWARY

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Nearly unheard of prior to the 1990s, the Limited Liability Company (LLC) quickly grew to become the dominant organizational form for new business ventures in the United States by a nearly two-to-one margin.¹ In Delaware, a popular venue for establishing new business entities, that margin rose to over three-to-one.² This rapid growth is generally attributed to the LLC's combination of favorable tax treatment, flexibility of governance structure, and limited liability for owners.³ Indeed, the LLC has proved popular for businesses of all types and sizes, including wholly-owned subsidiaries.⁴

Amidst this meteoric growth, com-

mentators have remarked on the lack of attention to the legal implications of the rising dominance of the LLC business form.⁵ Ironically, given that the popularity is partly predicated on the belief that the LLC offers litigation-related advantages, one issue that is not widely understood is the manner in which the citizenship of an LLC is determined for federal court jurisdiction purposes. As we explain below, citizenship of an LLC will ultimately turn on the citizenship of each of its members. Thus, in extreme cases, large, multi-member LLCs may not be able to establish the complete diversity of citizenship that is often necessary to file a case in, or remove it to, federal court regardless of the citizenship of the opposing party. Moreover, to establish diversity jurisdiction, an LLC must be prepared to disclose the citizenship of each of its members. This could be unattractive or impossible for confidentiality or other business reasons.

Diversity Jurisdiction Requires Consideration of Every Member of an LLC

As first-year law students learn, federal courts are courts of limited jurisdiction permitted to hear cases only if authorized by the Constitution and federal law. With respect to common business litigation including contract and tort disputes arising solely from state law, the basis for federal court jurisdiction arises under so-called "diversity jurisdiction." Diversity jurisdiction confers federal jurisdiction in



cases between citizens of different states.⁶ Congress has further restricted this jurisdiction, as is its right, 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.”⁷

Thus, assuming that the amount-in-controversy threshold is met, federal jurisdiction turns on the citizenship of the parties. While a relatively straightforward proposition for natural persons, it becomes more complicated when dealing with entities such as corporations and LLCs. Indeed, more than 200 years ago, the Supreme Court initially concluded that the citizenship of a corporation turned on “the character of the individuals who compose the corporation” (*i.e.*, the citizenship of the president, directors and shareholders).⁸ Later, the Court reconsidered this approach and held that corporations doing business in their state of incorporation would be deemed citizens of that state regardless of where the individuals making up the entity resided.⁹ This issue was only firmly resolved in 1958 by amendment to § 1332(c), which established that “a corporation shall be deemed to be a citizen of every State and foreign state by which it has been incorporated and of the State or foreign state where it has its principal place of business.”

In 1990, the Supreme Court held in *Carden v. Arkoma Associates* that a general partnership is a citizen of each of the states in which one of its member is a citizen.¹⁰ Thus, in a suit between an Arizona-organized partnership and citizens of Louisiana, the federal court in Louisiana lacked subject matter jurisdiction over the case because one of the limited partners of the plaintiff partnership was also a citizen of Louisiana.¹¹ The Court’s reasoning made clear that this analysis would

extend to all unincorporated entities regardless of how much their structure resembled that of a corporation.¹² Nearly every federal court of appeals has subsequently applied the *Carden* reasoning to LLCs.¹³ Thus, at this point it is clear that that citizenship of an LLC is determined by the citizenship of each of its members.

Failure to Recognize this Rule can be Costly

Despite the clarity of the jurisprudence, litigants regularly predicate diversity jurisdiction on an LLC’s state of organization as they would a corporation under § 1332(c). This may well be due to the perceived similarities between LLCs and corporations. In any event, this mistaken basis for jurisdiction has led to numerous costly situations in which a case proceeds in federal court without either the parties or the judge realizing that the federal courts are not competent to hear the dispute. In many instances, this realization does not occur until the case has reached the court of appeals, sometimes after the parties have tried the case to a verdict.

For example, the jurisdictional defect in *Belleville Catering Co. v. Champaign Market Place, LLC*¹⁴ was not discovered until after trial and a jury award of \$220,000 in favor of the defendant/counter-claimant.¹⁵ The appeals court, recognizing that the complaint improperly failed to disclose the identity and citizenship of the members of the defendant LLC, sua sponte ordered jurisdictional briefing that revealed that the plaintiff was incorporated in Illinois and the defendant LLC was composed of Illinois members, thereby destroying diversity and any basis for jurisdiction in federal court. The court, decrying the “litigants’ insouciance towards the requirements of federal jurisdiction,” ordered the case dis-

missed and both parties' counsel to perform any additional services necessary to bring the dispute to resolution at no charge to their clients.¹⁶

Additional Considerations Complicate the Analysis

Understanding the jurisdictional treatment of LLCs does not end with recalling that citizenship cannot be established on the basis of the state of organization. Rather, two additional factors add to the complexity of adequately establishing subject matter jurisdiction in cases involving LLCs: (i) the citizenship rules are "iterative"; and (ii) a party must affirmatively establish its citizenship.

