Diversity Jurisdiction: Could the Doors to Federal Courts Soon be Shuttered Against Lenders in Securitized Loans?

by Nelwyn W. Inman

Any party contemplating a legal claim in court likely considers their options for bringing an action in a state court as opposed to filing suit in a federal court. Forum shopping is not a dirty word, but has long been a cornerstone of any proper analysis of legal strategy. Likewise, a defendant sued in state court must quickly determine whether removal of the case to a federal court is their best option for a fair adjudication. 28 U.S.C. §1441. However, a ruling of the U. S. Supreme Court in March of 2016 in the *Americold Realty* case may be used to make the option of suing in federal court a luxury of the past no longer afforded to those having a stake in loans held in securitized trusts. *Americold Realty Trust v. Conagra Foods, Inc.*, 136 S.Ct. 1012 (2016)

In addition to hearing claims involving a "federal question" (28 U.S.C. §1331) or other specific areas of federal law such as admiralty (28 U.S.C. §1333) or bankruptcy (28 U.S.C. §1334), United States District Courts have long since had jurisdiction over even state law cases where claims are brought by a citizen of one state against a citizen of a different state provided that the amount in controversy between them is over $75,000. 28 U.S.C. §1332(a). Where there is more than one plaintiff or multiple defendants, there must be "complete" diversity such that the state of citizenship of no plaintiff is the same as any defendant. *Id.* Determining citizenship of human beings, though not without potential for dispute especially in our modern, mobile society, tends to be a fairly simple test: where does the individual live or of what state is the individual a resident. The issue of citizenship of entities is a much more complex than an inquiry which might look into the geographic location where a person has hung their family's framed, cross-stitched "Home Sweet Home" declaration over the fireplace.

Congress has long since taken the mystery out of the citizenship inquiry for corporations with the enactment of 28 U.S.C. §1332(c)(1) which provides that a corporation is a citizen of the state of incorporation and where it has its principal place of business. The statute makes no mention of the citizenship of the stockholders who own the corporation. While corporate citizenship opens the door for disputes on the location of a single, principal place of business, the statute does narrow the field of possibilities. Unfortunately, Congress has yet to provide similar guidance on the question of citizenship of other business entities which are not corporations including limited liability companies and partnerships.

Federal Diversity Citizenship for Trusts versus REITs

Citizenship of a trustee as a litigant on behalf of a trust has not been a matter of particular controversy with the citizenship of the trustee being considered the citizenship of the trust. By extension of this well-established rule, conventional wisdom would suggest that citizenship of a securitized trust for purposes of litigation would not become a matter of great debate; however, the decision of the Court in the *Americold* case may put that ball back

in the air for those looking to thwart federal court actions brought on behalf of a CMBS trust.

The disputed citizenship in the *Americold* case involved a real estate investment trust (REIT). The suit began when several corporations sued the REIT, Americold Realty Trust, under state law in a Kansas court on claims relating to damage suffered on account of a fire at property held and managed by the REIT. Americold successfully removed the suit to federal district court based on diversity of citizenship and an amount in controversy exceeding $75,000. The district court looked at the states in which each party was formed and the locations of their principal place of business and found complete diversity.

The Tenth Circuit reversed, finding that a test different from that applied to corporations was required to determine citizenship of the REIT which could be done only by drilling down to the citizenship of each shareholder of the REIT. There being no evidence of the citizenship of each holder of an interest in the REIT in the record, the appellate court ruled that the REIT as the defendant requesting removal of the state court action had failed to establish complete diversity of citizenship. The United States Supreme Court agreed.

The Supreme Court in *Americold* found that the rule to be applied to determine the citizenship of any artificial non-corporate entity is to look to the citizenship of all its component members. Americold is a real estate investment trust formed under Maryland law where "property is held and managed 'for the benefit and profit of any person who may become a shareholder.'" *Id.* at 1016. The *Americold* court rejected the notation that a REIT is a "traditional" trust which could only sue or be sued through its trustee or board of trustees. Based on the ruling in *Americold*, a REIT can avail itself of federal court diversity jurisdiction only if no shareholder of the REIT is a citizen of the same state as any adverse party. Considering the number of investors in any given REIT, especially one which is publicly traded, application of this rule makes those odds very slim.

Diversity of Citizenship Rules for a REIT be Applied to CMBS Trust

So goes the dim future of a REIT's prospects of getting into federal court, but how would the ruling in *Americold* affect the ability of a lender pressing its rights in federal court in the context of a CMBS loan? The answer to that comes from the United States District Court for the Northern District of Texas in the case of *Wells Fargo Bank, N.A. (as Trustee for the Registered Holders of J.P. Morgan Chase Commercial Mortgage Securities Corp., Commercial Mortgage Pass-Through Certificates Series 2001-C1 Acting by and Through Its Special Servicer CWCapital Asset Management LLC) v. Transcontinental Realty Investors, Inc.*, 2016 WL 3570648, (N.D. Tex. 2016).

