# DIVERSITY JURISDICTION AND TRUSTS

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*The federal courts are currently divided on how to determine the diversity citizenship of trusts. Several circuits hold that trusts take the citizenship of their trustees. Another circuit holds that trusts take the citizenship of the trust's beneficiaries, and yet another considers the citizenships of both the trustees and the beneficiaries. But beyond this circuit split, a more significant problem plagues the law in this area: The courts of appeals have failed to recognize the distinction between traditional and business trusts. The former—what is most commonly thought of as a trust—is a gift and estate planning tool. The latter is an alternative to incorporation, and is designed to run a business and generate profit for investors.*

*In this Note, I examine the differences between traditional and business trusts in the context of federal diversity jurisdiction. After discussing the history of diversity jurisdiction and the nature of these two forms of trusts, I explore the current circuit split over the citizenship rules for trusts. I then propose a new rule that fits within the current Supreme Court case law in the field: Traditional trusts take the citizenship of their trustees, while business trusts take the citizenship of their members—the beneficiaries. Having proposed a rule that depends upon the type of trust at issue, I conclude by explaining that a trust can be classified by determining the primary purpose for which it was organized.*



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## INTRODUCTION

On November 20, 2013, international media mogul Rupert Murdoch was in Manhattan, standing before a New York state judge. Murdoch was no stranger to the legal system—news coverage in the previous two years prominently featured his testimony before Parliament and a London judicial inquiry, all stemming from a tabloid phone-hacking scandal that mired his company in litigation.[1] But in the New York courthouse, the chairman of News Corp. was facing an experience shared by countless others across the world every year: He was getting a divorce.[2]

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[1] *See, e.g.*, John F. Burns, *Murdoch, Center Stage, Plays Powerless Broker*, N.Y. TIMES, Apr. 26, 2012, at A1 ("[W]hen Mr. Murdoch took center stage on Wednesday at Britain's most avidly followed public inquiry in years, at one point defying his 81 years by virtually trotting into the witness box, he hardly seemed the power-hungry newspaper baron of legend, nor in any way the patron of the black arts that have made his tabloid newspapers in Britain the center of the country's most wide-ranging criminal inquiry."); Robert Hutton & Thomas Penny, *Murdoch to Testify to Parliament as Police Seek Tape*, BLOOMBERG NEWS (July 10, 2013, 7:21 AM), http://www.bloomberg.com/news/2013-07-09/murdoch-agrees-to-testify-to-parliament-as-police-seek-ta.html ("Rupert Murdoch agreed to testify before the U.K. Parliament a second time as London police sought a recording of him discussing probes of bribery and phone-hacking at company newspapers.").

[2] *See* Jennifer Saba, *Rupert Murdoch and Wendi Deng Agree to Divorce Settlement*, REUTERS, Nov. 20, 2013, *available at* http://www.reuters.com/article/2013/11/20/us-murdoch-divorce-idUSBRE9AI19D20131120 ("Rupert Murdoch and his wife, Wendi Deng

Like any other divorce, the split of Rupert Murdoch and Wendi Deng included the division of marital property, albeit on a significantly larger scale.[3] However, the Murdoch family's control over News Corp. is unlikely to wane: "Nearly all of the Murdoch family's voting stock—a block of 38.4%—is held through the Murdoch Family Trust," of which Deng is not a beneficiary.[4] At the start of 2014, those shares alone held a value of over $2.5 billion.[5]

Despite the billion-dollar status of entities like the Murdoch Family Trust, the law governing their ability to litigate in federal court is presently in a state of mass confusion. When facing the question of how to determine the diversity citizenship of trusts, the courts of appeals have split three ways: Some circuits count the citizenship of the trustees, another counts the citizenships of the beneficiaries, and yet another counts both. This division creates the risk of forum shopping for the purpose of gaining or defeating federal diversity jurisdiction, especially since some of these rules depend on the substantive law of the state in which the federal district court is located.[6] Even more importantly, the divide generates uncertainty for litigants in circuits that have not yet decided this question, resulting in significant costs to litigate a jurisdictional question in cases that may be dismissed without a decision on the merits.

Beyond this disagreement, none of the current approaches have recognized the important distinction between the traditional trust—a tool designed for transfer and estate planning—and the business trust—a substitute for the corporate form. Despite their shared terminology, the two forms differ dramatically. The first is best seen as an agreement or set of fiduciary duties, while the second is an artificial entity designed to run a business and generate profit for investors. The citizenship rules currently employed by the courts of appeals fail to

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Murdoch, appeared before a Manhattan judge on Wednesday in a 10-minute hearing that cleared the way for ending their 14-year marriage.").

[3] *See id.* ("[A] person familiar with the terms of settlement said Deng is expected to keep the couple's home in Beijing and their Fifth Avenue apartment in Manhattan, purchased in 2004 for a then-record $44 million.").

[4] Martin Peers & Melissa Marr, *News Corp. Chief Files for Divorce*, WALL ST. J., June 14, 2013, at B3.

[5] At that time, News Corp. Class B shares (ticker symbol NWS)—the type of shares held in the Murdoch Family Trust, *see* Laurence Knight, *Who Calls the Shots at News Corp?*, BBC NEWS, http://www.bbc.co.uk/news/business-14183571 (last updated July 19, 2011, 2:36 PM) ("[O]f the remaining 'B shares'—the ones with voting rights—the Murdoch family trust owns only a 38% stake . . . .")—had a market capitalization of $6.76 billion, *News Corp (NASDAQ:NWS)*, GOOGLE FIN. (Jan. 6, 2014, 2:13 PM), https://www.google.com/finance?q=NASDAQ:NWS.

[6] *See infra* note 185 and accompanying text (discussing how the ability of trusts to sue or be sued in the federal courts is determined by the law of the forum state).

account for this difference, placing them afoul of existing Supreme Court case law: While diversity jurisdiction for traditional trusts has always been predicated on the citizenship of the trustees and not the beneficiaries,[7] the Court's diversity jurisprudence bases the citizenship of unincorporated business entities on the citizenship of the beneficial owners.[8]

Although a significant revision of existing diversity jurisdiction law may be the best way to overcome these issues, such a modification would require either congressional action or a departure from precedent by the Supreme Court. An academic prescription for this type of change would provide no guidance to the lower courts if the law remains in its present state, or to the Supreme Court if it wishes to clarify the law in this area without overturning its past decisions. Fortunately, there is a citizenship rule for trusts that resolves this conflict while remaining faithful to current Supreme Court case law: counting the trustees for traditional trusts and the beneficiaries for business trusts. This Note describes that rule and shows how it can be used in practice.

In Part I of this Note, I discuss the history of diversity jurisdiction for artificial entities. This discussion traces the development of the law up to the modern rule found in *Carden v. Arkoma Associates*,[9] which held that unincorporated associations take the citizenship of all their members. I then proceed to briefly survey the law of traditional and business trusts, describing and contrasting the two forms.

In Part II, I turn to the current case law on citizenship determinations for trusts. After discussing the Supreme Court case that led to the modern confusion in this area,[10] I review the current circuit split over the diversity citizenship of trusts and discuss the compatibility of these options with existing Supreme Court precedent.