The citizenship rules for unincorporated entities are "iterative" in 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.¹⁷ For example, in *Hart v. Terminex International*,¹⁸ the Illinois-domiciled plaintiffs filed a product liability action against Dow Chemical and Terminex International Company LP. Dow removed the action to federal court on the basis of diversity, claiming that Terminex was a Delaware limited partnership and neither of the partners were citizens of Illinois. The case proceeded in litigation for seven years before it reached the U.S. Court of Appeals for the Seventh Circuit. On appeal, the Seventh Circuit demanded a complete statement of citizenship for Terminex and discovered that the chain of membership of that entity included Illinois corporations. Thus, after more than eight years of litigation, it was finally revealed that the parties were not completely diverse, and the court was forced to dismiss the action for want of jurisdiction.

Moreover, because diversity affects a federal

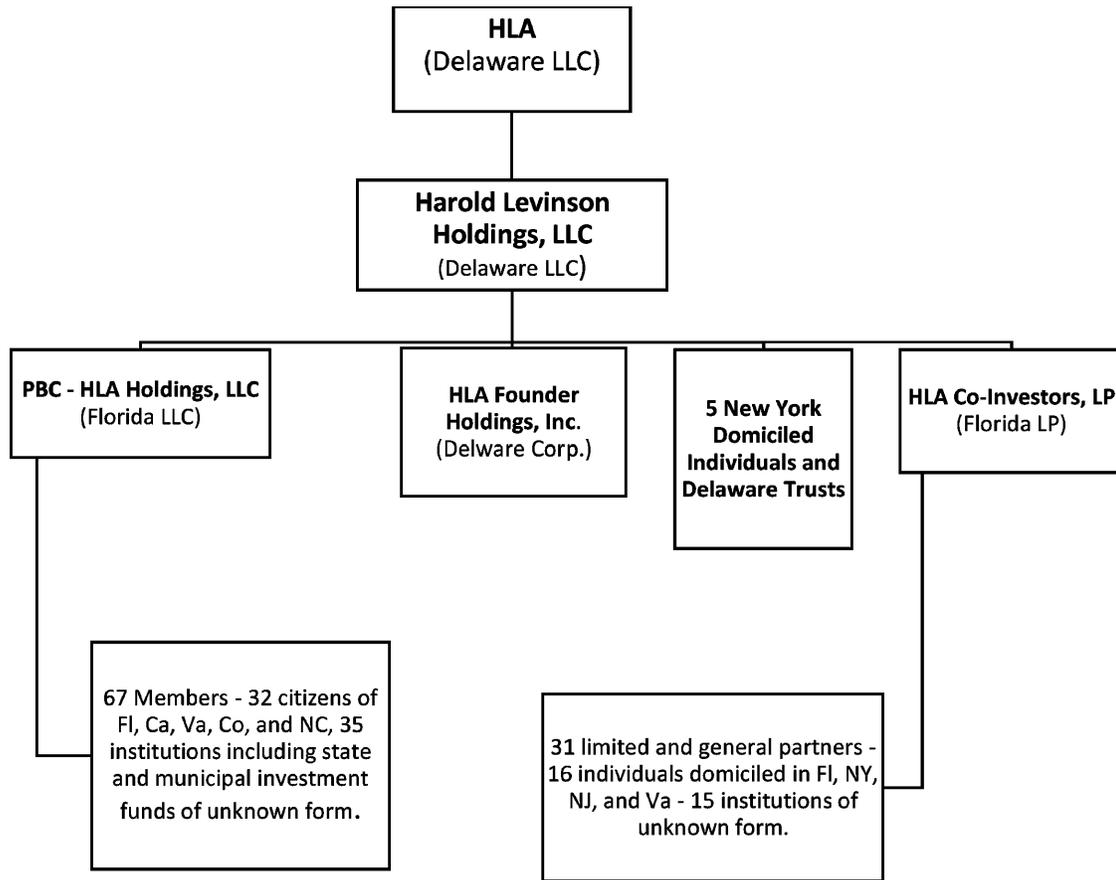
court's power to hear a case, the citizenship of the parties must be affirmatively established; it cannot be assumed, it cannot be stated in the negative, and any failure to identify citizenship precludes federal court jurisdiction.¹⁹ In *D.B. Zwirn*, the U.S. Court of Appeals for the First Circuit, recognizing an insufficient jurisdictional statement for the first time at oral argument, instructed the plaintiff LLC investment fund²⁰ to file an affidavit identifying its members. In response, the fund stated that according to its records "there were no members of the limited liability company who were citizens of" the defendant's home state. The First Circuit held this response insufficient, noting that the Supreme Court's 1888 decision in *Cameron v. Hodges*²¹ held that citizenship must be affirmatively established for jurisdictional purposes. The court explained that because certain persons are deemed "stateless" and invariably destroy diversity, statements of citizenship must affirmatively identify the citizenship of all parties.²² In light of the prior insufficient statement, the court gave the parties 15 days to file an adequate response. The parties settled the case before any such statement was filed.²³

