U.S. Supreme Court Holds That, for Diversity Jurisdiction Purposes, a Maryland REIT’s Citizenship Is Based Upon Citizenship of its Shareholders

Summary

The U.S. Supreme Court, in Americold Realty Trust v. Conagra Foods, Inc., No. 14-1382 (U.S. Mar. 7, 2016), held that, for diversity jurisdiction purposes1, the citizenship of an entity organized as a real estate investment trust under Maryland state law (a Maryland REIT)2 is based on the citizenship of all its members, including its shareholders. The Court thus declined to depart from the rule it has previously applied to unincorporated entities such as partnerships: while a corporation has existence and citizenship independent of that of its shareholders, other unincorporated entities do not. The Court’s decision may make it more difficult for certain entities not formed as corporations (including public companies organized as Maryland REITs or other unincorporated statutory trusts, and perhaps non-statutory business trusts) to access the federal courts.

The Court’s Reasoning

The Court noted that the different rule for corporations arose from the fact that corporations were originally not considered citizens of anywhere and thus were not able to sue or be sued in federal court, a rule the Court reversed by recognizing corporate citizenship in 1844. Slip op. at 3. However, the Court noted that:

Congress never expanded this grant of citizenship to include artificial entities other than corporations, such as joint-stock companies or limited partnerships. For these unincorporated entities, we too have adhered to our oft-repeated rule that diversity jurisdiction in a suit by or against the entity depends on the citizenship of all its members.

Despite our oft-repetition of the rule linking unincorporated entities with their “members,” we have never expressly defined the term. But we have equated an association’s members with its owners or the several persons composing such association. Applying this principle with reference to specific states’

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1 In order to institute a suit in (or remove it to) federal court, either (a) the suit must involve diversity of citizenship (i.e., a case between citizens of different states) and an amount in controversy of greater than $75,000 or (b) the court must have federal subject matter jurisdiction. Federal subject matter jurisdiction arises in cases in which the U.S. is a party or one or more of the claims is brought under the U.S. Constitution or federal laws such as securities, antitrust, copyright, patent or maritime laws. Such suits can be brought in federal court regardless of the “citizenship” of the litigants, and some such suits are restricted to federal court.

2 In this context, “REIT” does not refer to the tax status of the entity but instead refers to the type of entity formed under state law. Companies that are organized as corporations under state law (including those that elect to be treated as real estate investment trusts under federal income tax laws) are not affected by the Court’s decision.
laws, we have identified the members of a joint-stock company as its shareholders, the members of a partnership as its partners, the members of a union as the workers affiliated with it, and so on.

Id. at 3 (quotations and citations omitted). Turning to Maryland REITs, the Court looked to state law:

In Maryland, a real estate investment trust is an “unincorporated business trust or association” in which property is held and managed “for the benefit and profit of any person who may become a shareholder.” As with joint-stock companies or partnerships, shareholders have “ownership interests” and votes in the trust by virtue of their “shares of beneficial interest.” These shareholders appear to be in the same position as the shareholders of a joint-stock company or the partners of a limited partnership—both of whom we viewed as members of their relevant entities. ...We therefore conclude that for purposes of diversity jurisdiction, [the Maryland REIT's] members include its shareholders.

...Traditionally, a trust was not considered a distinct legal entity, but a “fiduciary relationship” between multiple people. ...Such a relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name. ...And when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes. ...For a traditional trust, therefore, there is no need to determine its membership, as would be true if the trust, as an entity, were sued.

Many states, however, have applied the “trust” label to a variety of unincorporated entities that have little in common with this traditional template. Maryland, for example, treats a real estate investment trust as a “separate legal entity” that itself can sue or be sued. So long as such an entity is unincorporated, we apply our oft-repeated rule that it possesses the citizenship of all its members...But neither this rule nor [a prior decision] limits an entity’s membership to its trustees just because the entity happens to call itself a trust. We therefore decline to apply the same rule to an unincorporated entity sued in its organizational name that applies to a human trustee sued in her personal name.

Id. at 4-5 (quotations and citations omitted).

The National Association of Real Estate Investment Trusts (NAREIT) submitted an amicus brief contrary to the Court’s decision in which NAREIT argued, among other things, that a Maryland REIT is nearly identical to a corporation and should be treated in the same manner for diversity jurisdiction. However, the Court left to Congress whether it would be prudent to re-examine the distinction between corporations and other unincorporated entities.

**Analysis**

The Court’s decision may make it substantially less likely for certain companies organized as entities other than corporations (including public companies organized as Maryland REITs for or other unincorporated statutory trusts, and perhaps non-statutory business trusts) to obtain access to federal court for disputes based upon diversity of citizenship. In particular, for any such companies that are publicly traded (and would therefore likely have shareholders in most or all U.S. states), the Court’s decision may effectively deprive access to the federal courts for disputes based solely upon diversity of citizenship.
Companies involved in litigation often determine that it is strategically advantageous to litigate in federal court due to considerations such as the perceived quality, experience and independence of the federal judiciary and other factors, including greater ease of taking discovery. As a result, parties to transactions across state borders often prefer to designate federal court as an agreed forum for the resolution of disputes. However, diversity of citizenship as a basis of jurisdiction is grounded in Article III of the Constitution, and cannot be waived: if a federal court would not have diversity jurisdiction over a case due to the citizenship of the parties, it cannot be conferred by their agreement. In light of the Court’s decision, companies that are organized as entities other than corporations—or that do business with such entities—and that view recourse to federal court as preferable for disputes should consider the possibility that (a) federal court may not be available and (b) in respect of particular contracts, provisions calling for mandatory jurisdiction solely in federal court may not be enforceable.

As a result of the Court’s decision, the unavailability of a federal forum for certain companies may suggest the wisdom of arbitration instead. Of course, companies could also consider changing their forms of organization to become corporations, but such a change may ascribe too much benefit to the potentially better access to federal courts, particularly if there are tax, state law or other advantages to their current structure.

In addition, parties organizing new companies should take this issue into consideration when determining the appropriate form of organization. However, as mentioned above, tax, state law or other advantages may outweigh the benefits of being better positioned to access federal courts.

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