ALERT MEMORANDUM

Rule 7.1 Amendment Puts Spotlight on Citizenship of Foreign Business Entities

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Federal Rule of Civil Procedure 7.1 was recently amended to aid federal courts in assessing the existence of diversity jurisdiction.

The amended rule requires that parties to diversity cases, early on in a case, identify the citizenship of individuals or entities whose citizenship is attributed to them. This may raise difficult questions for foreign business entities, which may not easily fit into the dichotomy between corporations and unincorporated entities under the framework that is applied to business entities in the United States. This article discusses the unsettled law governing the treatment of foreign business entities in diversity cases and practical considerations for litigants preparing to make these new disclosures.

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I. Background

One of the recent changes to the Federal Rules of Civil Procedure was an amendment to Rule 7.1. In federal cases based on diversity jurisdiction,[1] Rule 7.1(a)(2) now requires parties to file a disclosure statement that sets forth the citizenship of "every individual or entity whose citizenship is attributed to that party[.]" This requirement relates to the longstanding principle that, while corporations are citizens of their state of incorporation and principal place of business, *see* 28 U.S.C. § 1332(c), other business entities such as partnerships and limited liability companies ("LLCs") lack citizenship of their own.[2] Instead, the citizenship of every member of an unincorporated association is attributed to the entity. *See Carden v. Arkoma Assocs.*, 494 U.S. 185, 195-96 (1990); *Americold Realty Tr. v. Conagra Foods, Inc.*, 577 U.S. 378, 381 (2016). And if those members or partners are themselves unincorporated entities, the citizenship of those entities will likewise need to be determined by looking to the citizenship of their members, and on and on until the analysis stops with a natural person or corporation. *Lincoln Ben. Life Co. v. AEI Life, LLC*, 800 F.3d 99, 112 (3d Cir. 2015) (Ambro, J., concurring). At the end of this analysis, if even one of the potentially hundreds or thousands of members is a citizen of the same state as an opposing party, diversity is destroyed and the case cannot be heard in federal court. *Id.* at 105.

This rule is fairly straightforward, at least as applied to entities in the United States. But the practical and jurisdictional stakes can be very significant, and LLCs and limited partnerships with many members spread across the country could find it nigh impossible to obtain a federal forum on a diversity basis. *See id.* at 112. The Advisory Committee on Civil Rules acknowledged as much in its proposal to amend Rule 7.1, noting that it could be "difficult, and at times impossible, for an LLC to identify all of the individuals and entities whose citizenships are attributed to it, let alone determine what those citizenships are."[3] The Supreme Court has conceded that this approach is somewhat formalist, but it has suggested that any adjustments that may be necessary to reflect current business realities must emanate from Congress. *See Carden,* 494 U.S. at 196 (conceding formalism of approach).

II. Determining the Citizenship of Foreign Business Entities

Much less clear is how *foreign* business entities should be treated for purposes of diversity jurisdiction. This is especially true for entities in civil-law jurisdictions. *White Pearl Inversiones S.A. (Uruguay) v. Cemusa, Inc.*, 647 F.3d 684, 686 (7th Cir. 2011) ("If it is hard to determine whether a business entity from a common-law jurisdiction is equivalent to a 'corporation,' it can be even harder when the foreign nation follows the civil-law tradition."). Because Rule 7.1(a) requires that the disclosure statement must be filed when the case is filed in or removed to federal court, and when any later event occurs that could affect diversity jurisdiction, one of the first questions a foreign business entity in federal court now faces is whether it needs to determine and disclose the citizenship of potentially thousands of its "members."

The Supreme Court has addressed the diversity citizenship of foreign business entities only once, in

[1] So long as the amount in controversy exceeds $75,000, federal district courts have subject matter jurisdiction over cases between "citizens of different States," including such cases in which "citizens or subjects of a foreign state are additional parties;" cases between "citizens of a State and citizens or subjects of a foreign state;" and cases in which a foreign government sues citizens of a U.S. state. 28 U.S.C. § 1332(a). This diversity must be "complete;" that is, neither citizens of the same state nor foreign citizens can be on opposite sides of the litigation. *Wisc. Dep't of Corr. v. Schacht*, 524 U.S. 381, 388 (1998).

