Diversity Disclosures Under Amended Rule 7.1

What Federal Court Practitioners Need to Know

Zachary VanVactor

For more than two decades, Federal Rule of Civil Procedure 7.1 has required nongovernmental corporate parties to file a disclosure statement when they first appear or take any action in a federal court lawsuit. However, as of December 1, 2022, the amended version of Rule 7.1 now imposes a new requirement in diversity jurisdiction cases that each party or intervenor file a disclosure statement that names and identifies the citizenship of every individual or entity whose citizenship is attributed to it.

This amendment effectively formalizes an additional disclosure requirement and provides uniformity across all federal district courts in determining the citizenship attributed to every party and, consequently, the existence of diversity jurisdiction.

At first glance, this new requirement seems relatively straightforward, as attorneys practicing in federal court should be familiar with pleading diversity in complaints and notices of removal. Nevertheless, the new rule may present serious challenges in certain instances, which may in turn affect a party's ability to litigate in federal court. Federal practitioners would do well to familiarize themselves with this new requirement and how it applies to their clients.

The origins of Rule 7.1 corporate disclosures

Since 2002, Rule 7.1 has required nongovernmental corporate parties in federal court to file a disclosure statement that either identifies its parent corporation(s) and any publicly held corporation owning 10% or more of its stock, or states there is no such corporation. The original rule was adopted in furtherance of the "financial interest" standard of Canon 3C(1)(c) of the Code of Conduct for United States Judges, the primary purpose being to provide judges the information needed to make informed recusal decisions in situations that would require automatic disqualification.

Diversity jurisdiction and removal, generally

As federal practitioners are likely well aware, a party asserting federal jurisdiction based on diversity must establish (among other things) that the lawsuit is between "citizens of different states." 28 U.S.C. § 1332(a)(1). While a lawsuit certainly may be filed originally in federal court where diversity exists, diversity jurisdiction often is raised as the basis for removing a state court case to federal court.

Particularly on the defense side, proceeding in federal court is often seen as beneficial for a number of reasons, including but not limited to mitigating local bias by pooling juries from a larger geographic area. Under the federal removal statute, a defendant generally has 30 days from the date of service to remove an action filed in state court. 28 U.S.C. § 1446(b). And because removal implicates significant federalism concerns, the U.S. Supreme Court has long made clear that removal jurisdiction is to be strictly construed.

The effects of Rule 7.1's new citizenship disclosure requirement

While the original aim of Rule 7.1 was focused on judges' financial interests and whether such interests required disqualification (and thus was not intended to bear upon the issue of the court's jurisdiction), the amended rule now adds an additional focus on the determination of parties' citizenship for purposes of diversity jurisdiction. Rule 7.1, as amended, now includes the following requirement in subsection (a)(2):

> "In an action in which jurisdiction is based on diversity under 28 U.S.C. § 1332(a), a party or intervenor must, unless the court orders otherwise, file a disclosure statement. The statement must name—and identify the citizenship of—every individual or entity whose citizenship is attributed to that party or intervenor[.]"

This requirement does not relieve a party from its obligation to plead the grounds for jurisdiction, but rather was "designed to facilitate an early and accurate determination of jurisdiction." *See* Rule 7.1 advisory committee's note to 2022 amendment. And, importantly, the new rule applies both to plaintiffs and removing defendants, as well as to intervenors.

As was the case even before Rule 7.1's amendment, diversity jurisdiction turns on the citizenship not only of the parties themselves, but of all individuals and entities attributable to them. Determining the citizenship of individuals is usually an uncomplicated task. The citizenship of a corporation likewise is often easy enough to determine, as a corporation is typically deemed to be the citizen of the state(s) where it is incorporated and where it has its principal place of business (or its "nerve center," as more recent precedent dictates). However, the determination of citizenship for unincorporated entities—such as LLCs, partnerships, or joint ventures—may present more of a challenge and a potentially onerous task in complying with Rule 7.1(a)(2).

Unincorporated entities' citizenship generally is determined by the citizenship of their constituent members, partners or owners. That is, an unincorporated entity is considered a citizen of every state where its members or partners are citizens. If any of those members or partners are themselves unincorporated entities, then each of their members and partners also must be disclosed. And on and on down the rabbit hole it continues, at least until the ownership chain reaches an individual or corporation.