In Part III, I propose a new comprehensive rule for determining the diversity citizenship of trusts that accounts for the difference between traditional and business trusts while also remaining consistent with the Supreme Court's diversity jurisprudence. For traditional trusts, the citizenship of the trustees should be determinative. However, business trusts must take the citizenship of their members—in

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[7] *See* Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465–66 (1980) ("For more than 150 years, the law has permitted trustees who meet [certain] standard[s] to sue in their own right, without regard to the citizenship of the trust beneficiaries.").

[8] *See* Carden v. Arkoma Assocs., 494 U.S. 185 (1990) (holding that unincorporated associations take the citizenship of their members); *see also infra* notes 36–37 and accompanying text (arguing that "members" under the *Carden* line are the beneficial owners of the entity).

[9] 494 U.S. 185.

[10] *Navarro*, 446 U.S. 458.

this case, their beneficiaries. Since the application of this rule turns on which type of trust is at issue, I conclude this Note by explaining that a trust can be classified by determining the primary purpose for which it was organized.

## I
## THE DEVELOPMENT OF DIVERSITY JURISDICTION AND THE LAW OF TRUSTS

### *A. Diversity Jurisdiction for Jural Entities*

"It is a fundamental principle of federal jurisprudence . . . that the federal courts are courts of limited jurisdiction. They are empowered to hear only those cases that are within the constitutional grant of judicial power . . . ."[11] One such grant of power allows the federal courts to decide controversies "between Citizens of different States,"[12] with the modern extent of this power set forth by Congress in the federal diversity statute.[13] This statute has been interpreted to require complete diversity of citizenship,[14] allowing diversity jurisdiction only when "the citizenship of each plaintiff is diverse from the citizenship of each defendant."[15]

Diversity jurisdiction "has its foundation in the supposition that[ ] possibly the state tribunal might not be impartial between their own citizens and foreigners."[16] While this notion of bias in a state court is simple enough when one of that state's citizens is a party-opponent of a citizen of another state,[17] it becomes more complicated when one of

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[11] Sarmiento v. Tex. Bd. of Veterinary Med. Exam'rs, 939 F.2d 1242, 1245 (5th Cir. 1991).

[12] U.S. CONST. art. III, § 2.

[13] 28 U.S.C. § 1332 (2012).

[14] Caterpillar Inc. v. Lewis, 519 U.S. 61, 68 (1996) (citing Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806)).

[15] *Id.*

[16] Pease v. Peck, 59 U.S. (18 How.) 595, 599 (1855). It is unclear whether this fear was founded on any actual instances of bias in the state courts, but this argument is the one most often asserted by the federal courts in interpreting the provision. Henry J. Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483, 492 (1928); *see also, e.g.*, Taylor Simpson-Wood, *Has the Seductive Siren of Judicial Frugality Ceased to Sing?:* Dataflux *and Its Family Tree*, 53 DRAKE L. REV. 281, 287 (2005) ("[T]he purpose of diversity jurisdiction is to provide an out-of-state party with a neutral forum to avoid any local bias or prejudice that the party might be subjected to if the case were brought in state court.").

[17] In this, I certainly do not claim that such bias *actually* exists or is sufficient reason for retaining diversity jurisdiction. *See* Friendly, *supra* note 16, at 492–97 (discussing the bias argument and concluding that "there was little cause to fear that the state tribunals would be hostile to litigants from other states"); *see also* Howard C. Bratton, *Diversity Jurisdiction—An Idea Whose Time Has Passed*, 51 IND. L.J. 347, 349 (1976) ("[T]here are compelling reasons to advocate the elimination of diversity jurisdiction . . . .").

the parties is a corporation or unincorporated association. In this Subpart, I trace the historic evolution of diversity jurisdiction for jural entities and associations to its modern form, which I then apply to traditional and business trusts in the remainder of this Note.

In the original federal diversity statute, there was no provision describing the treatment of corporations for diversity purposes;[18] this determination was left to the courts.[19] Since then, Congress has amended the federal diversity statute to more clearly prescribe the citizenship rule for corporations.[20] The relevant section now provides that "a corporation shall be deemed to be a citizen of every State and foreign state by which it has been incorporated and of the State or foreign state where it has its principal place of business."[21] The Supreme Court has subsequently defined "principal place of business" to mean the corporation's "nerve center," or "where a corporation's officers direct, control, and coordinate the corporation's activities."[22]

Although the Court has developed this bright-line rule for corporations, it has "firmly resisted extending that treatment to other entities,"[23] a difference in treatment that has been dubbed the "doctrinal wall."[24] The Court laid the cornerstone of this wall in *Chapman v. Barney*, an 1889 case in which the Court declined to extend the place-of-organization rule from corporations to joint-stock companies.[25] The *Chapman* Court instead held that the joint-stock company was to be treated like a partnership, with the citizenships of "all the members" being relevant for diversity purposes.[26] This holding was subsequently

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[18] *See* James William Moore & Donald T. Weckstein, *Diversity Jurisdiction: Past, Present, and Future*, 43 TEX. L. REV. 1, 7 (1964) (noting that "the Judiciary Act of 1789 had been silent on the subject" of "the status of corporations for purposes of diversity jurisdiction").

[19] *See, e.g.*, Bank of the U.S. v. Deveaux, 9 U.S. (5 Cranch) 61 (1809) (holding that corporations take the diversity citizenships of each of their shareholders), *overruled in part by* Louisville, Cincinnati, & Charleston R.R. Co. v. Letson, 43 U.S. (2 How.) 497 (1844) (holding that a corporation may be treated as a citizen of the state in which it was incorporated).

[20] Act of July 25, 1958, Pub. L. No. 85-554, § 2, 72 Stat. 415, 415 (codified as amended at 28 U.S.C. § 1332 (2012)).

[21] 28 U.S.C. § 1332(c)(1) (2012).

[22] Hertz Corp. v. Friend, 559 U.S. 77, 92–93 (2010).

[23] Carden v. Arkoma Assocs., 494 U.S. 185, 189 (1990).

[24] *E.g.*, *id.*; United Steelworkers of Am. v. R.H. Bouligny, Inc., 382 U.S. 145, 151 (1965); Ryan A. Christy, *Redefining the Juridical Person: Examining the Business Trust and Other Unincorporated Associations for Citizenship Purposes*, 6 DUQ. BUS. L.J. 137, 139 (2004).

[25] 129 U.S. 677, 682 (1889).

[26] *Id.*

extended to "limited partnership associations,"[27] university boards of trustees,[28] and labor unions,[29] to name a few.[30]

The strict formulation of the corporations-are-different jurisprudence was reaffirmed in the 1990 case *Carden v. Arkoma Associates*.[31] In *Carden*, the Supreme Court faced two questions: whether a limited partnership, like a corporation, could be a "citizen" of its state of organization; and if not, whether the limited partners, and not just the general partners, should count for determining diversity.[32] In line with *Chapman* and its progeny, the Court rejected the notion that the partnership could be considered a citizen of the state in which it was organized.[33]

Turning then to the question of which partners' citizenships are counted for diversity purposes, the Court held that both the general and limited partners were considered members under *Chapman*.[34] This holding demonstrates the current rules for determining the diversity citizenship of artificial entities: While the citizenship of corporations is determined pursuant to the diversity statute,[35] the citizenship of all other artificial entities "depends on the citizenship of 'all the members,'"[36] a group that includes all the holders of beneficial interests in the entity.[37]

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[27] Great S. Fire Proof Hotel Co. v. Jones, 177 U.S. 449, 457 (1900).