[2] An exception is in actions subject to the Class Action Fairness Act ("CAFA"), in which unincorporated associations are also deemed to be citizens of the state where they have their principal place of business and the state under whose laws they are organized. 28 U.S.C. § 1332(d)(10).

[3] Memorandum from the Advisory Comm. on Civ. Rules to the Comm. on Rules of Prac. and Proc. (Dec. 9, 2020), https://www.uscourts.gov/sites/default/files/advisory_committee_on_civil_rules_-_december_2020_0.pdf.

Puerto Rico v. Russell & Co., 288 U.S. 476 (1933). There, the Court was faced with the question whether a *sociedad en comandita* organized under Puerto Rico law had the imputed citizenship of its members, like a partnership, or the citizenship of its place of organization, like a corporation. Recognizing that it could not easily apply the traditional corporation/partnership distinction to entities organized under Puerto Rico's civil law tradition, the Court examined the *sociedad* entity and concluded that the *sociedad* functionally had the same juridical personhood under Puerto Rican law as a corporation under U.S. law, and so should be treated like a corporation for purposes of assigning citizenship in diversity cases. *Id.* at 481-82 (*sociedad* could "contract, own property, and transact business, sue and be sued in its own name and right," was required to publicly file its articles of association, had a lifespan independent of its natural members, was governed by independent managers, and had limited liability).

In the following decades, a number of U.S. entities, such as labor unions, limited partnerships, and real estate investment trusts, asked the Supreme Court to apply *Russell*'s reasoning to hold that those entities had so many of the legal features of a corporation that they should be treated as one for citizenship purposes. The Supreme Court rejected these efforts. In *Carden*, the Court distinguished *Russell*, saying that *Russell* was about "fitting an exotic creation of the civil law . . . into a federal scheme which knew it not" and that the case did not establish a test for evaluating the citizenship of domestic common-law entities. 494 U.S. at 190 (quotations, citations and brackets omitted). But the Court has not squarely addressed the determination of the citizenship of *foreign* business entities since *Russell*.

III. Circuit Split

In the absence of Supreme Court guidance, the Circuit Courts have offered two different rules. The Fifth and Ninth Circuits have articulated a "juridical personhood" test. *See Berik Stiftung v. Plains Mktg., L.P.*, 603 F.3d 295, 298-299 (5th Cir. 2010); *Cohn v. Rosenfeld*, 733 F.2d 625, 629 (9th Cir. 1984). For these courts, the question is simply whether a foreign business entity is a "citizen or subject" of a foreign state under 28 U.S.C. § 1332(a)(2), not whether the entity is a "corporation" under § 1332(c). Looking to *Russell*, these circuits have held that if the entity is considered a juridical person under the law that created it, then it is a citizen of that jurisdiction for diversity purposes. By contrast, an association that lacks juridical personhood cannot independently be a citizen, and so would have the citizenship of its members.

