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## BUSINESS LAW

### Diversity Jurisdiction and the LLC

Time will tell whether Congress will amend the statute

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The federal court has jurisdiction over disputes between citizens of different states where the disputes exceed \$75,000. 28 U.S.C. Section 1332(a)(1). If a New Jersey citizen sues a New York citizen for more than \$75,000, then the federal court will have jurisdiction. Generally, a person is considered a citizen of the state of his or her residence. *Swiger v. Alleghany Energy, Inc.*, 540 F.3d 179, 182 (3d Cir. 2008).

There must also be complete diversity, meaning that the plaintiff cannot be a citizen of the same state as any defendant. *Midlantic National Bank v. Hansen*, 48 F.3d 693, 696 (3d Cir. 1995). For example, if a New Jersey citizen sues two parties, one who is a New York citizen and the other a New Jersey citizen, then the federal court will not have diversity jurisdiction.

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Corporations and Partnerships

A corporation is considered a citizen of the state of its incorporation and the state of its principal place of business. Therefore, a Delaware corporation with its principal place of business in New Jersey is a citizen of both New Jersey and Delaware.

Partnerships and other unincorporated associations are citizens of all states where any of their partners or members are citizens. *Carden v. Arkoma Assoc.*, 494 U.S. 185, 192-195 (1990). Therefore, a limited partnership formed in New York, having its principal place of business in New York, with one general partner and two limited partners residing in New Jersey, is considered a citizen of New Jersey only.

Likewise, if the same limited partnership has a general partner who is a Pennsylvania citizen and two limited partners who are citizens of New Jersey and Connecticut, then the limited partnership is considered a citizen of Pennsylvania, New Jersey and Connecticut, but not New York. Theoretically, if a large partnership has partners who are citizens of each and every state, the federal court would never have diversity jurisdiction of a dispute because the plaintiff and one of the partners will be citizens of the same state.

Limited Liability Companies

There are no published opinions from the United States Supreme Court, the United States Court of Appeals for the Third Circuit or the United States District Court for the District of New Jersey addressing the diversity jurisdiction of limited liability companies ("LLCs"). *Hessert Construction New Jersey, LLC v. Garrison Architects, P.C.*, 2007 WL 2066355 at \*2 (D.N.J. July 13, 2007). This is somewhat surprising given that LLCs have been authorized in New Jersey since 1993 and much earlier in other states (starting with Wyoming in 1977), and have become the most popular form of business entity. There are, however, a few unpublished opinions from the District Court (which borrow law from the Seventh Circuit) that provide guidance on the issue.

In *Master v. Quiznos Franchise Co.*, 2007 WL 419287 (D.N.J. Feb. 1, 2007), the court stated that "limited liability companies are (1) unincorporated associations, and (2) deemed citizens of each state in which their members are citizens, not the states in which they were formed or have their principal places of business."

By way of example, then, if an LLC is formed in Delaware, has its principal place of business in New York, and is comprised of two members who are natural persons residing in New Jersey, the LLC is a citizen of New Jersey only. If the same LLC is comprised of two members, one a natural person residing in New Jersey and the other a corporation formed in Delaware with its prin-

principal place of business in Pennsylvania, then the LLC is a citizen of New Jersey, Delaware and Pennsylvania. This is so because, as noted above, a corporation is deemed a citizen of the state of its incorporation and the state of its principal place of business. See 28 U.S.C. Section 1332(c).

In *Hessert*, the court noted that “a non-corporate business entity is deemed to be a citizen of every state in which an entity-owner is a citizen.” It further noted that the District Courts in the Third Circuit “have generally held [in unpublished opinions] that the citizenship of a limited liability company is determined by the citizenship of its members.”

Simply stated, the citizenship of an LLC for purposes of diversity jurisdiction is the citizenship of its members, not the state of its formation or the state of its principal place of business.

#### Tracing Ownership

Determining the citizenship of an LLC can get complicated if it has LLCs, partnerships or other unincorporated associations as members because “each membership layer must be traced and analyzed to determine a limited liability company’s citizenship.” *Community Preservation Corporation v. MYG Management, LLC*, 2008 WL 4792531 at \*1 (D.N.J. Oct. 27, 2008).