[28] Thomas v. Bd. of Trs. of Ohio State Univ., 195 U.S. 207, 218 (1904).

[29] *Bouligny*, 382 U.S. at 146–47.

[30] *See generally* Christy, *supra* note 24, at 139–43 (discussing the development of the *Chapman* doctrinal wall). The only exception to this doctrinal wall involved a Puerto Rican *sociedad en comandita*, which the Court decided was so "consistently regarded as a juridical person" under Puerto Rican law as to provide "no adequate reason for holding that the *sociedad* has a different status for purposes of federal jurisdiction than a corporation." Puerto Rico v. Russell & Co., 288 U.S. 447, 480–82 (1933). However, due to the completeness of the *sociedad*'s legal personality under Puerto Rican civil law—and thus its effective equivalence to corporations established under state law—this case may best be seen as the exception that proves the rule. *See Bouligny*, 382 U.S. at 151 ("The problem which it presented was that of fitting an exotic creation of the civil law, the *sociedad en comandita*, into a federal scheme which knew it not.").

[31] 494 U.S. 185 (1990).

[32] *Id.* at 187.

[33] *See id.* at 187–92 (discussing the *Chapman* line and refusing to breach the doctrinal wall for limited partnerships).

[34] *Id.* at 192, 195–96.

[35] *See supra* notes 20–22 and accompanying text (explaining the modern citizenship rules for corporations).

[36] *Carden*, 494 U.S. at 195 (quoting Chapman v. Barney, 129 U.S. 667, 682 (1889)).

[37] For example, the courts of appeals have interpreted *Carden* to require them to consider all of a limited liability company's "members"—the holders of beneficial interests—when determining its citizenship for diversity purposes. *See, e.g.*, Harvey v. Grey Wolf Drilling Co., 542 F.3d 1077, 1080 (5th Cir. 2008) (holding that an LLC's citizenship is determined by the citizenship of all of its members); Handelsman v. Bedford Vill. Assocs.

### *B. Traditional and Business Trusts*

Having discussed the current state of diversity jurisdiction for artificial entities, I turn to the particular form at interest in this Note: the trust. I begin by introducing what I refer to as the traditional trust, the type of trust most commonly viewed as an estate-planning tool. I then describe the business trust—an alternative to the corporate form—and contrast it with traditional trusts.

#### *1. The Traditional Trust as a Common Law Tool*

A traditional trust is primarily a method to transfer property or incomes.[38] As one scholar put it simply, "[t]rusts are gifts."[39] They are commonly used for estate planning,[40] where their primary purpose is to provide for the creator's family over time.[41]

To accomplish these ends, the person giving the gift—called the settlor[42]—transfers property to one or more trustees. These trustees then manage the trust property for the benefit of some third party—

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Ltd. P'ship, 213 F.3d 48, 51–52 (2d Cir. 2000) (same); Cosgrove v. Bartolotta, 150 F.3d 729, 731 (7th Cir. 1998) (same).

[38] *See* RESTATEMENT (THIRD) OF TRUSTS § 2 (2003) ("A trust . . . is a fiduciary relationship . . . subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee."); 1 AMY MORRIS HESS, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 1, at 1–2 (3d ed. 2007) ("A *trust* may be defined as a fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another."). Modern trusts stem from the "use," which was "a passive trust of land" under medieval English law. RESTATEMENT (THIRD) OF TRUSTS § 6(3) cmt. a. *See generally* 1 HESS ET AL., *supra*, § 2–7 (discussing the origins and development of uses and trusts); 1 AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER & MARK L. ASCHER, SCOTT & ASCHER ON TRUSTS §§ 1.3–1.9, 1.11 (5th ed. 2006) (same); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 632–43 (1995) (same).

[39] Langbein, *supra* note 38, at 632; *see also* 3 HESS ET AL., *supra* note 38, § 169, at 207 ("A person who intends a trust may naturally inform the beneficiary of the gift to him.").

[40] *See, e.g.*, Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 295 (S.D.N.Y. 2013) (stating that traditional trusts are "commonly used for gift or estate-planning purposes"); *In re* Jay M. Weisman Irrevocable Children's Trust of 1981, 62 B.R. 286, 288 (Bankr. M.D. Fla. 1986) (describing an irrevocable trust created to benefit the grantor's children as "nothing more than an estate planning device"); Cincinnati Bar Ass'n v. Heisler, 113 Ohio St. 3d 447, 448, 2007-Ohio-2338, 866 N.E.2d 490, 492 (describing trusts as one of several "estate-planning services" at issue in an attorney discipline case).

[41] 1 SCOTT ET AL., *supra* note 38, § 1.1. Though this may be the primary use of the traditional trust, "[t]he uses of the trust . . . go far beyond providing for the family." *Id.*; *see also* 5 HESS ET AL., *supra* note 38, §§ 231–255 (discussing the various uses of trusts).

[42] The settlor can also be referred to as the "grantor" or the "trustor." 1 HESS ET AL., *supra* note 38, § 41, at 439; 1 SCOTT ET AL., *supra* note 38, § 2.2.1, at 40–41.

the beneficiary.[43] In this way, the trust makes it "possible to separate the benefits of ownership from the burdens of ownership."[44]

There are three primary methods to create a trust:

> (a) a transfer by the will of a property owner to another person as trustee for one or more persons; or
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> (b) a transfer inter vivos by a property owner to another person as trustee for one or more persons; or
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> (c) a declaration by an owner of property that he or she holds that property as trustee for one or more persons . . . .[45]

The first of these methods results in a testamentary trust—a trust that is created by the settlor's will.[46] The second and third result in what is called an "inter vivos trust," in which the transfer of trust property or the declaration of trust is made while the settlor is still alive.[47]

While these methods of creation are a key way to distinguish the traditional trust from other forms, the traditional trust is best identified by the nature of the relationship it creates: a fiduciary relationship that subjects the titleholder of the trust property "to duties to deal with it for the benefit of . . . one or more [other] persons."[48] Thus, the traditional trust "is merely the description of a relationship between the legal and equitable owners of property."[49] This relationship can be examined by reviewing the roles of the trustees and the beneficiaries within the context of the trust.

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[43] *See, e.g.*, Brown v. Spohr, 73 N.E. 14, 16–17 (N.Y. 1904) ("There are four essential elements of a valid trust of personal property: (1) A designated beneficiary; (2) a designated trustee, who must not be the beneficiary; (3) a fund or other property sufficiently designated or identified to enable title thereto to pass to the trustee; and (4) the actual delivery of the fund or other property, or of a legal assignment thereof to the trustee, with the intention of passing legal title thereto to him as trustee."); 1 HESS ET AL., *supra* note 38, § 1, at 5–8 (describing the "basic elements of a viable trust"); *id.* § 41, at 440–42 (discussing the creation of a trust by the settlor).

