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SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

Allegations Supporting Diversity Jurisdiction Get Close Scrutiny

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Even a novice litigator can recite the two simple requirements for federal diversity jurisdiction: (1) complete diversity of citizenship of adverse parties and (2) an amount in controversy exceeding $75,000.[1] Three recent decisions from the U.S. District Court for the Southern District of New York serve as a reminder, however, that the dictates of the diversity statute, 28 U.S.C §1332, may not be as plain as they appear, especially to a judiciary growing skeptical of the continued need for diversity jurisdiction as a protection against local bias by state courts.

In *Mills 2011 v. Synovus Bank*[2] and *Abu Dhabi Commercial Bank v. Morgan Stanley*,[3] Southern District Judges Alison J. Nathan and Shira A. Scheindlin, respectively, each found diversity lacking after grappling with complicated questions pertaining to the citizenship of artificial entities. In *ACCD Global Agriculture v. Perry*,[4] Southern District Judge Katherine B. Forrest, sua sponte, dismissed the plaintiffs' amended complaint after rejecting the plaintiffs' unopposed efforts at alleging that more than $75,000 was in controversy.

Citizenship of a Trust

Judge Nathan's decision in *Mills 2011* provides a comprehensive and practical analysis of the factors for determining the citizenship of a trust for diversity purposes. The defendant in that action, Synovus Bank, a Georgia citizen, removed state law claims from state court alleging that plaintiff, Mills 2011 LLC, was a Delaware limited liability company with its principal place of business in New York, and that Synovus was unaware that any members of Mills were citizens of Georgia. Because Mills' sole member was a trust, whose beneficiary was another limited liability company, whose ownership traced to a third limited liability company that had Georgia citizens as its members—Mills sought remand arguing that it was non-diverse from Synovus.[5]

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Nathan assessed this labyrinthine chain of ownership in light of two Supreme Court decisions that appear, at first blush, to pull in opposite directions. In *Navarro Savings Association v. Lee*,[6] the court held that trustees were entitled to rely upon their own citizenship without consideration of the trust beneficiaries' citizenship when seeking to bring an action in their own names. By contrast, in *Carden v. Arkoma Associates*,[7] the court held that with respect to artificial entities, other than corporations, "citizenship depends on the citizenship of 'all of the members,' 'the several persons composing such association,' [and] 'each of its members.'"[8] Nathan harmonized these two decisions, holding that *Navarro* did not (as Synovus argued) speak to determining the citizenship of a trust, but rather answered the narrower question of determining the real party in interest in a suit by trustees brought solely in their own names.[9]

Finding that the Second Circuit had not addressed determining the citizenship of a trust litigating in its own name, Judge Nathan turned to the Third Circuit's detailed decision in *Emerald Investors Trust v. Gaunt Parsippany Partners*.[10] In *Emerald* the U.S. Court of Appeals for the Third Circuit considered four options for determining a trust's citizenship: "'(a) look to the citizenship of the trustee only; (b) look to the citizenship of the beneficiary only; (c) look to the citizenship of either the trustee or the beneficiary depending on who is in control of the trust in the particular case; or (d) look to the citizenship of both.'"[11]

Nathan approved *Emerald's* rejection of the first two approaches as contrary to *Carden's* directive to consider the citizenship of "all of the members of an artificial entity."[12] She also agreed with *Emerald's* conclusion that the third alternative—analyzing control on a case-by-case basis—imposed unnecessary burdens on the court and ran counter to the principle that jurisdictional rules should be simple and clear. She also noted that the third approach—to the extent it focuses on the real party to the controversy—is inconsistent with *Carden*, where the majority rejected the dissent's contention that the citizenship of a limited partnership should be determined by the real party to the controversy.[13]

Nathan then endorsed the Third Circuit's adoption of the final option, looking to the citizenship of both trustees and beneficiaries. She found persuasive the Third Circuit's conclusion that this approach was consistent with both *Navarro* and *Carden*, avoided a burdensome case-by-case approach, and "accommodated federal concerns attendant to the extension of diversity jurisdiction and the corresponding encroachment of the federal courts into the prerogatives of the state judiciary."[14] In addition, Nathan observed that state courts would be unlikely to show bias against a trust with either a local trustee or a

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local beneficiary.[15] Finally, she found the Third Circuit's "dual trustee-beneficiary approach" consistent with that of other district courts within the Second Circuit, which looked to the citizenship of beneficiaries in determining the citizenship of a trust.[16] Because Mills' long chain of memberships and beneficiaries ultimately led to citizens of Georgia, Nathan concluded that diversity was lacking.

