Jurisdictional issue jeopardizes eight-figure verdict

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1st Circuit's decision called 'required reading'

While its author called it a mere "reminder," attorneys view a recent 1st U.S. Circuit Court of Appeals decision as more of a stern warning of the dire consequences one faces if not scrupulous when invoking diversity of citizenship to get into federal court when a case involves limited liability companies or trusts.

In *BRT Management LLC v. Malden Storage, LLC, et al.*, the plaintiff-in-counterclaim won an eight-figure judgment against the plaintiff and a third-party defendant after six years of litigation.

"This is a decision that cannot be ignored."

But that award is now in jeopardy because the parties had never demonstrated — at least to the 1st Circuit's satisfaction — that there was complete diversity between them.

The issue was on the defendants' side, where there were dozens of members, including individuals, corporations and trusts, nested within the defendant LLCs.

The defendants filed the latest in a series of affidavits, which they believed cured the jurisdictional deficiencies identified by both the 1st Circuit and the court below. But the 1st Circuit found that filing "still insufficient" because the defendants had "failed to undertake the 'iterative' process that is required to determine the citizenship of an unincorporated association whose members are themselves unincorporated associations," Judge William J. Kayatta Jr. wrote for the panel.

Specifically, some of the ultimate owners of the nested LLCs that own the defendant LLCs are trusts, and the defendants had only provided the citizenship of the trustee without describing the nature of the trust.

“Nor have defendants provided information about the trusts’ beneficiaries or members (however defined) that might moot any need to determine whether it is necessary to look beyond the citizenship of the trust or its trustees,” Kayatta wrote.

Given that the defendants had failed to meet the 1st Circuit’s mandate, dismissal would arguably be appropriate, Kayatta noted.

But instead, the court decided to give the parties “one more chance” to establish that the District Court has subject matter jurisdiction.

‘Required reading’

The plaintiff’s attorney in *BRT Management*, John S. Davagian II of Sudbury, said his impression was that everyone involved in the case, including the presiding judge, U.S. District Court Judge F. Dennis Saylor IV, thought the jurisdictional issue had been resolved.

While Saylor had directed some questions to the defendants concerning the diversity of the parties, he seemed satisfied enough with the response that the case continued through discovery and ultimately trial, Davagian noted.

But once Davagian filed his appeal, the 1st Circuit explored the jurisdictional issue anew.

“Obviously, the 1st Circuit did not look at it the same way,” Davagian said.

Davagian has already benefited in his practice from the 1st Circuit saying, in essence, “a pox on both of your houses.” Last month, he drew upon his experience in *BRT* to get a case in the 3rd Circuit dismissed on the grounds of a lack of diversity between the parties. Both the plaintiff and defendant had members in Texas.

The defendants’ attorneys in *BRT Management*, Boston’s Alec S. Pine and John H. Brazilian, had not responded to requests for comment as of Lawyers Weekly’s deadline.

But Boston attorney Stephen D. Riden called *BRT* “required reading for any attorney who is going to represent or be adverse to an LLC or trust in federal court.”

The case illustrates that the burden to conclusively establish the diversity of citizenship "never ends," Riden said. He noted that the parties thought they were doing the right thing by stipulating that diversity existed, apparently having mutually decided that it may not be worth the effort to drill down and identify every natural person involved in a trust or LLC.

But the 1st Circuit was "merciless" in emphasizing that there are "no shortcuts," he said.

Boston attorney Payal Salsburg agreed, though she said she was surprised that the case had gotten as far as it did without it being firmly established that subject matter jurisdiction existed.

"It drives home the point that even things that are legal technicalities are super important," she said.

As much as the 1st Circuit's decision is a "cautionary tale," it is also a "helpful guide," recommending a process of conducting limited jurisdictional discovery of non-public information at the outset of a case to confirm that jurisdictional diversity exists, Riden observed.

"This is a decision that cannot be ignored, with application to every single case in federal court with an LLC, LLP or a trust as a party," Riden said.

Boston business litigator Emily C. Shanahan concurred that *BRT* is "a stark reminder that subject matter jurisdiction should neither be treated as an academic exercise nor glossed over, especially when one or more of the parties is, or will be treated as, an unincorporated entity for diversity jurisdiction purposes."

She noted that the challenge the plaintiff faced — identifying the citizenship of the individual members of a defendant limited liability company — is not unique.

"Access to such information through public records is limited," she said.

Shanahan suggested that, given the potential for collateral litigation over the existence of complete diversity, counsel should consider whether filing in federal court is in the client's best interest. That is especially true when the claims involve only questions of state law.

> **"[*BRT*] sends a loud message to practitioners not to make assumptions about diversity, or you can waste a lot of time and money only to find out everything was for naught."**

Filing in state court relieves the plaintiff of the burden of having to track down the individual members of a defendant LLC or disclose the plaintiff's own members, she said.

"If the defendant opts to remove the case, it then assumes the burden of establishing subject matter jurisdiction," Shanahan said.