[44] 1 SCOTT ET AL., *supra* note 38, § 1.1.

[45] RESTATEMENT (THIRD) OF TRUSTS § 10 (2003).

[46] BLACK'S LAW DICTIONARY 1747 (10th ed. 2014); 1 SCOTT ET AL., *supra* note 38, § 3.1.

[47] *See* BLACK'S LAW DICTIONARY, *supra* note 46, at 1744 (defining inter vivos trust as "[a] trust that is created and takes effect during the settlor's lifetime"); 1 SCOTT ET AL., *supra* note 38, § 3.1 (describing the creation of trusts); *see also* Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 295 (S.D.N.Y. 2013) (defining those two methods as creating inter vivos trusts).

[48] 1 SCOTT ET AL., *supra* note 38, § 2.1.3; *accord* RESTATEMENT (THIRD) OF TRUSTS § 2.

[49] Colo. Springs Cablevision, Inc. v. Lively, 579 F. Supp. 252, 254 (D. Colo. 1984); *see also* 1 SCOTT ET AL., *supra* note 38, § 2.1.3–2.1.4 (describing trusts as relationships).

a. The Role of the Trustees

Central to the traditional trust is the transfer of legal title to the trust property—also called the res[50]—from the settlor to the trustee.[51] It is this act that finalizes the trust's creation.[52] Once this transfer has occurred, except as limited by the trust agreement or by statute, the trustee has full power over the trust property—subject, of course, to her fiduciary duty to hold and use the property for the benefit of the beneficiaries.[53] As Scott and Ascher put it, "[w]hen we say that the trustee has the power to do something, we mean that the trustee is under no duty to the beneficiaries not to do it."[54]

Important to this analysis is that a traditional trust is not historically a legal person with the capacity to sue or be sued in its own right.[55] To attack the trust property, or for a claim to be asserted in its

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[50] 1 SCOTT ET AL., *supra* note 38, § 2.2.2.

[51] *See id.* § 3.1 ("Usually, a trust comes into existence upon the transfer of property, either during the owner's lifetime or by will, to another, as trustee."). Instead of transferring the trust property to a separate beneficiary, the settlor can also "create a trust by declaring himself or herself trustee for others." *Id.* § 3.1.1; *see also* RESTATEMENT (THIRD) OF TRUSTS § 10 ("[A] trust may be created by . . . a declaration by an owner of property that he or she holds that property as trustee for one or more persons . . . .").

[52] *See, e.g.*, Agudas Chasidei Chabad of U.S. v. Gourary, 833 F.2d 431, 434 (2d Cir. 1987) (noting that under New York law, the creation of a valid trust requires "the delivery of the res by the settlor to the trustee with the intent of vesting legal title in the trustee" (citing Brown v. Spohr, 73 N.E. 14, 14 (N.Y. 1904))); RESTATEMENT (THIRD) OF TRUSTS § 10 ("[A] trust may be created by . . . a transfer . . . by a property owner to another person as trustee for one or more persons . . . .").

[53] *See, e.g.*, Whiting v. Hudson Trust Co., 138 N.E. 33, 38 (N.Y. 1923) ("The trustee of an express trust . . . has the whole title and estate."); RESTATEMENT (THIRD) OF TRUSTS § 85(1) ("In administering a trust, the trustee has, except as limited by statute or the terms of the trust, (a) all of the powers over trust property that a legally competent, unmarried individual has with respect to individually owned property . . . ."); Langbein, *supra* note 38, at 641 ("A strategy of maximum empowerment displaced the former law . . . . These statutes empower trustees to engage in every conceivable transaction that might wrest market advantage or enhance the value of trust assets.").

[54] 3 SCOTT ET AL., *supra* note 38, § 16.1.

[55] *See, e.g.*, First Union Nat'l Bank *ex rel.* Se. Timber Leasing Statutory Trust v. Pictet Overseas Trust Corp., 351 F.3d 810, 814 (8th Cir. 2003) ("Historically, a trust estate was not a juridical entity, hence the observation that 'a suit by strangers to the trust must be brought against the trustees . . . .'" (quoting Yonce v. Miners Mem'l Hosp. Ass'n, 161 F. Supp. 178, 188 (W.D. Va. 1958))); Irwin Union Collateral Inc. v. Peters & Burris, LLC, No. CV 09-605-PHX-MHM, 2009 WL 5184902, at *3 (D. Ariz. Dec. 22, 2009) ("[T]he vast majority of jurisdictions appear to favor the traditional rule that trusts lack the capacity to sue or be sued."); Larson v. Sylvester, 185 N.E. 44, 45 (Mass. 1933) ("Speaking generally a trust is not a legal personality. . . . [I]t cannot be sued. It is represented by the trustee."); N. Sec. Ins. Co. v. Doherty, 987 A.2d 253, 256 (Vt. 2009) ("[A]t common law, trusts are not independent legal entities with the capacity to sue or be sued."); Erin C.V. Bailey, *Asset Protection Trusts Protect the Assets: But What About the Trustees?*, PROB. & PROP., Jan./Feb. 2007, at 58, 58–59 ("The orthodox rule is that trusts are not legal entities that can be sued in their own right. . . . Trusts are relationships enforced by the imposition of duties and are unlike organizations with entity status such as corporations or partnerships.").

favor, litigation must proceed through the trustee.[56] In this way, the trustee acts as "a buffer between the beneficiaries and the outer world,"[57] reinforcing the role of the trustee as the primary actor within the traditional trust.

b. The Role of the Beneficiaries

In stark contrast to the trustees, the beneficiaries of a traditional trust have a passive role.[58] By default, they have no management powers over the trust[59]—as discussed above, that power rests solely with the trustees.[60] Furthermore, "[t]he beneficiaries cannot appoint a new trustee, unless the terms of the trust or the applicable statute allows them to do so."[61]

Not only do beneficiaries generally have no control over the operation of the trust or the selection of trustees, but "[i]t is possible to create a trust in favor of beneficiaries who have no notice of the creation of the trust."[62] This is in accord with the definition of the trust as a gift.[63] Since the beneficiary is the passive recipient of the

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[56] *See* 5 SCOTT ET AL., *supra* note 38, § 28.1 ("As against one who acts adversely to the trustee, it is the trustee who is the proper party to maintain the action, whether at law or at equity. The trustee can maintain such an action or suit just as though the trustee owned the trust property outright.").

[57] *Id.*

[58] This is true even in the case of a passive trust for which the sole purpose is to allow "the beneficiary to directly possess and enjoy the trust property." 4 HESS ET AL., *supra* note 38, § 208. In such a case, while the beneficiary may possess the trust property in the colloquial sense, she does not have any role in the administration of the trust itself, which exists to allow for and continue the aforementioned possession. For a brief definition of active and passive trusts, see *infra* notes 143, 145 and accompanying text.

[59] *Cf.* Progressive Land Developers, Inc. v. Exch. Nat'l Bank of Chi., 266 Ill. App. 3d 934, 940 (1994) (differentiating land trusts from conventional trusts in that the beneficiaries in land trusts hold management powers).