In Extreme Cases, LLCs May Never Satisfy Diversity Jurisdiction

The two difficulties identified above came together in a recent case in the District of Massachusetts, *Garber Brothers Inc. v. Louis Troilo & Harold Levinson & Associates, LLC*.²⁴ A suit was filed in state court solely against defendant Troilo and removed to the District of Massachusetts. The Massachusetts-incorporated plaintiff then amended the complaint to add Harold Levinson and Associates, LLC (HLA) as an additional defendant, describing it as "a New

York limited liability company with a principal place of business” in New York.²⁵ The district court raised the jurisdictional issue sua sponte

and ordered HLA to identify the citizenship of each of its members. HLA submitted an affidavit describing the following organization structure:²⁶



HLA’s structure consisted of at least four organizational tiers, each containing some LLCs or LPs. Fatally for HLA, although each of the entities it could identify was diverse from the Massachusetts plaintiff (*i.e.*, was a citizen of some state other than Massachusetts), HLA was unable to determine the citizenship of more than 40 of its members. Nor was this due to counsel’s lack of effort in ascertaining the factual bases for jurisdiction. According to an affidavit from HLA’s Executive Vice President, the institutional entities were either unwilling or restricted by contract from disclosing the identities of their investor partners.²⁷ Based on HLA’s inability to affirmatively identify the citizenship of all of its members, the court, concluding that it lacked

subject matter jurisdiction, remanded the case to state court.²⁸

Practice Tips When Dealing with Jurisdiction over LLCs

The Supreme Court’s decision in *Carden* makes clear that regardless of how much LLCs may resemble or operate like corporations, the courts will continue to resolve citizenship questions by looking at each of the members of the entity.²⁹ One solution to this lack of access to the federal courts would be to amend 28 U.S.C. § 1332(c) to simplify the citizenship analysis of an LLC perhaps by adopting, in whole or in part, the rules applicable to a corporation, which is deemed a citizen of its state of organization and

principal place of business. *Carden* suggests that the Court would deem such a statutory revision adequate notwithstanding the constitutional dimensions of the jurisdiction issue.³⁰

Absent congressional action, however, federal jurisdiction for LLCs will remain a trap for the unwary. This is particularly true for large, multi-member LLCs, such as investment vehicles, that are likely to have many layers of artificial entities as members and value the confidentiality of the identity of those members. It may be true that some LLCs are established by sophisticated parties and counsel with the expectation that they may never satisfy diversity jurisdiction in federal court.³¹ However, for the practitioner who would like to preserve the option to litigate in federal court based on diversity of citizenship, we can offer a number of suggestions.

First, when initially drafting the LLC operating agreement, an attorney could consider using language that would require all members to identify their residency and that of their own members if required to establish citizenship for litigation purposes. There is authority supporting the view that such a disclosure to a court may be made under seal³² to alleviate any potential privacy concerns on the part of the LLC's members.

Second, when drafting a jurisdictional statement either in a complaint or a notice of removal, counsel must take reasonable steps to attempt to ascertain the citizenship of an LLC (whether the opposing party or one's own client). Counsel should budget adequate time and resources for this research and should consider looking at secretary of state filings, UCC filings, corporate reports and disclosures, and filings in other litiga-

tion involving the entity in question. Unlike for corporations, documents necessary to establish the jurisdiction of an LLC are often difficult to find publicly and, in many cases, are unobtainable by third parties. Nevertheless, failure to adequately investigate jurisdictional facts has been characterized as a violation of a party's obligations under Federal Rule of Civil Procedure 11,³³ which requires a party to conduct a reasonable inquiry into the truth of its factual contentions.³⁴