As a result, the determination of the citizenship attributable to a party that must be disclosed under Rule 7.1 can range from the exceedingly simple to the outright impossible, depending on the circumstances. For example, it is a relatively straightforward task to ascertain the citizenship(s) attributable to an LLC with a single individual member. But what about an LLC with 50 members, each of which are themselves LLCs, and each of which in turn have 50 members themselves who also are LLCs? In such an instance, the job of determining the names and citizenships of all such entities can quickly become exponentially more difficult, if not altogether unfeasible and impractical. (Indeed, the Advisory Committee's report of December 9, 2020 expressly acknowledged that "more elaborate LLC ownership structures may make it difficult, and at times impossible, for an LLC to identify all of the individuals and entities whose citizenships are attributed to it, let alone determine what those citizenships are.")

Nevertheless, the new rule may present serious challenges in certain instances, which may in turn affect a party's ability to litigate in federal court.

And, in such instances, those challenges are further complicated both by Rule 7.1(b)'s timing requirement (which requires the filing of the Rule 7.1(a)(2) disclosure with the party's first federal court filing) and by the 30-day removal deadline in § 1446(b).

The new diversity disclosure requirement thus has several important implications for attorneys who represent companies in federal court. Depending on how a company's ownership is structured, it may require significant time, energy and resources to run down all of the information needed to comply with Rule 7.1(a)(2). Moreover, there may be legitimate privacy concerns with divulging the names and citizenships of members/partners, particularly where an unincorporated entity has multiple organization tiers and those members/partners are far up the chain or are otherwise remote to the actual litigant party.

So what are federal practitioners to do to? First and foremost, they would be prudent to advise their clients who are businesses—particularly those who are LLCs or other unincorporated entities—to maintain up-to-date records on the citizenship of every individual or entity whose citizenship is attributable to them for purposes of establishing diversity. And, assuming such records aren't readily available or don't already exist, they would be wise (particularly on the defense side) to address these issues as early as possible to avoid risking an untimely removal and remand back to the state court.

Additionally, it should be noted that by adding the clause "unless the court orders otherwise," the drafters of Rule 7.1(a)(2) included a clear mechanism for limiting the required disclosure and for protecting clients' and others' interests where necessary. The Advisory Committee's comments reinforce the point that courts may limit the required disclosure "in appropriate circumstances," such as "when there are substantial interests in privacy and when there is no apparent need to support discovery by other parties to go behind the disclosure." *See* Rule 7.1 advisory committee's note to 2022 amendment. Still, as the new Rule 7.1 has only been in force for a few months, significant questions remain as to how, whether and in what instances courts will use that power.

The common theme that has emerged in the limited case law thus far—consistent with the stated purpose of the new rule—has been to affirm the importance of correctly determining the citizenships at play and, thus, the existence of diversity jurisdiction. Nevertheless, the handful of decisions that have addressed these issues have produced varied results. For example, several recent decisions by district courts in the Eleventh Circuit have taken a strict approach to parties' adherence to the new disclosure requirements—in one instance rejecting the use of a negative statement (e.g., "no member of the party LLC's sub-entities is nondiverse"), and in another ordering a defendant LLC to "identify the citizenship of each of its members, traced through until a corporation or natural person is reached."

By contrast, a district court in the Eighth Circuit granted a defendant's request to cut off its disclosure after three tiers where the LLC at that third tier had "hundreds or thousands" of members, finding the sheer number and remoteness of those members constituted the sort of "appropriate circumstances" envisioned by the Advisory Committee's comments. The precise contours of the new rule and how courts may limit the disclosures required no doubt will be fleshed out further in the coming months and years.

The amended version of Rule 7.1 has impacted, and will continue to impact, federal court practice and the litigation of cases based on diversity jurisdiction. Federal practitioners would be well served to familiarize themselves with the new rule—and, perhaps more importantly, to educate their business clients on the rule's new requirements.

Zack VanVactor is the co-chair of the LBA's Federal Practice Section and a partner in Stites & Harbison's Business Litigation Service Group. He practices a variety of trial court and appellate litigation in both state and federal court in Kentucky and Indiana. ■