The approach taken by the Seventh Circuit, since followed by the Eighth Circuit, has been to ask whether a foreign entity is roughly equivalent to a "corporation" under 28 U.S.C. § 1332(c). *See Jet Midwest Int'l Co. v. Jet Midwest Grp. LLC*, 932 F.3d 1102, 1105 (8th Cir. 2019); *Lear Corp. v. Johnson Elec. Holdings Ltd.*, 353 F.3d 580, 583 (7th Cir. 2003). According to the Seventh Circuit, *Russell* has been limited to its facts. *Fellowes, Inc. v. Changzhou Xinrui Fellowes Off. Equip. Co.*, 759 F.3d 787, 788-89 (7th Cir. 2014). Juridical personhood alone cannot give a foreign entity its own citizenship any more than it can give an LLC or limited partnership its own citizenship. *Id.* at 789-90. Instead, these courts analyze the legal features of the foreign entity, emphasizing the standard elements of legal personhood (perpetual existence, the right to contract and do business in its own name, and the right to sue and be sued), the ability to issue tradable shares, limited liability of investors, and treatment as independent from equity investors. *See Lear*, 353 F.3d at 583; *Jet Midwest*, 932 F.3d at 1105. An entity with these features will be treated as a corporation and will enjoy the citizenship of its place of incorporation and principal place of business; one lacking these features will be treated like an unincorporated association and will inherit its members' citizenship.

Other Circuits have not established a rule. Accordingly, unless there happens to be precedent in the particular jurisdiction addressing how to assess the citizenship of a specific foreign business entity, it may be difficult to determine what kind of disclosure needs to be made under Rule 7.1(a)(2).

IV. Practical Considerations

We note some practical issues to consider in making those disclosures. **First**, do not assume that a foreign

business entity will be treated as a corporation. Conversely, do not assume that it is akin to an unincorporated association based on its label. For example, the German *Gesellschaft mit beschränkter Haftung* ("GmbH")—literally translated as "company with limited liability"—and the "limited company" present in historically English-law jurisdictions have both been held to be, notwithstanding their monikers, more like U.S. corporations than U.S. LLCs for purposes of diversity jurisdiction. *See, e.g.*, *Jet Midwest*, 932 F.3d at 1105 (Hong Kong limited company); *Superl Sequoia Ltd. v. Carlson Co.*, 615 F.3d 831, 832 (7th Cir. 2010) (same); *Envtl. Prot. Comm'n v. Mercedes-Benz USA, LLC*, Case No. 8:20-cv-2238-VMC-JSS, 2023 WL 1781559, at *2 (M.D. Fla. Feb. 6, 2023) (GmbH).[4] Relatedly, more than one type of entity from the same foreign jurisdiction may qualify for treatment as a corporation. The applicable legal tests require substantive analysis of the legal features of the relevant foreign entity.

Second, while the parties' positions on the citizenship of a given entity will not bind courts, litigants may be met with skepticism if they take conflicting positions across cases, especially if their disclosures appear to depend on whether they seek to defeat or preserve diversity jurisdiction in a particular case. Therefore, it will be important to coordinate Rule 7.1 disclosures across different cases.

Last, Rule 7.1(a)(2) only requires a statement of the citizenship of any individuals or entities whose citizenship is imputed to a party. It does not require full briefing on the nature of the business entity and the basis of its citizenship. But a party should always be prepared to substantiate its position. Subject-matter jurisdiction can be raised at any time, including on appeal and on the court's own motion. In *Lear*, for example, the Seventh Circuit highlighted the failure to examine earlier in the case whether a Bermuda limited company was equivalent to a corporation for diversity purposes, remarking that even after it requested additional briefing on this question, "[c]ounsel did not get the point." 353 F.3d at 582. Therefore, although Rule 7.1(a)(2) may not require explanation of a party's disclosures relating to its citizenship, parties should be prepared to offer that substantive justification at any point in the case.

V. Conclusion

We expect that Rule 7.1(a)(2) will draw renewed attention to the question of how to determine the citizenship of foreign business entities and that the federal courts will develop a more robust body of case law to guide this inquiry. In the meantime, non-U.S. entities can prepare to address questions about their citizenship early on in litigation, to help avoid having years' worth of litigation voided in an instant by a court decision that unwarranted assumptions were made about the citizenship of a foreign business entity and a case was not properly in federal court.

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[4] In fact, the German GmbH form was created by statute in 1893, and the Austrian GmbH form in 1906, whereas LLCs did not appear in the United States until 1977, showing that one cannot assume foreign entities are modeled on similarly named U.S. entities.