If taken to its logical conclusion, court enforcement of this approach could deprive a party of its right to litigate in federal court simply because the facts underlying its opponent's citizenship are nonpublic, preventing it from adequately alleging diversity jurisdiction.³⁵ However, where a party has taken reasonable steps, such as those outlined above, and is still unable to determine the citizenship of the adverse parties, all may not be lost. Two recent appeals court decisions in the Third and Ninth Circuits have held that in this situation, a party may comply with its Rule 11 obligations and survive a motion to dismiss by identifying the steps it took to ascertain jurisdiction and then alleging, "on information and belief," that the adverse parties are citizens of different states.³⁶ Noting that it would be transparently unfair to deny jurisdiction based on facts solely within an opponent's possession, both courts held that in the event the opponent then challenges jurisdiction, the district court would be permitted to order limited jurisdictional discovery.³⁷ The Third Circuit noted that this discovery should be relatively straightforward to accomplish: "in determining the membership of an LLC or other unincorporated association, a few responses to interrogatories will often suffice."³⁸ While this approach is practical and

logically compelling, it has only been adopted in two circuits³⁹ and only very recently; counsel should be cautious in relying upon it in other jurisdictions.

Conclusion

The LLC form of business organization has been widely embraced by lawyers and business people, but it can be highly disadvantageous if the organization is seeking diversity-based jurisdiction in the federal courts. Conversely of course, it can help defeat federal diversity jurisdiction if the LLC prefers to be in state court. Thus, if federal diversity jurisdiction is an important right that the business wishes to retain, careful consideration must be given at the time the entity is established as to whether the LLC is the best form for organizing the business.

For the LLC involved in a dispute, litigation counsel should be aware that the test for determining the citizenship of these entities involves an unintuitive and often cumbersome inquiry into the citizenship of every member of the LLC. Diligent counsel must be aware of these rules at the outset of litigation to avoid potentially wasting significant time (and their client's money) in federal court only to discover that jurisdiction was lacking all along.

ENDNOTES:

¹See Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 and How LLCs Were Taxed for Tax Years 2002-2006*, 15 Fordham J. Corp. & Fin. L. 459, 460 (2010).

²*Id.* at n.4.

³Howard M. Friedman, *The Silent LLC*

Revolution-The Social Cost of Academic Neglect, 38 Creighton L. Rev. 35, 36-40 (2004).

⁴*Id.* at 44.

⁵See John Tyler, et. al, *Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures*, 33 Quinnipiac L. Rev. 235, 271-72 (2015) (noting that "many practitioners and law professors bemoaned the 'dearth' of case law" early in the development of the form).

⁶U.S. Const. art. III, § 2, cl. 1.

⁷28 U.S.C. § 1332(a) (emphasis added). Note that § 1332 governs "original jurisdiction" of federal courts for civil actions. That is, actions originally filed by a plaintiff in federal court. Actions originally filed in state court but removed to federal court are governed by the federal removal statute, 28 U.S.C. § 1441. This statute permits removal for cases that could have been brought in federal court under "original jurisdiction" including under § 1332.

⁸*Bank of U.S. v. Deveaux*, 9 U.S. 61, 92 (1809).

⁹*Louisville, C. & C.R. Co. v. Letson*, 43 U.S. 497, 558, 2 How. 497, 11 L. Ed. 353, 1844 WL 5963 (1844).

¹⁰*Carden v. Arkoma Assocs.*, 494 U.S. 185, 195-96 (1990).

¹¹*Id.* at 186.

¹²*Id.* at 193-96.

¹³See, e.g., *D.B. Zwirn Special Opportunities Fund, LP v. Mehrotra*, 661 F.3d 124, 125 (1st Cir. 2011); *Johnson v. Smithkline Beecham Corp.*, 724 F.3d 337, 348 (3d Cir. 2013); *Intec USA, LLC v. Engle*, 467 F.3d 1038, 1041-42 (7th Cir. 2006); *GMAC Commercial Credit LLC v. Dillard Dep't Stores, Inc.*, 357 F.3d 827, 829 (8th Cir. 2004); *Segundo Suenos, LLC v. Jones*, 494 Fed. Appx. 732 (9th Cir. 2012); *Siloam Springs Hotel, L.L.C. v. Century Sur. Co.*, 781 F.3d 1233, 1234 (10th Cir. 2015).

¹⁴*Belleville Catering Co. v. Champaign Market Place, L.L.C.*, 350 F.3d 691 (7th Cir. 2003).

¹⁵See also *GMAC Commercial Credit LLC*,

357 F.3d at 829 (jurisdictional defect identified post-trial; appeals court remanded for jurisdictional discovery).

¹⁶*Id.* at 692.

