Are You *Sure* It's a Corporation?

Diversity Jurisdiction and Foreign Businesses

*By Jeff Bowen**

In June 2011, attorneys representing Cemusa, an American subsidiary of a Spanish firm, and White Pearl Inversiones, a Uruguayan consulting entity, appeared before a Seventh Circuit panel to argue the appeal of a contract dispute. Cemusa had hired White Pearl to help it win advertising contracts with U.S. cities for placement of advertising on "street furniture" such as trash bins and bus shelters, and the dispute focused on the amount of compensation due to White Pearl. The panel, however, surprised the attorneys with detailed questions about the legal status of White Pearl itself under Uruguayan law and whether it could be treated as a corporation for diversity purposes. As the panel noted, federal diversity jurisdiction requires complete diversity, and the presence of a business entity other than a corporation may require an examination of the citizenship of individual partners, investors, or shareholders. The panel ordered supplemental briefing on the jurisdictional issue. *See White Pearl Inversiones S.A. (Uruguay) v. Cemusa, Inc.,* 647 F.3d 684, 687-88 (7th Cir. 2011).

The *White Pearl* case is hardly unique, as other attorneys representing foreign business entities have also found themselves subject to detailed jurisdictional questioning at oral argument. For example, in one case, the court ordered supplemental briefing on the citizenship of the defendant's individual partners and, when that proved inadequate, ordered the case dismissed for want of jurisdiction. *Guaranty Nat. Title Co., Inc. v. J.E.G. Associates,* 101 F.3d 57 (7th Cir. 1996). In another case, a panel ordered additional briefing on the citizenship of individual names in a Lloyd's of London syndicate. *Indiana Gas Co., Inc. v. Home Ins. Co.,* 141 F.3d 314 (7th Cir. 1998). Another panel ordered additional briefing on the legal status of a Bermuda "limited' organization. *Lear Corp. v. Johnson Elec. Holdings Ltd.,* 353 F.3d 580 (7th Cir. 2003).

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Although, at first blush, each of these cases involved businesses primarily operating in different states or countries, on closer inspection, each of them raised potentially serious issues under the diversity jurisdiction statute. As a whole, therefore, these cases serve as a reminder that attorneys need to consider diversity jurisdiction carefully, particularly when a case involves foreign business entities.

General Principles of International Diversity or Alienage Jurisdiction

Congress established federal jurisdiction over disputes involving foreign individuals or businesses based on an explicit grant of authority under the Constitution. The Constitution provides that the judicial power of the United States extends, among other circumstances, to controversies "between citizens of different states" and "between a state, or the citizens thereof, and foreign states, citizens or subjects." Const. Art. III Sec. 2. Congress has set forth the parameters of that jurisdiction at 28 U.S.C. § 1332, which currently provides for original jurisdiction over civil actions where the amount in controversy exceeds $75,000 and the dispute involves "(1) citizens of different States; (2) citizens of a State and citizens or subjects of a foreign state; (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and (4) a foreign state . . . as plaintiff and citizens of a State or of different States." 28 U.S.C. § 1332(a). As a result, disputes involving foreign individuals or businesses may only give rise to diversity jurisdiction if they also involve citizens of a State. Disputes solely among foreigners cannot give rise to diversity jurisdiction. *Karazanos v. Madison Two Assocs.,* 147 F.3d 624, 626 (7th Cir.1998) (citing *Hodgson v. Bowerbank,* 9 U.S. (5 Cranch) 303 (1809)).

The Supreme Court long ago established that in most circumstances diversity must be "complete." *Strawbridge v. Curtiss,* 7 U.S. (3 Cranch) 267, 2 L.Ed. 435 (1806). In the domestic context, the complete diversity rule generally means that no plaintiff may be a citizen of the same state as any defendant. *Fidelity & Deposit Co. of Maryland v. City of Sheboygan Falls,* 713 F.2d 1261, 1264 (7th Cir. 1983) (noting that courts will analyze the dispute in making this determination rather than relying on the parties as identified in the pleadings). Courts and commentators have linked this rule to the justification most often cited for the existence of diversity jurisdiction for citizens of different states — the avoidance of potential prejudice against an out-of-state defendant. *See generally* Wright & Miller, *Federal Practice and Procedure* § 3601 (3d ed.).

