

Client Alert

Real Estate and Financial Restructuring Practice Groups

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Supreme Court Rules that Citizenship of a Real Estate Investment Entity is Based on Citizenship of its Members, Which Includes Shareholders

On March 7, 2016, the U.S. Supreme Court (the “Supreme Court”) ruled that the citizenship of a Real Estate Investment Entity (“REIT”), for purposes of federal diversity jurisdiction, is based on the citizenship of its members, which includes its shareholders.ⁱ This pronouncement is significant because it rejects an often commonly-held view that a REIT’s citizenship was based on the citizenship of its trustee or the state under whose laws it was organized.

Factual Background

The plaintiffs, a group of corporations, filed a lawsuit against Americold Realty Trust (“Americold”) in state court based on a contract dispute. Americold removed the suit to the federal court (the “District Court”), based on diversity of parties. The plaintiffs were corporate citizens of Delaware, Nebraska, and Illinois and Americold was a REIT organized under Maryland law. The District Court accepted jurisdiction and ultimately resolved the dispute in favor of Americold.

On appeal, the U.S. Court of Appeals for the Tenth Circuit (the “Tenth Circuit”) held that Americold’s citizenship must be determined based upon the citizenship of its members.ⁱⁱ

The Supreme Court accepted certiorari to “resolve confusion among the Courts of Appeals” regarding whether citizenship of unincorporated entities should be based on the entity’s State of organization or on the citizenship of its members.ⁱⁱⁱ

Applicable Law

The United States Code (the “Code”) explicitly provides that a corporation is a citizen of its State of incorporation and the State where it has its principal place of business.^{iv} However, the Code does not define the citizenship of unincorporated entities. Accordingly, the citizenship of unincorporated entities was unclear under existing law. In addition, to the extent one assumed the unincorporated entity’s citizenship is determined by the citizenship of its members, there was no clear definition of who constitutes a “member.”^v The Supreme Court addressed both of these previously unanswered questions.

For more information, contact:

Mark M. Maloney

+1 404 572 4857

mmaloney@kslaw.com

C. Spencer Johnson, III

+1 404 572 2765

csjohnson@kslaw.com

Anthony W. Rothermel

+1 212 556 2127

trothermel@kslaw.com

Elizabeth Tramm

+1 404 572 2813

ltramm@kslaw.com

King & Spalding

Atlanta

1180 Peachtree Street, NE

Atlanta, Georgia 30309-3521

Tel: +1 404 572 4600

Fax: +1 404 572 5100

New York

1185 Avenue of the Americas

New York, New York 10036-4003

Tel: +1 212 556 2100

Fax: +1 212 556 2222

www.kslaw.com

The Supreme Court's Decision

The Supreme Court agreed with the Tenth Circuit that the REIT's citizenship was determined by the citizenship of its members, rather than by its State of formation. The Supreme Court looked to Maryland law for guidance on who are members of a REIT and concluded that shareholders were members based on the ownership interests and voting rights provided to them under Maryland law.

The Supreme Court rejected the argument that the REIT was a "trust" in the traditional sense of the word, which would have meant that its citizenship was that of its trustees. The Supreme Court also explicitly declined to extend the corporate rules of citizenship (citizenship based on State of incorporation and its principal place of business) to an unincorporated entity.

Impact of Ruling and Guidance

While the Supreme Court's holding is limited to REITs, the opinion reiterates the rule that the citizenship of any unincorporated entity—including an LLC—is determined by the citizenships of its members, not its State of formation. Accordingly, when forming or adding new members or shareholders to REITs and LLCs, the citizenship of all such members or shareholders should be considered. Applying the *Americold* ruling, unincorporated entities will be able to sue and be sued in any jurisdiction in which any member or shareholder is a citizen. Similarly, just as is the case with larger partnership organizations, the availability of federal diversity jurisdiction (which requires that plaintiffs and defendants be resident in different states) will be limited severely for REITs and LLCs who have shareholders and members from a large number of states. Further, this ruling can have important implications for the formation of new real estate companies looking to be structured as "real estate investment trusts" for federal income tax purposes. Given that a corporation can elect "real estate investment trust" status for federal income tax purposes, founders, sponsors and others forming new REITs may prefer to have the transparency of its citizenship for diversity purposes readily determinable.

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ⁱ *Americold Realty Trust v. Conagra Foods Inc. et al.*, 136 S.Ct. 1012 (2016).

ⁱⁱ *Id.* at 1014-15.

ⁱⁱⁱ *Id.* at 1015.

^{iv} 28 U.S.C. §1332(c).

^v For instance, the Supreme Court has held that the "members" of a joint-stock company include its shareholders, the "members" of a partnership include the partners, and the "members" of a union include the workers affiliated with it. See *Americold*, 136 S.Ct. at 1015.