

The Case for a Unified Approach to Corporate and LLC Citizenship

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By [Jamie Dean](#)

Imagine opening your email one morning to find a copy of a complaint and summons just received by your out-of-state corporate client. The caption shows a familiar North Carolina company as the lone plaintiff, and a cursory review of the allegations reveals several indicia of a case that you would prefer to defend in federal court: a demand for substantial damages, a remote venue with limited court calendars, a plaintiff who is a major employer in the forum county, and potentially complicated legal issues that would benefit from full briefing. *No problem*, you think, because the matter will probably be removable, given the amount at issue and your client’s out-of-state incorporation and headquarters. When you scrutinize the caption again and note the three letters “LLC” appended to the plaintiff’s name, however, what first seemed clear becomes opaque.

At this juncture, a quick review of the rules applicable to diversity jurisdiction and removal is helpful. The familiar requirements for diversity jurisdiction include (1) an amount in controversy in excess of \$75,000 and (2) diversity of citizenship between each plaintiff and each defendant.¹ Additionally, no defendant may remove a matter filed in a state where the defendant is a citizen, and all defendants properly joined and served in a matter must consent to removal.² Generally, a defendant must remove within 30 days of service of a pleading or other paper showing the propriety of diversity jurisdiction.³ During the first year after the action is commenced, if the initial pleading is not removable, a defendant may also remove within 30 days of receiving a paper demonstrating removal is proper.⁴

A corporation is a citizen of (1) the state where it is incorporated and (2) the state where it has its principal place of business.⁵ In 2010, the Supreme Court clarified that “the phrase ‘principal place of business’ refers to the place where the corporation’s high level officers direct, control, and coordinate the corporation’s activities,” often referred to as its “nerve center.”⁶ An LLC, on the other hand, is a citizen of every state where its members are citizens.⁷ Consequently, the state where an LLC is formed and the location of its principal place of business are irrelevant for

¹ 28 U.S.C. § 1332(a).

² *Id.* at §§ 1441(b)(2), 1446(b)(2)(A).

³ *Id.* at § 1446(b)(1).

⁴ *Id.* at §§ 1446(b)(3), 1446(c)(1).

⁵ *Id.* at § 1332(c).

⁶ *Hertz Corp. v. Friend*, 559 U.S. 77, 80-1 (2010) (internal citations omitted).

⁷ *Meyn America, LLC v. Omtron USA LLC*, 856 F. Supp.2d 728, 732 (M.D.N.C. 2012) (internal citation omitted).

diversity purposes.⁸ Rather, to determine an LLC's citizenship, one must ascertain the citizenship of each member following the guidelines provided in § 1332.⁹

Returning to the hypothetical, assume the complaint alleges that plaintiff is a North Carolina LLC with its principal office in Greensboro, but says nothing about plaintiff's members. The North Carolina Secretary of State's website confirms the domestic formation, but is silent about the current membership. Unless you find another source that identifies plaintiff's members, you are stuck litigating in your non-preferred forum, at least until you can use the discovery process to identify plaintiff's members, a process that could take weeks or months.

As this scenario illustrates, taking differing approaches to LLC and corporate citizenship can give rise to potentially frustrating inefficiencies. Several factors favor abandoning this disparate approach and applying the same citizenship criteria to corporations and LLCs.

Simplicity –

A unified approach simplifies the process of identifying a party's citizenship. In adopting the nerve center test for ascertaining a corporation's principal place of business, the Supreme Court "place[d] primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible."¹⁰ Using a member-based approach for LLCs opposes this objective.

Determining the citizenship of a corporation is generally straight forward. A corporation's state of incorporation is a matter of public record and the location of its key officers, if not public, often is readily ascertainable. Even for private corporations, on whom less public information is available, at least the inquiry halts after key officers have been identified and located.

For LLCs, the analysis can become cumbersome. Even for LLCs with a single layer of ownership, members can be numerous, and each member's citizenship must be analyzed. The situation becomes significantly more complicated when the LLC is nested in a family that includes other LLCs. Consider an LLC with three members, each of whom is also an LLC. Determining the citizenship of the first LLC requires determining the citizenship of the three member LLCs, which requires determining the citizenship of the members of each of those LLCs. As the number of layers of ownership increases, the number of members relevant to the analysis can go up, exponentially. The inquiry only stops when a member is identified who is either an individual or a corporation whose citizenship can be determined under the guidelines of § 1332. While application of the corporate citizenship test would not make it easier to locate information about an LLC's members, it would at least focus the inquiry on those who are key decision-makers.

Fairness –

Congress declared that a corporation is a citizen of its principal place of business to prevent local companies from availing themselves of diversity jurisdiction in their home states, simply because

⁸ *Id.* at 733 (citation omitted).

⁹ *See, e.g. Id.* (analyzing state of incorporation and principal place of business of corporation that was sole member of defendant LLC to determine LLC's citizenship).

¹⁰ *Hertz*, 559 U.S. at 80.

they might be incorporated elsewhere.¹¹ The nerve center test adopted by the Supreme Court furthers this objective, ensuring that a corporation cannot affect its citizenship by arbitrarily designating a headquarters or principal office in a foreign state.

