

Congress Should Amend the Diversity Statute to Address LLCs

November 29, 2023

Parties must decide at the outset of their case whether to litigate in state court or federal court. Businesses often prefer to litigate in federal court for the highly qualified judges not subject to election, less-crowded dockets, and well-developed rules and case law for civil matters. But access to federal courts will vary depending on a party's corporate structure.

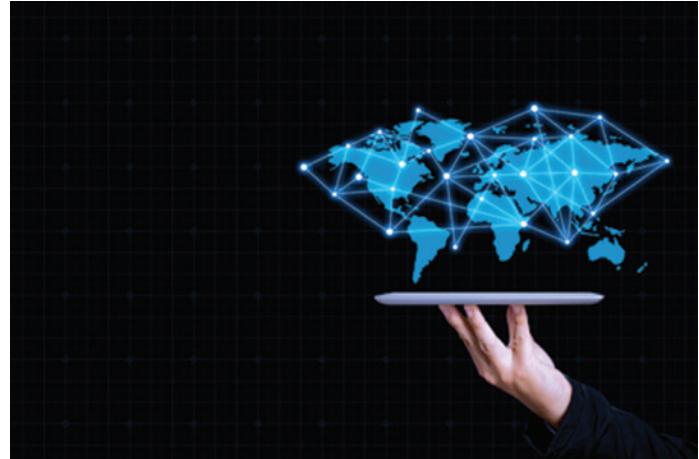
LLCs are an increasingly popular business form for a variety of reasons, including limited liability for its owners, easy start up, pass-through taxation, and flexible management. However, LLCs and other unincorporated entities face unique hurdles in meeting the criteria necessary for federal diversity jurisdiction because an LLC's citizenship is determined by the citizenship of its members. If, as is frequently the case, the members are also LLCs, the party's citizenship will be determined by the citizenship of its members' members, and so on until it traces back to a natural person or corporation.

Courts, academics, and practicing attorneys have long acknowledged that the method of determining LLC citizenship causes practical difficulties and leads to unfair outcomes. Congress should amend the diversity statute to treat LLCs similar to corporations. The citizenship of LLCs for the purposes of diversity jurisdiction should be determined by the LLC's principal place of business and the state under whose laws it is organized, not by the citizenship of each of its members.

Current Method

For a federal court to have diversity jurisdiction over an action, 28 U.S.C. §1332 requires that (i) the amount in controversy exceeds \$75,000; and (ii) the parties' citizenship is completely diverse (i.e., no plaintiff and defendant are citizens of the same state). When a party is a corporation, that corporation is "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." 28 U.S.C. §1332(c)(1).

The citizenship of an LLC is determined by the citizenship of each member of the LLC. See, e.g., *Agoliati v. Block*



865 Lot 300 LLC, 2023 WL 405769, at *2 (2d Cir. Jan. 26, 2023) ("for diversity purposes, a limited liability company takes the citizenship of all of its members") (quotation and citation omitted). If the LLC has a small number of members who are all individuals or corporations, that determination is relatively simple, and the analysis stops there. However, if any member is itself an LLC or a partnership, then the identity of each of the members of those entities must be traced and attributed to the party LLC. "There is no *de minimis* exception, and likewise there is no exception on the basis that determining citizenship is burdensome or impossible." *Federal Diversity Jurisdiction*, 2 Ribstein and Keatinge on Ltd. Liab. Cos. §13:7 (2023).

Determining LLC Citizenship

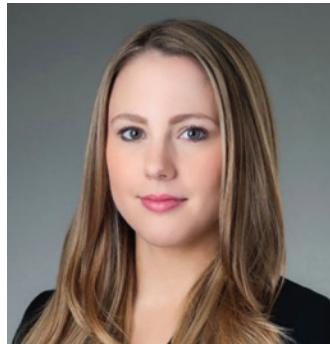
The practical implications of tracing back citizenship has long caused headaches for litigants, practicing attorneys, and courts.

For plaintiffs, determining a defendant LLC's citizenship may be difficult at the outset of the litigation. A plaintiff bringing an action in federal court and relying on diversity jurisdiction is required to plead facts demonstrating that diversity exists. Fed. R. Civ. P. 8(a)(1).

If a defendant is an LLC, the plaintiff must make a reasonable effort to determine the defendant LLC's citizenship. But "[t]he membership of an LLC is often not a matter



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of public record." *Lincoln Ben. Life Co. v. AEI Life, LLC*, 800 F.3d 99, 209 (3d Cir. 2015).