However a case ends up in federal court, it is in the parties' interests to ensure a solid foundation for subject matter jurisdiction exists before moving ahead with litigating the claims on the merits, she added.

Boston attorney Louis M. Ciavarra joined the chorus of those saying that *BRT* "sends a loud message to practitioners not to make assumptions about diversity, or you can waste a lot of time and money only to find out everything was for naught."

When corporations were the primary business entity that existed in the world, establishing diversity of citizenship was much easier, he said.

"The disclosure required by Rule 7.1 should provide this information, but you are relying on the accuracy of it, and if the information is wrong, you could still be dismissed because subject matter jurisdiction can't be waived," Ciavarra said.

As a practical matter, it is best to do as much due diligence as possible on your own, he said.

"When you receive the [other party's] disclosure, follow up on the information," Ciavarra said. "And if there are any unknown facts about citizenship, start out with some early discovery, as suggested in this case."

He added that the Rules Committee could consider adding a requirement to the automatic disclosures in Rule 26.1 and LR 26.1(b) to encourage the exchange of sufficient information.

Multiple chances

Unable to resolve a contract dispute over the design and construction of New York and Massachusetts storage facilities, plaintiff BRT Management LLC filed a federal lawsuit against defendants Malden Storage LLC, Plain Avenue Storage LLC and Banner Drive Storage LLC.

Neither the original suit nor the defendants' counterclaims presented a question of federal law, and the only basis for federal jurisdiction was diversity jurisdiction under 28 U.S.C. §1332.

BRT's complaint contained a bare assertion that "there is complete diversity between the parties." BRT noted that it was a Massachusetts limited liability company with a usual place of business in Massachusetts, while the defendants were Delaware LLCs with usual places of business in Illinois.

As a matter of black letter law, such an assertion as a basis for federal jurisdiction was insufficient because it made no mention of the citizenship of the members of the LLCs, the 1st Circuit noted.

Saylor ordered BRT to show cause why the action should not be dismissed for lack of subject matter jurisdiction. BRT responded by alleging that its sole member was a natural person who was a resident of Massachusetts, that the sole member of both Malden and Plain Avenue was C Banner Storage LLC, a "Delaware LLC," and that the sole member of Banner was Banner Storage Holding LLC, "also a Delaware LLC." BRT did not allege the citizenship of any members of C Banner Storage or Banner Storage Holding.

Saylor then issued a second order to show cause. This time, BRT responded that, after diligent investigation, it had been unable to identify the citizenship of the C Banner Storage or Banner Storage Holding members and requested limited jurisdictional discovery, which Saylor granted.

The parties then filed a "stipulation regarding diversity jurisdiction" vouching that complete diversity of citizenship existed, though the facts detailed in the stipulation peeled back only a few more layers of the onion. It left unidentified the citizenship of B-Dev Manager LLC, which was the sole member of C Banner Storage, which in turn was the sole member of both Malden and Plain Avenue.

The stipulation also noted that there were more than 80 members of Banner Drive Storage, including various individuals, LLCs and trusts, and at least one investor who was a Massachusetts resident, which led the parties to dismiss Banner to preserve diversity as basis for federal jurisdiction.

After a nine-day bench trial in 2021, Saylor granted judgment for the defendants and awarded them over $10 million on their counterclaims, including attorneys' fees.

BRT appealed, which prompted the 1st Circuit to issue an order identifying problems with subject matter jurisdiction “yet again.”

In response to the court’s order, BRT reiterated that it had only one member, a Massachusetts resident, while the defendants offered up the same facts set out in the stipulation in the District Court.

Perhaps unsurprisingly, given the eight-figure verdict hanging over its head, BRT lost interest in salvaging the jurisdictional viability of the litigation and moved to remand the case to the District Court for additional jurisdictional discovery, pointing out a number of defects with the defendants’ appellate filing.

In response, Malden and Plain Avenue filed under seal yet another affidavit of jurisdictional facts, providing additional information regarding the ownership of the LLC members of Malden and Plain Avenue and those LLCs’ members, identifying the ultimate owners of defendants’ members as individuals, corporations and trusts.

For the individuals, their citizenship was identified by their domiciles. For the corporations, their principal places of business and states of incorporation were provided. For the trusts, the defendants noted the domiciles of their trustees.

The defendants figured they had finally solved the diversity riddle. But the 1st Circuit had other ideas.

A case for limited discovery

In what it called a “coda” to its decision, the 1st Circuit noted the “predicament” plaintiffs like BRT face when they wish to sue an unincorporated entity but the information necessary to establish jurisdiction “may be uniquely in the possession of the would-be defendant.”

Through its public record searches, BRT had been able to discover nothing more than the states of organization of the defendant LLCs, the panel pointed out.

The 1st Circuit called “sensible” Saylor’s approach to allowing limited jurisdictional discovery after the plaintiff’s good-faith allegation that complete diversity of citizenship existed.

“If done right, limited and succinct jurisdictional discovery to confirm diversity that is otherwise not belied by what is known to the parties can assure the parties and the court at an early stage of litigation that complete diversity exists,” Kayatta wrote.

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