Under the current framework, however, the forum shopping Congress and the Supreme Court attempted to curtail is still available to an LLC. No matter where an LLC is formed and no matter where its operations and decision-makers are located, its citizenship depends only on the citizenship of its members. Thus, a North Carolina LLC with all operations and offices in North Carolina, but out-of-state members, could remove a suit filed by a North Carolina plaintiff in North Carolina state court. This runs contrary not only to the theory undergirding the nerve center approach to corporate citizenship, but also to the notion that a defendant sued in its own state courts does not need the protections afforded by diversity jurisdiction.¹²

Tying an LLC's citizenship to the citizenship of its members could also unfairly inhibit an LLC's ability to avail itself of federal jurisdiction. The purpose of diversity jurisdiction is to protect a foreign defendant against local bias.¹³ The member-centered test increases the likelihood that this protection will not be afforded to an LLC. For example, an LLC formed and operating exclusively in Virginia with a single member in North Carolina could not remove a matter filed by a North Carolina plaintiff in North Carolina state court. If the North Carolina resident is the sole owner of the Virginia LLC defendant, this might not seem unfair. The result seems less reasonable, though, if the North Carolina resident is one of numerous members. If the North Carolina resident is only tangentially related to the Virginia LLC defendant through a structure of nested LLCs, as discussed above, then the result becomes very difficult to square with diversity jurisdiction's goal of giving foreign defendants a fair forum. The nerve center aspect of the corporate citizenship test would mitigate this problem by linking citizenship to the locus of company control rather than the more arbitrary location of its membership.

Theoretical Consistency –

The prevailing analysis equates an LLC to a partnership.¹⁴ This ignores the form and function of modern LLCs, which more closely resemble those of corporations. For example, like corporations, LLCs are creatures of statute, not common law.¹⁵ Like shareholders (and unlike general partners), members in an LLC are not personally liable for the company's obligations.¹⁶ Finally, the LLC is plainly encroaching on territory that was previously the province of corporations, as national and multi-national companies, such as Chrysler, Westinghouse Digital, and Domino's Pizza, choose the LLC form. If the object is for courts to treat comparable entities

¹¹ S. REP. 85-1830, 85TH Cong., 2ND Sess. 1958.

¹² This is reflected in 28 U.S.C. § 1446(b)(2)'s prohibition on a defendant removing an action filed in a state where the defendant is a citizen.

¹³ *Long v. Sasser*, 91 F.3d 645, 648 (4th Cir. 1996).

¹⁴ *See Meyn America*, 856 F. Supp.2d at 732.

¹⁵ *LLCs: Is the Future Here?: A History and Prognosis*, GP|SOLO LAW TRENDS & NEWS – BUSINESS LAW, Vol. 1, No. 1, Oct. 2004, available at

<http://www.americanbar.org/newsletter/publications/law_trends_news_practice_area_e_newsletter_home/llc.html> (noting that, since 1996, every U.S. jurisdiction has had an LLC statute).

¹⁶ *See, e.g.* Uniform Limited Liability Company Act § 304 (National Conference of Commissioners on Uniform State Laws 2006), available at

http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca_final_06rev.pdf, Pg. 56

similarly, it makes sense to subject LLCs to the same citizenship criteria employed for corporations.

Practicality –

Finally, disparate treatment of corporations and LLCs creates practical problems for attorneys on both sides of the courtroom. For a plaintiff who prefers to litigate a particular state court claim in federal court, there is the obvious difficulty of ascertaining an LLC's members, pre-suit, to determine if diversity jurisdiction is proper. If the plaintiff sues in federal court based on available information suggesting that the LLC is diverse, then turns out to be wrong, it faces dismissal. Even worse, because subject matter jurisdiction is not waivable and may be raised at any time,¹⁷ a defendant LLC could adopt a wait and see approach, then use the jurisdictional issue to take a second bite at the apple if the litigation does not go its way in federal court. On the other hand, a plaintiff who sues in state court may not remove its own matter if it learns that the defendant LLC is diverse.¹⁸ The Plaintiff must either proceed in its non-preferred state court forum or take a voluntary dismissal then refile in federal court. Of course, any result that leads to a procedural dismissal and re-litigation in a different forum is likely to create a host of problems, not the least of which is client unhappiness.

Defendants also face potential inefficiencies and pitfalls due to the difficulty of ascertaining an LLC's citizenship. Unless the complaint names a plaintiff LLC's members, a defendant will likely be required to wait until it can obtain discovery on that issue before it can determine if the case is removable. This delay is inefficient and potentially prejudicial. For instance, a defendant could be required to expend resources answering and responding to discovery on claims that, while sufficiently pled under North Carolina's pleading standard, would not survive the more strenuous federal standard. By the time the case is removed, the value of challenging those claims might be diminished by the litigation activities already completed in state court. Worse, if the plaintiff avoids disclosing its members' citizenship for more than a year, the defendant's opportunity to remove is lost, altogether, unless the court determines the plaintiff acted in bad faith.

Even where the LLC at issue is the defendant, the difficulty of ascertaining citizenship could be problematic. Most practitioners have experienced the urgency that accompanies receiving a summons and complaint from a client within days or even hours of the removal deadline. In the case of large or nested LLCs, quickly ascertaining the citizenship of every member may not be possible. Once the removal window closes, it cannot be re-opened based on a party's ignorance of its own citizenship. Consequently, both plaintiffs and defendants would benefit from a more straight-forward approach that simplifies the process of identifying a party's citizenship.

Conclusion –

Employing different analyses to determine the citizenship of LLCs and corporations exposes courts and litigants to a host of inefficiencies, without any obvious advantages. Adopting the corporate approach and treating an LLC as a citizen of the state of its formation and the state where its nerve center is located would eliminate these problems while still protecting against forum shopping and advancing diversity jurisdiction's purpose of protecting foreign litigants.

¹⁷ *U.S. v. Wilson*, 699 F.3d 789, 792 (4th Cir. 2012) (internal citation omitted).

¹⁸ *See* 28 U.S.C. § 1441(a) (only authorizing removal by "the defendant or the defendants").

The need for such an approach is only going to grow as LLCs continue to multiply in number and sophistication.

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