Indeed, the anonymity of LLC ownership is cited as one of its benefits. See, e.g., *Qin v. Deslongchamps*, 31 F.4th 576, 579 (7th Cir. 2022) (some states permit members to be anonymous, and even in states that do not, members are often not easily determined). If an LLC's membership is not public—or if a member of the defendant LLC is in turn an LLC or partnership whose membership is not public—a plaintiff will not have access to the facts necessary to determine whether or plead that diversity jurisdiction exists.

Some courts have addressed this practical problem by allowing plaintiffs to plead the facts necessary for diversity jurisdiction in the negative (i.e., that after a good faith investigation, the plaintiff believed that no defendant was a citizen of plaintiff's state). See, e.g., *Lincoln Ben. Life Co.*, 800 F.3d at 110 (plaintiff did not have to affirmatively allege citizenship of each member of defendant LLC if it was unable to do so after reasonable investigation and could instead allege in good faith that defendant LLC's members were not citizens of the same state as plaintiff).

In these cases, jurisdictional discovery is often ordered to determine whether there is complete diversity. *Id.* at 109-11. Other courts have rejected this approach, holding instead that the citizenship of each LLC member must be identified in the complaint. See, e.g., *Opportunities Fund, L.P. v. Mehrotra*, 661 F.3d 124, 125-26 (1st Cir. 2011) (holding that allegations of LLC's citizenship in the negative are insufficient to establish diversity jurisdiction).

The practical difficulties imposed by the LLC citizenship rule are not limited to plaintiffs. If a defendant is sued in state court by a plaintiff LLC and wishes to remove to federal court pursuant to 28 U.S.C. §1441, the defendant will face the same issues determining the plaintiff LLC's citizenship if it is not pleaded.

Further, defendant LLCs may encounter problems determining their own citizenship prior to removal or after being sued in federal court. Although a defendant LLC should know its own membership, if an LLC has a complex structure with multiple layers of LLCs or partnerships up the ownership chain, information on each member's members may not always be available.

In response to the practical difficulties routinely experienced by plaintiffs suing LLCs, on Dec. 1, 2022, Federal Rule of Procedure 7.1 was updated to require parties or intervenors in a diversity case to file a disclosure statement that must "name—and identify the citizenship of—every individual or entity whose citizenship is attributed to that party or intervenor," unless the court orders otherwise.

The advisory committee notes for the amended rule state that the new disclosure obligations are meant to assist the court in determining whether diversity jurisdiction exists when a plaintiff suing an LLC "may not have all the information it needs to plead the LLC's citizenship." Rule 7.1 Advisory Committee Notes—2022 Amendment.

But determining the membership of an LLC with a complex structure including many layers of LLCs or partnerships can be a burdensome, expensive, and even impossible undertaking. The committee notes acknowledge that "[t]his rule does not address the questions that may arise when a disclosure statement or discovery responses indicate that the party or intervenor cannot ascertain the citizenship of every individual or entity whose citizenship may be attributed to it." Rule 7.1 Advisory Committee Notes—022 Amendment.

The rule does provide some flexibility, recognizing that the court may limit disclosure. The Rule's notes suggest that the flexibility is intended for situations in which "a party reveals a citizenship that defeats diversity jurisdiction" or "the names of identified persons might be protected against disclosure to other parties when there are substantial interests in privacy and when there is no apparent need to support discovery by other parties to go behind the disclosure." *Id.*

But courts have already declined to exercise diversity jurisdiction where a defendant could not determine the citizenship of each of its members and their members and so on, indicating that the failure to file a proper Rule 7.1 statement could lead to dismissal regardless of the practical difficulties of such disclosure. See, e.g., *Niemann v. Carlsen*, 2023 WL 22038, at *2 (E.D. Mo. Jan. 3, 2023) (no federal diversity jurisdiction where party could not determine the citizenship of each of its thousands of partners or members); *Lachmanaya v. Rocky Towing, LLC*, 2023 WL 2329855, at *3 (E.D.N.Y. Mar. 2, 2023) (remanding for lack of jurisdiction where citizenship not adequately set forth in Rule 7.1 disclosures).

Unfair Implications

Scholars and judges alike have expressed dissatisfaction with the unwieldy practical implications and fundamental flaws and unfairness of LLC citizenship treatment. See, e.g., 14 A.L.R. Fed. 849 (1973) ("widespread dissatisfaction has been expressed with respect to it"). Even where the membership and citizenship of an LLC is well-known and does not pose a practical challenge, many have questioned the fairness of the rule.

