

Lawyer Insights

April 13, 2017

Beware: The Traps of Federal Diversity of Jurisdiction Over LLCs

by Jamie Isani and Rail Seoane

Published in Daily Business Review



It is every litigator's worst nightmare: litigating a case for many months, winning a judgment and then having the entire proceedings thrown out on a jurisdictional technicality. That is what happened in *Thermoset v. Building Materials of America*, No. 15-13942 (11th Cir. March 2, 2017). The case is an important reminder that for purposes of federal court diversity jurisdiction, a limited liability corporation is a citizen of any state of which any member of the company is a citizen.

Thermoset involved a dispute arising from the alleged failure of a roof system at an airport in the Bahamas. *Thermoset*, a roofing contractor, filed suit in Florida state court against a manufacturer and distributor, alleging several claims under Florida law. The manufacturer, Building Materials Corp. of America (GAF), removed the case to federal court, invoking diversity jurisdiction. GAF alleged that *Thermoset* was a citizen of Florida; GAF was incorporated in Delaware, with its principal place of business in New Jersey; and the distributor, Roofing Supply Group Orlando (RSGO), was incorporated in Delaware with its principal place of business in Texas. After nearly a year of litigation, the defendants moved for summary judgment, which the district court granted.

Thermoset appealed. While no party had challenged jurisdiction, the Eleventh Circuit sua sponte issued a jurisdictional question. The court questioned whether diversity jurisdiction was present because the pleadings did not identify or provide the citizenship of each member of RSGO, an LLC.

In the parties' responses to the jurisdictional question, it became clear that diversity jurisdiction did not exist at the time of removal because one of RSGO's members was a Florida citizen (as was the plaintiff). *Thermoset* asserted that this flaw could not be cured and asked the court to vacate the judgment and remand the case to state court. The defendants argued that the problem could be cured by dismissing RSGO because it was a nominal party whose citizenship should not be considered for jurisdictional purposes, or that the court should dismiss RSGO under Federal Rule of Civil Procedure 21 in order to preserve diversity jurisdiction over the rest of the case.

Beware: The Traps of Federal Diversity Jurisdiction Over LLCs
By Jamie Isani and Rail Seoane
Daily Business Review | April 13, 2017

The Eleventh Circuit found that RSGO was not a nominal defendant and concluded that allowing the action to continue without RSGO would "unfairly reward GAF for the jurisdictional defect it created and should have known about all along." The court vacated the judgment and sent the case back to be remanded to state court.

The Thermoset decision has important takeaways for both litigators and transactional attorneys. For litigators, the decision is a stark reminder of the need to properly plead the citizenship of an LLC when filing or removing a case to federal court. Although the rule for determining the citizenship of an LLC is well established, parties often allege the citizenship of LLCs as if they were traditional corporations, which are citizens of the state in which they are incorporated and of the state in which they have their principal place of business (as GAF did).

Litigators representing LLCs must conduct a thorough investigation to be sure they have properly accounted for the citizenship of every member. If a member of an LLC is another LLC, then the citizenship of every member of that LLC needs to be taken into account. In *Purchasing Power v. Bluestem Brands*, No. 16-11896 (March 20), the Eleventh Circuit again raised a jurisdictional question sua sponte, which led to the realization that one LLC did not hold an interest in another LLC directly; rather, a corporation set up for tax purposes was in the middle. The district court sanctioned the plaintiffs counsel for misrepresenting to the court that diversity jurisdiction existed. Although the Eleventh Circuit reversed the sanctions, it reminded us that "It is in everyone's best interest, both the litigants' and the courts', to verify that diversity jurisdiction exists before proceeding with the case," and "The simplest misstep has the potential to derail years of litigation and result in a massive financial sanction, as happened here."

Transactional attorneys who set up corporate structures should consider the implications on the jurisdictions in which an entity may sue or be sued. If an LLC has numerous members scattered throughout the country, citizens of numerous states would be able to sue in their respective state courts, and the LLC would be unable to remove to federal court on diversity grounds. There may be various reasons to utilize the LLC structure, but depending on the type of business and the volume of litigation that may be anticipated, and given that subject matter jurisdiction cannot be waived and may even be raised by the court sua sponte, this is a factor that should be considered when setting up a legal entity. If an LLC structure is utilized, the company should consider maintaining a log of the jurisdictions of each of its members that could be consulted in the event of litigation. Such log should be periodically reviewed for accuracy and completeness because, as *Purchasing Power* demonstrates, even the creation of an intermediary entity for tax purposes can destroy diversity jurisdiction and derail years of litigation.

Jamie Isani is a partner at Hunton & Williams LLP. She focuses her practice on complex business and financial services litigation, consumer class action defense, First Amendment litigation and complex appellate matters of all types. She can be reached at jisani@hunton.com. Rail Seoane is an associate at Hunton & Williams LLP. He focuses his practices primarily on general corporate representation and cross-border transactions. He can be reached at rseoane@hunton.com.