In disputes involving both citizens and international parties, however, the analysis of "complete diversity" differs. Opposing United States citizen parties must be diverse, but the presence of non-U.S. parties as both plaintiff and defendant does not automatically destroy diversity, even if they are from the same country. For example, in *Allendale Mutual Insurance Co. v. Bull Data Systems, Inc.,* 10 F.3d 425 (7th Cir. 1993), an insurer based in the U.S. and its British subsidiary sued a U.S.-based policyholder and related foreign entities. The Seventh Circuit explained that § 1332(a)(3), covering disputes "between citizens of different States" with foreign entities as additional parties, requires U.S. citizens on both sides but permits any combinations of additional non-citizen parties. Section 1332 (a)(2) by contrast requires citizens of a U.S. state on one side and foreign citizens or subjects on the other, thus precluding suits between "foreigners and a mixture of citizens and foreigners." *Id.* at 428. The court acknowledged language in earlier decisions indicating that the presence of foreigners on both sides of a controversy could destroy diversity jurisdiction but pointed out that in those cases, U.S. citizens had not been present on both sides, and section 1332 a(3) was not available.

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The Third Circuit reached a similar conclusion in a dispute between a U.S. policyholder and its Canadian subsidiary on the one hand and various Lloyd's of London insurance syndicates, including a New Hampshire insurer. *Dresser Industries, Inc. v. Underwriters at Lloyd's of London,* 106 F.3d 494, 499-500 (3d Cir. 1997). The court added that traditional diversity concerns over in-state bias in favor of one party were not impacted by the presence of aliens on both sides of the dispute and also that the foreign relations concerns underlying alienage jurisdiction continued to apply. Several district courts later elaborated that the same analysis applied even if citizens or subjects of the same foreign country were found on both sides of the dispute. *Zenith Electronics Corp. v. Kimball Intern. Mfg., Inc.,* 114 F. Supp.2d 764 (N.D. Ill. 2000); *Bank of New York v. Bank of America,* 861 F. Supp. 225 (S.D.N.Y.1994).

For diversity purposes, corporations are deemed by statute to have the citizenship of both their state of incorporation and their principal place of business. Corporations owned by a foreign government may also be treated as a foreign state under § 1332(a)(4). In light of disputes over discerning corporate citizenship, Congress passed the Jurisdiction and Venue Act of 2011, clarifying that a corporation shall be deemed a citizen of each state or foreign country in which it is incorporated, as well as the state or foreign country in which it has its principal place of business. Pub. L. No. 112-63 (H.R. 394), 125 Stat. 758 (2011). In the Class Action Fairness Act of 2005, Congress also relaxed the complete diversity requirement for corporations involved in a class or mass action in which the aggregate total of plaintiffs' claims exceeds $5 million. In that situation, diversity jurisdiction exists when *any* plaintiff is a citizen of a different state than *any* defendant, or if the disputes involves any citizen of a state and any alien. 28 U.S.C. § 1332(d).

These basic rules merit careful attention but rarely result themselves in the need for the supplemental jurisdictional briefing described above. Instead, attorneys engaged in litigation involving foreign business entities should be especially careful with the legal status of those entities under foreign law.

The Treatment of Unincorporated Business Entities

While corporations have the citizenship of their place of incorporation and their principal place of business, the same rule does not apply to other business entities that have not been incorporated. In *Chapman v. Barney,* 129 U.S. 677 (1889), the Supreme Court held that a joint-stock company was not a corporation for the purposes of diversity jurisdiction but that, instead, the citizenship of each individual stockholder needed to be considered for diversity purposes. Courts have applied the *Chapman* rule to a wide variety of unincorporated business entities, including partnerships, limited partnerships and limited liability companies. *E.g. Cosgrove v. Bartolotta,* 150 F.3d 729, 731 (7th Cir.1998) (concluding that "the citizenship of an LLC for purposes of the diversity jurisdiction is the citizenship of its members"). In *Carden v. Arkoma Associates,* 494 U.S. 185, 195 (1990), the Supreme Court further clarified that in order to determine the citizenship of an organization other than a corporation, the court must consider the citizenship of all of the entity's members, including both general partners and limited partners. Furthermore, if those partners are themselves business entities, their citizenship must be established, and if they are not incorporated, the court must inquire into their constituent members as well. For example, in *Guaranty Nat. Title Co., Inc. v. J.E.G. Associates,* 101 F.3d 57 (7th Cir. 1996), the court ordered the case dismissed for want of jurisdiction when the parties (despite supplemental briefing) failed to identify the citizenship of the trust and a limited partnership that themselves constituted the defendant limited partnership.