State-Related Entities

While unincorporated associations can destroy diversity by virtue of their multistate citizenship, other entities can destroy diversity by lacking citizenship in any state. In *Abu Dhabi Commercial Bank*, the defendants challenged diversity arguing that two plaintiffs—the Pennsylvania Public School Employees' Retirement System (PSERS) and the State Board of Administration of Florida (FSBA)—were "arms" of their respective states, and therefore, like the states themselves, not a citizen of any state.[17] They argued in turn that presence of a party that is not a citizen of any state destroys complete diversity.

Judge Scheindlin considered, but quickly rejected that the court could exercise supplemental jurisdiction over non-diverse plaintiffs permissively joined under Federal Rule of Civil Procedure 20. In doing so, she distinguished supplemental claims that do not satisfy the amount in controversy requirement, from a defect in diversity, which "contaminates" the entire case and removes it from the purview of the supplemental jurisdiction statute.[18]

Scheindlin next addressed whether PSERS and FSBA were in fact arms of their respective states. Scheindlin concluded that PSERS' claims had to be dismissed for the court to retain jurisdiction, as plaintiffs had conceded that it was an arm of the state.[19] However, the parties disputed whether FSBA was an arm of the state of Florida—a question Scheindlin held required application of the Supreme Court's six-factor test in *Moor v. Alameda*,[20] relating to the relationship of the entity to the state. *Moor* calls for consideration of: "(1) whether [the entity] had 'corporate powers and [was] designated a body corporate and politic'; (2) whether it 'could sue and be sued'; (3) whether it was 'a local public entity in contrast to the state and state agencies'; (4) whether it was 'liable for all judgments against it [and] authorized to levy taxes to pay such judgments'; (5) whether it could 'sell, hold, or otherwise deal in property'; and (6) whether it was 'empowered to issue general obligation bonds payable from county taxes' which 'create no obligation on the part of the State.'"[21]

Applying these factors, Scheindlin concluded that FSBA was a separate entity for purposes of diversity jurisdiction. She relied principally on the Florida Supreme Court's characterization of FSBA as a separate body corporate with the power to own property, to sue, and be sued. Exercising her authority under Federal Rule of Civil Procedure 21 to dismiss "parties whose presence in the litigation destroys jurisdiction,"[22] Scheindlin dismissed the claims of PSERS while retaining FSBA as a party.

Judge Forrest's decision in 'Perry' suggests a greater willingness to push back against conclusory allegations as to the amount in controversy.

Amount in Controversy

In *ACCD Global v. Perry,* Judge Forrest independently assessed the sufficiency of allegations designed to satisfy the $75,000 amount in controversy requirement for diversity jurisdiction. Plaintiffs asserted claims arising from a failed business venture and sought $1 million in lost profits for defendants' alleged failures to properly support the venture.[23] Defendants moved to dismiss five of the amended complaint's seven claims under Federal Rule of Civil Procedure 12(b)(6), without challenging the court's subject matter jurisdiction or plaintiffs' demand for lost profits.[24]

Instead of ruling on defendants' motion, Forrest dismissed the amended complaint sua sponte for lack of subject matter jurisdiction under Rule 12(b)(1).[25] While discussing at length the substantive law on recovery of lost profits, particularly as to new ventures, she observed that "[a] plaintiff may recover lost profits 'only if he can establish both the existence and amount of such damages with reasonable certainty.'"[26] Parsing the amended complaint, Forrest concluded that it lacked "a single allegation…suggesting that [the plaintiffs' entity] would ever have been profitable" and that when limited to well-pleaded allegations, was left only with a claim for $12,157—the amount plaintiffs claim to have advanced to defendants.[27]