¹⁷*D.B. Zwirn Special Opportunities Fund, LP*, 661 F.3d at 126-27.

¹⁸*Hart v. Terminex Intern.*, 336 F.3d 541 (7th Cir. 2003).

¹⁹*D.B. Zwirn Special Opportunities Fund, LP*, 661 F.3d at 126.

²⁰While the caption of the case indicates that D.B. Zwirn Special Opportunities Fund, L.P. was a limited partnership, at the time of removal it had become a limited liability company. *See* 661 F.3d at 125 n.2.

²¹*Cameron v. Hodges*, 127 U.S. 322, 8 S. Ct. 1154, 32 L. Ed. 132 (1888).

²²*D.B. Zwirn*, 661 F.3d at 126 (identifying United States citizens domiciled abroad, Indian tribes, and U.S. states as examples of entities that destroy diversity under 28 U.S.C. § 1332).

²³*See D.B. Zwirn Special Opportunities Fund, LP v. Mehrotra*, No. 11-1172, Document No. 0011630219 (1st Cir. Dec. 9, 2011).

²⁴*Garber Brothers Inc. v. Louis Troilo & Harold Levinson & Associates, LLC*, No. 1:15-cv-10148-IT, slip op. (D. Mass., June 25, 2015).

²⁵Am. Compl. at ¶ 5, *Garber Brothers Inc. v. Louis Troilo & Harold Levinson & Associates*, No. 1:15-cv010148 (D. Mass. Jan. 30, 2015).

²⁶Affidavit of Barry Feldman at 2-3, *Garber Brothers Inc. v. Louis Troilo & Harold Levinson & Associates*, No. 1:15-cv010148 (D. Mass. June 4, 2015).

²⁷*Id.*

²⁸*Garber Brothers Inc. v. Louis Troilo & Harold Levinson & Associates*, No. 1:15-cv010148, slip op. at 8 (D. Mass. June 25, 2015).

²⁹*Carden* at 195-96.

³⁰*Id.* at 196 (“Congress has not been idle. In 1958 it revised the rule established in *Letson*, providing that a corporation shall be deemed a citizen not only of its State of incorporation but

also ‘of the State where it has its principal place of business.’” (quoting 28 U.S.C. § 1332(c)).

³¹Moreover, regardless of the structure of the LLC, certain *types* of actions essentially preclude diversity jurisdiction when they involve LLCs. These include: suits between the LLC and one of its members; suits between members of an LLC in which the LLC is an indispensable party; and derivative suits brought on behalf of the LLC. *See* Carter G. Bishop and Daniel S. Kleinberger, *Diversity Jurisdiction for LLCs? Basically, forget about it*, *Business Law Today* (Sept./Oct. 2004).

³²*D.B. Zwirn Special Opportunities Fund, L.P. v. Mehrotra*, 661 F.3d 124, 125 (1st Cir. 2011).

³³*Belleville Catering Co. v. Champaign Market Place, L.L.C.*, 350 F.3d 691, 692-93 (7th Cir. 2003).

³⁴Fed. R. Civ. P. 11(b).

³⁵Of course there is nothing illegitimate about an LLC keeping that information confidential; there are many reasons why LLC members may wish not to disclose their identity and, indeed, such protections are one of the attractions of using an LLC structure.

³⁶*Lincoln Benefit Life Co. v. AEI Life, LLC*, No. 14-2660, 2015 U.S. App. LEXIS 15576 (3d Cir. Sept. 2, 2015); *Carolina Cas. Ins. Co. v. Team Equipment, Inc.*, 741 F.3d 1082 (9th Cir. 2014).

³⁷The Third Circuit’s decision in *Lincoln Benefit Life Co.* contains a “concurrence” joined by all three panel judges in which the court, noting Congress’s inaction, urges the Supreme Court to abandon its *Carden* jurisprudence and treat LLCs as citizens of the state in which they are organized. *Lincoln Benefit Life Co.*, 2015 U.S. App. LEXIS 15576, at *23 (Ambro, J., concurring).

³⁸*Lincoln Benefit Life Co.*, 2015 U.S. App. LEXIS 15576, at *18; *see also Carolina Cas. Ins. Co.*, 741 F.3d at 1088 (“If the defendants deny that the court has jurisdiction, the district court should evaluate the record created by the parties to determine its jurisdiction. Jurisdictional discovery may be appropriate.” (internal citations

omitted)).

³⁹See also *Medical Assur. Co., Inc. v. Hellman*, 610 F.3d 371,376 (7th Cir. 2010) (permit-

ting plaintiff to alleged the citizenship of natural persons on information and belief).