[60] *Supra* notes 53–54 and accompanying text.

[61] 2 SCOTT ET AL., *supra* note 38, § 11.11.4. "This is true even if the beneficiaries could terminate the trust and compel the trustee to transfer the trust property to them." *Id.*

[62] 1 SCOTT ET AL., *supra* note 38, § 5.6 (citing Fletcher v. Fletcher, (1844) 67 Eng. Rep. 564 (Ch.), 4 Hare 67); *see also* Sec. Trust & Safe Deposit Co. v. Farrady, 82 A. 24, 26 (Del. Ch. 1912) ("Notice to the cestui que trust is not essential to the validity of the trust."); Martin v. Funk, 75 N.Y. 134, 138 (1878) ("[I]t is not essential that the property should be actually possessed by the *cestui que trust*, nor is it even essential that the latter should be informed of the trust."); RESTATEMENT (THIRD) OF TRUSTS § 14 (2003) ("A trust can be created without notice to or acceptance by any beneficiary . . . ."); 3 HESS ET AL., *supra* note 38, § 169 ("It is generally held that notice by the settlor to the beneficiary that a trust has been created is not necessary to the completion of a trust, subject to the power of the beneficiary to reject the trust when he is informed of it.").

[63] *See supra* note 39 and accompanying text (noting one scholar's description of traditional trusts as gifts from the settlor to the beneficiaries).

property placed in trust by the settlor, there is no need for her to be aware of the trust until the time comes for her to accept its benefits.[64]

This view of the trust as a gift of the settlor—with the trustee holding legal title to and exercising control over the trust property, and the beneficiary acting as a passive recipient—defines the traditional trust. However, there is another legal form using the term "trust" that dramatically varies from this paradigm, with the trustees acting as managers of a business entity owned by the beneficiaries. That form, discussed below, is commonly called the "business trust."

### *2. The Arrival of the Business Trust*

The business trust developed in response to the early limitations on the corporate form,[65] serving as a substitute for purposes of business organization.[66] Though originating in Massachusetts—hence its nickname, the "Massachusetts trust"[67]—use of the business trust was popularized across the country in the early twentieth century.[68] Similar to a traditional trust, a business trust is "created by an instrument by which property is to be held and managed by trustees."[69] This instrument is also known as a declaration of trust, and its execution is often sufficient to create the entity.[70] However, this shared vocabulary is where the similarities largely end.

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[64] *See* 3 HESS ET AL., *supra* note 38, § 169 (stating that while no notice to the beneficiary is necessary, "a trust cannot arise or continue for a named or described beneficiary after he has refused to accept it").

[65] *See* 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 8227 (rev. vol. 2003) ("The main advantage of this form of business organization has been considered to be avoidance of legal restrictions imposed on corporations."); Sheldon A. Jones et al., *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421, 426 (1988) ("[B]usiness trusts were attractive because they provided an alternative to corporations which could be organized only pursuant to the restrictive state corporate statute.").

[66] *See* 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8227 ("The 'Massachusetts trust' or 'business trust' has for some time been an organizational alternative to the corporate form.").

[67] 5 HESS ET AL., *supra* note 38, § 247. The business trust is also sometimes called a "'common law trust,'" Jones et al., *supra* note 65, at 432 n.70 (quoting MINN. STAT. § 318.02(2) (2013)), though I find this terminology misleading—especially since it is the traditional trust that most directly stems from the common law of England, *see* sources cited *supra* note 38 (discussing the history of the traditional trust).

[68] *See* 5 HESS ET AL., *supra* note 38, § 247 ("For many years the trust had been used in Massachusetts as a form of business organization, a substitute for incorporation, and in the years following the First World War the device came widely to be used elsewhere.").

[69] 13 AM. JUR. 2D *Business Trusts* § 1 (rev. vol. 2013).

[70] *See* Jones et al., *supra* note 65, at 423–24 ("Unlike a corporation, which is a creature of state statute, a business trust is created by agreement."). For example, in the case of the Massachusetts business trust, "[f]iling a declaration of trust with the Commonwealth of Massachusetts is not a condition precedent to the existence of the trust," though failing to

The primary characteristic of the business trust is that it is organized "as a device for profit making through the combination of capital contributed by a number of investors."[71] In this way, the business trust is similar to a corporation in its "general scheme of organization and business operations,"[72] and is "established to run a business enterprise."[73] The business trust differs dramatically from the traditional trust, which again is fundamentally a gift from the settlor to the beneficiaries.[74]

As a result of business trusts' profit-seeking motive and corporate-like organization, the trustees and beneficiaries in a business trust take on significantly different roles from their traditional trust counterparts. In the business trust, the trustees share several similarities with the directors or managers of a corporation or other business association.[75] The trustees also no longer act as a strict buffer between the trust and the outside world[76]—unlike traditional trusts, the business trust often has legal personality, and can sue or be sued in its own name.[77]

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file may subject the trustees to penalty. *Id.* at 424 & n.12 (citing MASS. GEN. LAWS ch. 182, § 2 (2013)).

[71] 5 HESS ET AL., *supra* note 38, § 247; *accord* Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 295 (S.D.N.Y. 2013).

[72] 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8227.

[73] *Thales*, 989 F. Supp. 2d at 296 (quoting *In re* Secured Equip. Trust of E. Air Lines, Inc., 38 F.3d 86, 90 (2d Cir. 1994)).

[74] *Supra* note 39 and accompanying text; *see also* 5 HESS ET AL., *supra* note 38, § 247 (describing the difference between business trusts and "ordinary trusts established by will or inter vivos"). "In some respects, business trusts closely resemble both partnerships and corporations. However, regardless of its similarity to an ordinary trust, to a partnership, and to a corporation, the general opinion is that the business trust should be regarded as sui generis." 13 AM. JUR. 2D *Business Trusts*, *supra* note 69, § 2.

[75] *See* Jones et al., *supra* note 65, at 433, 435 (noting that trustees of business trusts can act by majority if provided by the declaration of trust, must be consulted and participate in trust administration, can act through other officers and agents, and are held to the same standard of care as corporate directors under federal securities law); *see also* 15 U.S.C. § 80a-2(a)(12) (2012) ("'Director' means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management company created as a common-law [i.e., business] trust."). *But see* Jones et al., *supra* note 65, at 433 (noting some differences between corporate directors and trustees of business trusts).

[76] *See* 5 SCOTT ET AL., *supra* note 38, § 28.1 (noting that for traditional trusts, "[t]he trustee is in many respects a buffer between the beneficiaries and the outer world").