Forrest's decision in *Perry* is interesting in light of the general approach in the Second Circuit recognizing a "rebuttable presumption that the face of the complaint is a good faith representation of the actual amount in controversy" and that a "party opposing jurisdiction must show *to a legal certainty* that the amount recoverable does not meet the jurisdictional threshold."[28] Forrest's close scrutiny of plaintiffs' demand may stem from skepticism about the continued need for diversity jurisdiction. Although noting diversity remains "an open avenue to the federal courts," she questioned "whether the fear of…local biases continues to justify the ability to access the federal courts, especially in light of the expertise one assumes state courts have over the issues of state law."[29] She also remarked on "the overwhelming number of cases" based on diversity jurisdiction.[30] Such criticisms are neither uncommon nor new,[31] but Forrest's decision in *Perry* suggests a greater willingness to push back against conclusory allegations as to the amount in controversy.

Conclusion

This trio of recent Southern District cases is a reminder that while many litigants will reach to satisfy the requirements of the diversity statute in order to have their cases heard in federal court, the courts themselves are less anxious to stretch the bounds of such jurisdiction and will resist novel theories and conclusory allegations pertaining to the dual requirements of complete diversity and amount in controversy.

1. *Moser v. Pollin*, 294 F.3d 335, 340 (2d Cir. 2002).
2. 2013 WL 443541 (S.D.N.Y. Feb. 5, 2013) (Nathan, J.).
3. 2013 WL 395044 (S.D.N.Y. Feb. 1, 2013) (Scheindlin, J.).
4. 2013 WL 840706 (S.D.N.Y. March 1, 2013) (Forrest, J.).
5. Id. at *1-2.
6. 446 U.S. 458 (1980).
7. 494 U.S. 185 (1990).
8. 2013 WL 443541, at *3 (quoting *Carden* 494 U.S. at 195-96).
9. Nathan also distinguished the Second Circuit decision in *Catskills Development v. Park Place Entertainment*, 547 F.3d 115 (2d Cir. 2008), on the grounds that like *Navarro*, it concerned a suit brought by trustees in their own names. 2013 WL 443541, at *4.
10. 492 F.3d 192 (3d Cir. 2007).
11. 2013 WL 443541, at *5 (quoting *Emerald*, 492 F.3d at 201).
12. Id.
13. Id at *6.
14. Id.
15. Id.
16. Id. at *7 (citing *Quantlab Fin. v. Tower Research Capital*, 715 F.Supp.2d 542, 546-49 (S.D.N.Y. 2010) (Cote, J.); *FMAC Loan Receivable Trust 1997-C v. Strauss*, 2003 WL 1888673 (S.D.N.Y. April 14, 2003) (Kaplan, J.); *Pavlov v. Bank of N.Y. Co.*, 135 F.Supp.2d 426, 432 (S.D.N.Y.2001) (Kaplan, J.)).
17. 2013 WL 395044, at *1.
18. Id. at *2 & n.18.
19. Id.
20. 411 U.S. 693 (1973).
21. 2013 WL 395044, at *1 (quoting *Moor*, 411 U.S. at 719).
22. Id. at *1 n.3.
23. 2013 WL 840706, at *3-4.
24. Id. at *4.
25. Id. at *1.
26. Id. at *5 (quoting *Schonfeld v. Hilliard*, 218 F.3d 164, 172 (2d Cir. 2000)).
27. Id. at *6-7.
28. *Scherer v. Equitable Life Assurance Soc'y of U.S.*, 347 F.3d 394, 397 (2d Cir. 2003) (internal quotations omitted) (emphasis added).
29. 2013 WL 840706, at *1.
30. Id.
31. See, e.g., *Lumbermen's Mut. Cas. v. Elbert*, 348 U.S. 48, 54 (1954) (Frankfurter, J., concurring) (referring to "the mounting mischief inflicted on the federal judicial system by the unjustifiable continuance of diversity jurisdiction").