Assume LLC 1 is formed in Delaware and has its principal place of business in New York. Further assume that its members consist of Jersey Joe, who resides in New Jersey, and LLC 2, which was formed in and has its principal place of business in New Jersey. The citizenship of LLC 1 cannot be determined until the members of LLC 2 are identified and their states of citizenship determined. Assume that LLC 2 is owned by Florida Fred, who resides in Florida. As a result, LLC 1 is a citizen of New Jersey (based on the citizenship of Jersey Joe, a member of LLC 1) and Florida (based on the citizenship of Florida Fred, a member of LLC 2, which is the other member of LLC 1).

Therefore, the citizenship of an LLC for purposes of diversity jurisdiction

is determined by the citizenship of its members who are natural persons and corporations, even if the parties and the court need to trace and analyze the citizenship of various ownership layers of LLCs and other unincorporated associations until they reach and determine the citizenship of all natural persons and corporations.

#### Misunderstandings

There are, however, misunderstandings about the proper analysis of LLCs for purposes of diversity jurisdiction. For example, in *Brauser Real Estate, LLC v. Meecorp Capital Markets, LLC*, 2008 WL 324402 at \*1 (D.N.J. Feb. 4, 2008), the court stated that it had jurisdiction as the parties had diversity of citizenship. The court noted that the plaintiff was a Florida LLC with its principal place of business in Florida and the defendant was a New Jersey LLC with its principal place of business in New Jersey. The court did not explain how it determined diversity jurisdiction, but based on the court’s identification of the state of formation and the state of the principal place of business of each LLC, it appears that the court may have determined the citizenship of the LLCs as if they were corporations.

This common misunderstanding is not surprising given the similarities between LLCs and corporations. To be sure, a recent Westlaw search in the NJ-CS-ALL database found 70 opinions referring to LLCs as “limited liability corporations” instead of limited liability companies. See e.g. *MNI Mgt. Inc. v. Wine King LLC*, 542 F. Supp. 2d 389, 400 (D. N.J. 2008).

#### Pleading Diversity

Nonetheless, in federal court actions based on diversity jurisdiction, the pleadings must properly allege the citizenship of any parties who are LLCs (or other unincorporated associations) by identifying the members and their states of citizenship. Otherwise, plaintiffs risk the dismissal of their complaints and defendants who remove state actions to

the federal court based on diversity jurisdiction risk both a remand to the state court and sanctions. 28 U.S.C. Section 1447(c).

The identity of the members of a privately-held LLC is not publicly available, making it difficult to include allegations about the members and their states of citizenship. For an excellent article on the pitfalls of determining the existence of diversity jurisdiction in federal actions involving LLCs, see Carter G. Bishop and Daniel S. Kleinberger, “Diversity Jurisdiction for LLCs? Basically, Forget About It,” *14 Bus. L. Today* 31 (ABA Sept./Oct. 2004).

#### Suggestions

One commentator suggests that Congress should amend the diversity jurisdiction statute to treat LLCs in a manner identical to corporations; that is, for diversity purposes, the citizenship of an LLC should be based on the state of its formation and on the state of its principal place of business. See Debra R. Cohen, “Limited Liability Company Citizenship: Reconsidering an Illogical and Inconsistent Choice,” *90 Marq. L. Rev.* 269 (2006); Debra R. Cohen, “Citizenship of Limited Liability Companies for Diversity Jurisdiction,” *6 J. Small & Emerging Bus. L.* 435 (2001).

This suggestion has merit and would simplify the determination of diversity jurisdiction of LLCs. It would, however, increase the number of lawsuits filed in the federal court based on diversity of citizenship of LLCs.

#### Conclusion

Time will tell whether Congress will amend the statute to treat LLCs like corporations for purposes of diversity jurisdiction. Until then, the Supreme Court has stated that the federal courts will apply different standards to determine diversity jurisdiction for corporations on the one hand and unincorporated entities (including LLCs) on the other. Until the statute is amended, the diversity citizenship of LLCs will continue to be determined, even with some difficulty, by the citizenship of its members. ■