[77] *See, e.g.*, First Union Nat'l Bank *ex rel.* Se. Timber Leasing Statutory Trust v. Pictet Overseas Trust Corp., 351 F.3d 810, 814 (8th Cir. 2003) ("Some states also now recognize the so-called 'business' or 'Massachusetts' trust. Unlike traditional trusts, this form of business organization gives the trust powers to sue and be sued in its own name and usually subjects trust assets to execution and attachment in the same manner as corporate assets." (citations omitted)); Boyd v. Boulevard Nat'l Bank, 306 So. 2d 551, 553 (Fla. Dist. Ct. App. 1975) (holding that a Massachusetts business trust is "a separate legal entity for the

These similarities with the corporate form and other business associations carry over to the beneficiaries as well. For example, the beneficiaries of business trusts are often referred to as "shareholders."[78] These shareholders hold "certificates evidencing beneficial interests in the trust estate,"[79] and these certificates are typically transferable.[80] Also like the stockholders of a corporation, the shareholders of a business trust often have the power to elect, control, and remove the trustees, and also to amend the trust instrument.[81]

Beyond the roles of the trustees and beneficiaries in the business trust, several other factors can help distinguish a business trust from the traditional form. These include centralized management,[82] continuity of existence,[83] and requirements to file and register with state authorities.[84]

In sum, the business trust is a "voluntary association" formed to conduct business.[85] Accordingly, business trusts have far more in common with partnerships and limited liability companies than with traditional trusts. In fact, for this reason, one of the leading treatises on the law of trusts deliberately excluded business trusts from its coverage.[86]

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purpose of being sued"); *see also* 13 AM. JUR. 2D *Business Trusts*, *supra* note 69, § 3 (noting that several courts and statutory schemes recognize business trusts as distinct legal entities); Recent Case, *Trusts—The Business Trust as a Legal Entity*, 9 TEX. L. REV. 299, 300 (1931) ("[A] Massachusetts trust is held . . . to be a legal entity, owning a note in its own name, on which it alone, and not the trustees, could sue.").

78 Jones et al., *supra* note 65, at 423; *accord* 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8240.

79 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8228; *see also* Hecht v. Malley, 265 U.S. 144, 146–47 (1924) ("The 'Massachusetts Trust' is a form of business organization . . . whereby property is . . . held and managed for the benefit of such persons as may from time to time be the holders of transferable certificates . . . showing the shares into which the beneficial interest in the property is divided.").

80 *See Hecht*, 265 U.S. at 147 ("These certificates, which resemble certificates for shares of stock in a corporation and are issued and transferred in like manner, entitle the holders to share ratably in the income of the property, and, upon termination of the trust, in the proceeds."); 5 HESS ET AL., *supra* note 38, § 247 ("The indentures under which business trusts are organized invariably provide for the issuance of transferable shares of beneficial interest, and there is no doubt that such provisions are effective.").

81 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8244; 5 HESS ET AL., *supra* note 38, § 247.

82 13 AM. JUR. 2D *Business Trusts*, *supra* note 69, § 6.

83 *Id.*

84 Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 296 (S.D.N.Y. 2013); *see also* MASS. GEN. LAWS ch. 182, § 2 (2013) (requiring Massachusetts trusts to file a copy of the declaration of trust with every city or town in which it has a usual place of business). For more on how courts might distinguish traditional and business trusts, see *infra* Part III.C.

85 Jones et al., *supra* note 65, at 423 (internal quotation marks omitted).

86 *See* 1 SCOTT ET AL., *supra* note 38, § 2.1.2 ("[B]ecause the use of the trust as a substitute for incorporation, as in the case of the so-called business trust or Massachusetts

Despite the widespread recognition in the literature of the difference between the two forms, federal courts have generally failed to distinguish between traditional and business trusts when determining their citizenship for diversity purposes.[87] This issue, along with the broader circuit split concerning the diversity treatment of trusts, is discussed in Part II below.

## II
## The Current State of Trusts and the Federal Courts

The case law regarding trusts and diversity jurisdiction is currently in shambles. There is a three-way circuit split on how the citizenship of a trust is determined, with some courts counting the trustees alone, some counting the beneficiaries alone, and others counting both the trustees and the beneficiaries.[88] At least one district court—the Southern District of New York—is split all three ways by itself.[89]

Moreover, the courts have generally failed to recognize the existence of an even deeper problem: the mistaken application of this case law across all trusts, regardless of whether they are traditional or business trusts.[90] The problem thus has two layers: First, the courts of appeals have disagreed on the legal rule for determining the diversity citizenship of trusts, resulting in the conflicting approaches mentioned above. Second, none of the current approaches recognize the impor-

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trust, necessarily differs in many important ways from the use of the trust as a gratuitous transfer, each of the Restatements leaves these trusts for discussion along with other forms of business organizations. So does this treatise." (footnote omitted)).

[87] For a review of how several federal courts have glossed over this distinction, see *infra* Part II.C. As discussed in Part III.A–B, consistency with existing Supreme Court case law demands a citizenship rule based on the type of trust at issue.

[88] *See* Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 201–06 (3d Cir. 2007) (examining the current split and adopting the third of these approaches).

[89] *Compare* Mills 2011 LLC v. Synovus Bank, 921 F. Supp. 2d 219, 226 (S.D.N.Y. 2013) (using the *Emerald Investors* approach and taking the citizenships of both the trustees and the beneficiaries), *with* Feiner Family Trust v. VBI Corp., No. 07 Civ. 1914 (RPP), 2007 WL 2615448, at *3 (S.D.N.Y. Sept. 11, 2007) (holding that trusts take the citizenship of their trustees), *and* FMAC Loan Receivable Trust 1997–C v. Strauss, No. 03 Civ. 2190 (LAK), 2003 WL 1888673, at *1 (S.D.N.Y. Apr. 14, 2003) (holding that business trusts take the citizenships of their beneficiaries/shareholders).

[90] *See, e.g.*, *Emerald Investors*, 492 F.3d at 198 n.10 ("Our research . . . has not led us to conclude that the type of trust calls for a difference in treatment when determining a trust's citizenship for diversity of citizenship jurisdictional purposes."); Hicklin Eng'g, L.C. v. Bartell, 439 F.3d 346, 348 (7th Cir. 2006) (stating that "[t]he citizenship of a trust is that of the trustee" without noting any distinctions based on the type of trust). *But see* Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 298–300 (S.D.N.Y. 2013) (classifying the trust in question as a traditional trust, not a business trust, and determining its citizenship for diversity purposes on this basis).

tant distinction between traditional and business trusts, and the resulting need for different citizenship rules between the two forms.

In this Part, I begin by examining the primary source of this confusion—the Supreme Court's decision in *Navarro Savings Ass'n v. Lee*.[91] I then outline the current split over how the citizenship of trusts is determined, and conclude by describing how some courts have misinterpreted *Navarro* and *Carden* to apply the same rule to both traditional and business trusts.

### *A.* Navarro Savings Association v. Lee*: The Source of Modern (Mis)interpretation*

The most recent Supreme Court decision addressing diversity jurisdiction and trusts was the 1980 case *Navarro Savings Ass'n v. Lee*. In *Navarro*, eight trustees filed suit in their own names on behalf of a Massachusetts business trust.[92] The district court dismissed the action for lack of subject-matter jurisdiction, holding "that a business trust is a citizen of every State in which its shareholders reside," destroying complete diversity in that case.[93]

The Supreme Court disagreed. Concluding that the plaintiffs were "active trustees whose control over the assets held in their names [was] real and substantial" and were "real parties to the controversy," the Court held that the trustees could sue in their own right without regard to the citizenships of the beneficiaries.[94] The *Navarro* Court suggested that this status depended on whether the trustees possessed "certain customary powers to hold, manage, and dispose of assets for the benefit of others."[95] In this case, the declaration of trust gave the trustees "exclusive authority over [trust] property free from any power and control of the Shareholders, to the same extent as if the Trustees were the sole owners of the Trust Estate in their own right."[96]

Though this holding—involving a Massachusetts business trust[97]—may seem to create a gap in the doctrinal wall making all unincorporated entities take the citizenships of all of their members,[98] the Supreme Court explicitly rejected this reading ten years later in

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[91] 446 U.S. 458 (1980).