The plaintiff in *Transcontinental*, as holder of a securitized loan, sought a money judgment for guaranty liability against a Nevada entity with a principal place of business in Texas in federal court based on diversity of citizenship, asserting its citizenship as South Dakota, it being a national bank with its main office in that state. The defendant moved to dismiss the case based on lack of diversity jurisdiction, and the court granted the motion finding that plaintiff had not met its burden of establishing that there is complete diversity of citizenship.

The district court in *Transcontinental* found that it was necessary to "disregard nominal or formal parties and rest jurisdiction only upon the citizenship of real parties to the controversy." *Id.* at 2. The court decided to overlook the fact that the trustee was the named party plaintiff and instead put stock in the use of the defined term "Trust" used interchangeably with the defined term "Plaintiff" further finding that the trustee was but a nominal party and that the trust itself was the real party in interest. The court found any otherwise applicable precedent holding that the citizenship of a trust is that of its trustee to have been overturned by the ruling of the Supreme Court in *Americold*. *Id.*

The district court in *Transcontinental* made some moment of the plaintiff not being a "traditional" trust denoted by a fiduciary relationship. Rather than being a true trust which can sue and be sued only through its trustee, the district court found the CMBS trust to be "an artificial entity with its own legal existence" apparently independent of the trustee. Based on this finding, the district court found that it would be necessary to establish the citizenship of each "member" of the trust in order to determine whether there is complete diversity of citizenship. The plaintiff having failed to do so, the court dismissed the case for lack of jurisdiction. Not surprisingly, the case is being appealed to the Fifth Circuit Court of Appeals. A similar ruling made on the same fundamental basis was issued by the United States District Court for the Southern District of Texas in *Juarez v. DHI Mortgage Company, Ltd.*, 2016 WL 3906296 (S. D. Tex. 2016) in regard to a residential mortgage.

Not All Courts Apply the *Americold* Rule to CMBS Trusts

Fortunately, other district courts have found the long standing rule that citizenship of the trustee determines citizenship of a securitized trust still holds true and is not contrary to the ruling in *Americold*: See, *The Bank of New York Mellon, as Trustee for the Benefit of The Certificate Holders of CWABS, Inc., Asset Backed Certificates, Series 2004-2 v. Townhouse South Association, Inc.*, 2016 WL 3563503 (D. Nev. 2016); *U.S. Bank, National Association, solely in its capacity as Trustee of Mastr Adjustable Rate Mortgages Trust 2006-OA2, Mastr Adjustable Rate Mortgages Trust 2007-1 v. UBS Real Estate Securities Inc.*, 2016 WL 4690410 (S.D. N.Y. 2016); *Halley v. Deustche Bank National Trust Company, as Trustee for Morgan Stanley ABS Capital I Inc., Trust 2004-HE3, Mortgage Pass-Through Certificates, Series 2004-HE3*, 2016 WL 3855872 (S.D. Tex. 2016); and *HSBC Bank USA, National Association, as Trustee for Deutsche Alt-A Securities Inc. Mortgage Loan Trust, Mortgage Pass-Through Certificates Series 2007-1 v. Johnson*, 2016 WL 1626219 (S.D. Tex. 2016).

If the line of reasoning used by the district court in the *Transcontinental* case is followed, the option of a holder of a securitized loan to enforce its contractual rights or to defend a lender liability claim in a federal court would be all but gone. It would be a rare case indeed where there is no stakeholder in the trust having the same citizenship of any obligor or other defendant at any given moment in time. For any limited liability company or partnership holder of a bond, it would be necessary to drill down further to the holders of those interests until they are found to be in the hands of a corporation, an individual, or possibly a decedent's estate - no matter how many levels must be penetrated to do so or degrees of separation there are standing between the bond holder and the "real" corporate or individual

party in interest. Even if a plaintiff wished to devote the first ten pages of its complaint to establishing the citizenship of every individual or corporation which directly or indirectly holds an interest, there would be few cases where no defendant hailed from the same state as even one direct or indirect holder of a stake in the trust.

The district court in *Transcendental* seems to take the lesson of the Supreme Court in *Americold* to be that you should never be misled by the use of the work "trust" in any party name and always look for it to be something other than denoting a fiduciary relationship. It is not clear that the Court in *Americold* intended to upend well-established law on the citizenship and ability to sue and be sued of a trustee who truly does have a fiduciary duty to beneficiaries of the trust. The *Transcontinental* ruling, if followed by other courts, would do just that since, by definition, a trustee does not itself hold a direct stake in the benefits of the trust, but rather owes the heightened fiduciary duty to those beneficiaries who do. The beneficiaries of any trust are always the real parties in interest on questions involving assets of the trust with something either to lose or to gain by the result of any litigation. The trustee by definition is a nominal holder with no interest in its own right but with the duty to act only on behalf of the beneficiaries.

A Legislative Solution

The Supreme Court in *Americold* noted the best path to a solution for what seems an arbitrary result with treatment of corporations receiving such different treatment as opposed to non-corporate artificial business entities including REITs, limited liability companies, and partnerships: Congress. Congress enacted the rule for citizenship of corporations in 28 U.S.C. §1332(c), and Congress can likewise enact rules for other forms of business entities that create some parity in availability of the federal courts to all duly formed entities. It is high time that Congress did just that.

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