Attributing the citizenship of an LLC based on its members is like determining a corporation's citizenship based on where its C-suite executives live or where its parent company is located, even if both are entirely disconnected from the corporation's location and state of incorporation. The citizenship of a single, possibly remote, member of an LLC should not determine the forum for litigation.

Courts have been commenting on this issue for years. In 1965, the District of Delaware observed that "[t]here are persuasive arguments that unincorporated associations should be treated as citizens of the state where the principal place of business is located" but that "any such innovation in diversity standards can only result from legislative action." *Int'l Union, United Auto., Aircraft and Agr. Implement Workers of Am. v. Piasecki Aircraft Corp.*, 241 F. Supp. 385, 389 (D. Del. 1965).

In the 1960s, the American Law Institute drafted proposed legislation to amend 28 U.S.C. §1332 to provide that for the purpose of diversity jurisdiction, "[a] partnership or other unincorporated association capable of suing or being sued as an entity in the State in which an action is brought shall be deemed a citizen of the State or foreign state where it has its principal place of business...." See 14 A.L.R. Fed. 849 (1973). This proposed legislation was never adopted.

Congress has addressed this issue in other contexts. The citizenship of an unincorporated entity is not determined by the citizenship of its members under other statutes, including under the Class Action Fairness Act of 2005 (CAFA).

When evaluating jurisdiction under CAFA, the statute provides that "an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized." 28 U.S.C. §1332(d)(10).

Some circuits have applied this provision of the statute to LLCs. See, e.g., *Ferrell v. Express Check Advance of S.C. LLC*, 591 F.3d 698, 702-04 (4th Cir. 2010); *City of East St. Louis, Ill. v. Netflix, Inc.*, 83 F.4th 1066, 1070-71 (7th Cir. 2023). Courts in the Southern District of New York have adopted the practice as well, *Kim v. Trulia, LLC*, 2021 WL 8743946, at *3 (E.D.N.Y. Mar. 31, 2021), but the Second Circuit has not resolved the question, *Carter v. HealthPort Techs., LLC*, 822 F.3d 47, 60 (2d Cir. 2016).

The Supreme Court itself has expressed skepticism of unincorporated entity citizenship determination as far back as 1965, when it noted in the context of labor unions that there was "considerable merit" to the argument that "it is not good judicial administration, nor is it fair, to remit a labor union or other unincorporated association to vagaries of jurisdiction determined by the citizenship of its members and to disregard the fact that unions and associations may exist and have an identity and a local habita-

tion of their own." *United Steelworkers of Am., AFL-CIO v. R. H. Bouligny, Inc.*, 382 U.S. 145, 150 (1965).

The Supreme Court subsequently noted that the decisions mandated by the diversity statute "can validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization" and that "basic fairness" may require unincorporated entities to be treated the same as corporations for diversity purposes. *Carden v. Arkoma Assoc.*, 494 U.S. 185, 196 (1990). However, the court observed that whether unincorporated entities should be treated as corporations for diversity purposes is "a matter for legislative consideration," and the Court would "le[ave] further adjustments to be made by Congress." *Id.*

In the more than 30 years since the *Carden* decision, Congress has not amended the diversity statute to treat LLCs, limited partnerships, or other unincorporated entities as corporations. In 2015, a concurring opinion by Third Circuit Judge Ambro and joined by the other judges on the panel observed that "[t]here is no good reason to treat LLCs differently from corporations for diversity-of-citizenship purpose" and proposed that "[a]s Congress has not accepted the invitation of the Court to craft a workable law of business citizenship, the latter should step into the breach." *Lincoln Ben. Life Co.*, 800 F.3d at 111 (concurring opinion). However, the Supreme Court appears uninterested in this invitation, particularly given the Court's prior statement that it would defer to Congress.

Treating LLCs the Same as Corporations

In light of the practical issues and unfairness created by the current approach to determining the citizenship of LLCs for diversity purposes, Congress should amend 28 U.S.C. §1332 to provide that the citizenship of unincorporated entities such as LLCs and limited partnerships should be determined by the entity's principal place of business and the state under whose laws it is organized.

Such an amendment would only apply to entities like LLCs, limited partnerships, and limited liability partnerships that are organized under state laws and would not be applicable to other types of unincorporated entities not organized under state law. 28 U.S.C. §1332(c) already describes the citizenship of a corporation, and the amendment proposed above could easily be modeled on that section's language.

This amendment would bring the statute in line with the practicalities of modern practice and corporate operations, and would ensure that no party is denied the opportunity to litigate in federal court when a single member of a member up the ownership chain of the LLC happens to be a citizen of the same state as the opposing party.

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