[92] *Id.* at 459.

[93] *Id.* at 460.

[94] *Id.* at 465.

[95] *Id.* at 464 (citing Bullard v. City of Cisco, 290 U.S. 179, 189 (1933)).

[96] *Id.* at 459 (internal quotation marks omitted).

[97] *Id.*

[98] *See supra* notes 23–37 and accompanying text (describing the formation and development of the doctrinal wall).

*Carden v. Arkoma Associates*.[99] Discussing the *Navarro* opinion at some length, the *Carden* Court clarified that "*Navarro* had nothing to do with the citizenship of the 'trust,' since it was a suit by the trustees *in their own names*."[100] Instead, *Navarro* dealt with "the quite separate question [of] whether parties that were undoubted 'citizens' (viz., natural persons) were the real parties to the controversy."[101]

Because *Navarro* did not decide how to determine the citizenship of a trust itself,[102] or perhaps despite it declining to do so,[103] the courts of appeals are significantly divided in answering this question. This divide, and how these courts' interpretations of *Navarro* may be directly contributing to it, is discussed in Part II.B below.

### *B. The Current Divide: A Three (or More) Way Split*

The Third Circuit recently examined the diversity citizenship of trusts in *Emerald Investors Trust v. Gaunt Parsippany Partners*.[104] In that case, complete diversity hinged on whether the beneficiaries alone determined the trust's citizenship, or whether the citizenships of the trustees were also relevant.[105] Noting that this question was "a subject of great differences of opinion,"[106] the court examined the two options taken by other courts and another suggested by a leading treatise, but instead chose to create an entirely new method of citizenship

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[99] 494 U.S. 185 (1990). For further discussion of *Carden*, see *supra* notes 31–37 and accompanying text.

[100] 494 U.S. at 192–93 (emphasis added). Specifically, the Court mentioned that *Navarro*'s analysis "involved not a juridical person but the distinctive common-law institution of trustees." *Id.* at 194. Business trusts like the one in *Navarro* may in fact be considered juridical persons. *See supra* note 77 and accompanying text (distinguishing business trusts from traditional trusts in that some courts deem them to have legal personality). Accordingly, the Court's statement can best be seen as claiming that the citizenship of the trust qua trust was never at issue because the trustees exercised their power under the trust agreement to sue in their own names.

[101] *Carden*, 494 U.S. at 191.

[102] By this, I also mean the citizenship attributed to a membership interest in another artificial entity when that membership interest is part of the trust property. *See* Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 300 (S.D.N.Y. 2013) (determining diversity citizenship "when an unincorporated business entity is a party to a case, and an ownership interest in that entity is within the res of a traditional trust").

[103] *See infra* Part II.B.1 (discussing how some courts have cited *Navarro* as standing for the proposition that trusts take the citizenships of their trustees).

[104] 492 F.3d 192 (3d Cir. 2007).

[105] *See id.* at 197–98 ("[T]he district court decided that it could exercise diversity of citizenship jurisdiction because . . . a court determines the citizenship of an unincorporated business trust by determining the citizenship of its beneficiary or beneficiaries . . . . The court did not consider the citizenship of . . . the trustee . . . in making this determination.").

[106] *Id.* at 199.

determination.[107] In this Subpart, I examine these four options and the extent of their adoption throughout the federal courts.

### *1. Citizenship of Trustees as Controlling*

The first option discussed by the court in *Emerald Investors* is to count the citizenships of only the trustees when determining the diversity citizenship of trusts.[108] Under *Navarro* and its predecessors, the citizenships of the trustees are controlling when the trustees sue or are sued in their own names and are the "real parties to the controversy."[109] In the case of a traditional trust, since the trust itself cannot normally be a party,[110] the trustees will almost always sue or be sued in their own names. Since the trustees of a traditional trust will satisfy the *Navarro* factors for determining the real party to the controversy,[111] *Navarro*'s holding appears to be binding when trustees sue or are sued on behalf of a traditional trust.[112]

However, several courts of appeals have cited *Navarro* as directly standing for the proposition that "[t]he citizenship of a trust [itself] is that of the trustee,"[113] despite the Court's specific rejection of this

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[107] *Id.* at 201–06.

[108] *Id.* at 201.

[109] Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465 (1980); *see also* Bullard v. City of Cisco, 290 U.S. 177, 190 (1933) ("As the transfers . . . were made to [plaintiffs] as trustees, were real and not simply for purposes of collection, and invested them with the full title they were entitled, by reason of their citizenship and of the amount involved, to bring the suit in the federal court."). For more on when the trustees are deemed to be real parties to the controversy, see *supra* notes 94–96 and accompanying text.

[110] *See supra* note 55 and accompanying text (noting that traditional trusts cannot typically sue or be sued).

[111] *Compare Navarro*, 446 U.S. at 464 (holding that trustees who possessed "certain customary powers to hold, manage, and dispose of assets for the benefit of others" were real parties to the controversy), *with supra* notes 50, 53 and accompanying text (discussing how for traditional trusts, legal title is vested in the trustee, who typically has full power over the trust property).

[112] *See, e.g.*, Universitas Educ., LLC v. Nova Grp., Inc., 513 F. App'x 62, 63–64 (2d Cir. 2013) (applying *Navarro* to count only the citizenships of the trustee when the trustee was sued in its own name); Lenon v. St. Paul Mercury Ins. Co., 136 F.3d 1365, 1371 (10th Cir. 1998) (doing the same for a suit brought by the trustees of a union trust fund); N. Trust Co. v. Bunge Corp., 899 F.2d 591, 594 (7th Cir. 1990) (reading *Navarro* as holding that "trustees of express trusts who have legal title to trust property and who sue in their own names can establish diversity based on their own citizenship").