The precise legal status of foreign business entities adds an extra dimension to the analysis. Citizenship may be determined based on the location or incorporation of the organization itself or instead based on the citizenship of its individual members, depending on the legal status of the entity, and that status may be difficult to determine under foreign law. Only the equivalent of a corporation under foreign law may use its place of incorporation or principal place of business for citizenship purposes, and many legal systems do not explicitly use the term "corporation." Courts may therefore be forced to analyze the business law of the relevant country to determine whether the entity in question is the equivalent of a corporation.

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For example, in *Lear Corp. v. Johnson Electric Holdings Ltd.,* 353 F.3d 580 (7th Cir. 1993), the court directed the parties to file post-argument briefs discussing how "limited" entities organized under Bermuda law should be classified for purposes of diversity jurisdiction. The briefing proved unhelpful, but the parties attached a copy of Bermuda's Companies Act of 1981, which the court examined in detail. The court concluded that "a business organization 'limited by shares' under Bermuda law is equivalent in all legally material respects to a corporation under state law." *Id.* at 583. In reaching that conclusion, the court highlighted the entity's perpetual existence, its governance by a Board of Directors, its issuance of tradable shares, and its independence from equity investors (who were not liable for its debts). *Id.*

Under other governing statutes, this analysis may prove rather difficult, particularly in civil law countries. As the Seventh Circuit noted, "[i]f it is hard to determine whether a business entity from a common-law nation is equivalent to a 'corporation,' it can be even harder when the foreign nation follows the civil-law tradition." *White Pearl,* 647 F.3d at 686. In one early civil law example, the Supreme Court treated a *sociedad en comandita* under Puerto Rico law as a citizen of Puerto Rico for diversity purposes because it was "consistently regarded as a juridical person" under *Puerto Rico* law. *Puerto Rico v. Russell & Co.,* 288 U.S. 476, 481-82 (1933). The Supreme Court later stressed, however, that the *Russell* decision had been the product "of fitting an exotic creation of the civil law ... into a federal scheme which knew it not" and declined to extend its reasoning. *United Steelworkers of America v. R. H. Bouligny, Inc.,* 382 U.S. 145, 151 (1965). More recently, the Supreme Court again warned against an expansive interpretation of *Russell* and emphasized that only incorporated groups should be treated as legal persons for diversity purposes. *Carden,* 494 U.S. at 190. Thus, detailed analysis of an individual country's civil business law code may be required before a business entity can be treated as a corporation.

In light of these difficulties, it may be easier at times for attorneys to provide the identity of the investors or members rather than arguing the legal characteristics of the civil law business entity and risking rejection by the court. For example, in *White Pearl,* after prompting from the court, the parties identified White Pearl as a *sociedad anómina* and pointed to an earlier Seventh Circuit characterization of that entity as a joint stock company. 647 F.3d at 687 (citing *Twohy v. First National Bank of Chicago,* 758 F.2d 1185, 1194–95 (7th Cir.1985)). The *White Pearl* court noted that a joint stock company is not treated as a corporation for diversity purposes and suggested that a *sociedad anónima* might instead be characterized as a corporation in light of various features described in the Uruguay Commercial Companies law. Nonetheless, the court concluded that it need not reach the question because a joint-stock company takes the citizenship of its equity investors, and the only two equity investors in While Pearl were citizens and residents of Brazil. The court therefore had diversity jurisdiction regardless of whether or not White Pearl could be characterized as a corporation. *Id.* Attorneys dealing with foreign business entities consisting of a limited number of investors may want to consider a similar strategy for establishing diversity jurisdiction.

Overall, these cases serve as a cautionary tale for attorneys casually relying on diversity jurisdiction without confirming the underlying facts. Attorneys should not automatically assume that a foreign business entity is really a corporation for diversity purposes, and they should consider the citizenship status of the appropriate partners, members, or investors. Knowing the relevant facts in advance can not only spare potential embarrassment at oral argument but can also avoid the risk and cost of supplemental briefing or, worse, dismissal of the case.