[113] Hicklin Eng'g, L.C. v. Bartell, 439 F.3d 346, 348 (7th Cir. 2006) (citing *Navarro*, 446 U.S. 458); *accord* Mullins v. TestAmerica, Inc., 564 F.3d 386, 397 n.6 (5th Cir. 2009); Johnson v. Columbia Props. Anchorage, LP, 437 F.3d 894, 899 (9th Cir. 2006); Homfeld II, L.L.C. v. Comair Holdings, Inc., 53 F. App'x 731, 732 (6th Cir. 2002); *see also* Erlich v. Ouellette, Labonte, Roberge and Allen, P.A., 637 F.3d 32, 34 n.2 (1st Cir. 2011) ("[A] trust . . . is in some cases a citizen of whatever states its trustees are citizens of." (citing *Navarro*, 446 U.S. at 464)).

reading in *Carden*.[114] Other circuit courts have also lent support to this reading in dicta.[115] In circuits that have not directly answered the question of how the diversity citizenship of trusts is determined,[116] some district courts have also cited *Navarro* in this manner.[117]

### 2. *Citizenship of Beneficiaries as Controlling*

The second option explored by the court in *Emerald Investors* is the opposite of the trustees-only choice discussed above. Instead of counting the citizenships of the trustees, this approach would count the citizenships of all the trust's beneficiaries or shareholders.[118]

The Eleventh Circuit took this approach in *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, which directly addressed the citizenship of business trusts.[119] In *Riley*, one of the defendants, a Massachusetts business trust, had shareholders whose citizenship would destroy diversity if counted.[120] Citing to *Carden*'s discussion of *Navarro*,[121] the *Riley* court claims "*Carden* made clear that the incorporated/unincorporated distinction applies specifically to Massachusetts business trusts, requiring their citizenship to be deter-

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114 Carden v. Arkoma Assocs., 494 U.S. 185, 192–93 (1990) ("*Navarro* had nothing to do with the citizenship of the 'trust,' since it was a suit by the trustees in their own names.").

115 *See* E.R. Squibb & Sons, Inc. v. Accident & Cas. Ins. Co., 160 F.3d 925, 931 (2d Cir. 1998) (characterizing *Navarro* as "deem[ing] the citizenship of the trustees to be determinative"); N.Y. State Teachers Ret. Sys. v. Kalkus, 764 F.2d 1015, 1018 (4th Cir. 1985) ("[T]he Supreme Court held in *Navarro* . . . that only the citizenship of the trustee of a Massachusetts business trust had to be taken into account for purposes of diversity jurisdiction.").

116 *See, e.g.*, Quantlab Fin., LLC v. Tower Research Capital, LLC, 715 F. Supp. 2d 542, 547 (S.D.N.Y. 2010) (noting that the Court of Appeals for the Second Circuit has not yet "squarely addressed the question of how to determine the citizenship of a trust for diversity jurisdiction purposes").

117 *See, e.g.*, Feiner Family Trust v. VBI Corp., No. 07 Civ. 1914 (RPP), 2007 WL 2615448, at *3 (S.D.N.Y. Sept. 11, 2007) ("For purposes of diversity, a trust is a citizen of the state where its trustee is domiciled." (citing *Navarro*, 446 U.S. at 462)).

118 Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 202 (3d Cir. 2007).

119 *See* 292 F.3d 1334, 1339 (11th Cir. 2002) ("[A] Massachusetts business trust . . . is *not* to be accorded the status of a corporation for diversity purposes. Instead, like the limited partnership in *Carden*, it is to be treated as a citizen of each state in which one of its shareholders is a citizen."), *abrogated on other grounds by* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006). *Riley*'s continued relevance has been confirmed by at least one case in the Eleventh Circuit. *See* Crook-Petite-El v. Bumble Bee Seafoods L.L.C., 502 F. App'x 886, 887 (11th Cir. 2012) ("Citizenship of an unincorporated business trust is to be determined on the basis of the citizenship of its shareholders." (citing *Riley*, 292 F.3d at 1337–39)).

120 *Riley*, 292 F.3d at 1337.

121 *See* Carden v. Arkoma Assocs., 494 U.S. 185, 191–93 (1990) (discussing and distinguishing *Navarro*).

mined on the basis of the citizenship of their shareholders."[122] The court distinguished *Navarro* by limiting it to situations when the trustees themselves are parties and are also "the real parties in interest,"[123] as opposed to when the trust itself is the relevant party.[124]

While it appears that no other circuit has yet adopted the beneficiaries-only approach, several district courts have held that a trust's beneficiaries are counted toward its citizenship.[125] However, at least one of those courts applied this approach without regard to whether the trust in question was a business trust.[126] In contrast, *Riley* limited its holding to business trusts and only applies in situations where the citizenship of the trust itself is at issue.[127]

### *3. The* Emerald Investors *Mixed Approach: Both Trustees and Beneficiaries Control*

After considering the two options discussed above, the *Emerald Investors* court settled on a third option: taking the citizenships of both the trustees and the beneficiaries.[128] The court began by observing—much in line with *Riley*[129]—that *Navarro* does not apply to situations in which the trust itself is the relevant party.[130] After eliminating any potential restriction from *Navarro*, the court offered several legal and policy arguments in favor of its "dual trustee-beneficiary rule."[131]

The first argument offered by the *Emerald Investors* court is that the dual approach "does not offend" *Carden*'s requirement that the

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122 *Riley*, 292 F.3d at 1338.

123 *Id.*

124 *See id.* at 1336 n.2 (noting that the business trust itself—in this case the Merrill Lynch Growth Fund—was a named defendant in the case).

125 *See, e.g.*, Yueh-Lan Wang *ex rel.* Wong v. New Mighty U.S. Trust, 841 F. Supp. 2d 198, 207 (D.D.C. 2012) (holding that "the members of a trust include its beneficiaries" without deciding whether the trustees are also counted); FMAC Loan Receivable Trust 1997–C v. Strauss, No. 03 Civ. 2190 (LAK), 2003 WL 1888673, at *1 (S.D.N.Y. Apr. 14, 2003) (holding that business trusts take the citizenships of their beneficiaries/shareholders).

126 *See Yueh-Lan*, 841 F. Supp. 2d at 203, 207 (stating the question as how to determine "the citizenship of a trust" without noting whether the trust in question was a business or traditional trust).

127 *See Riley*, 292 F.3d at 1339 ("[A] Massachusetts business trust . . . is to be treated as a citizen of each state in which one of its shareholders is a citizen.").

128 Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 203 (3d Cir. 2007).

129 *See* 292 F.3d at 1338 (noting that *Navarro* only applies when "the trustees themselves [are] the real parties in interest").

130 *See Emerald Investors*, 492 F.3d at 203 ("*Navarro* is not implicated because it dealt with a situation in which the trustees brought the action in their own names, a situation different from that here in which the trust is the plaintiff.").

131 *Id.*

citizenships of all the members be considered.[132] Keying in on one line of the *Carden* opinion, the *Emerald Investors* court read *Carden* as holding that they "must take into account *not* '*less than* all of the entity's members' when determining the citizenship of an artificial entity."[133] Thus, even if either the trustees or the beneficiaries are not considered "members" of the trust, *Carden* is not offended because the court is simply counting *more than* all the members.[134] In any event, the *Emerald Investors* court held "that a 'member' . . . includes a trust's trustee as well as its beneficiary," largely because legal title to the trust property is traditionally vested in the trustee.[135]

The *Emerald Investors* court also presented policy arguments in support of the dual trustees-beneficiaries rule. First, the court claimed that the dual approach "obviates the possibility of an illogical outcome" wherein either the trustees or the beneficiaries control the trust and yet are not counted toward its diversity citizenship.[136] Second, since counting both the trustees and the beneficiaries creates the greatest possibility for diversity to be destroyed, the court believed that "the dual rule approach best accommodates [its] 'concerns of judicial economy and of due respect for the principles of federalism'" by avoiding "the extension of diversity jurisdiction."[137] The weaknesses of these arguments are discussed in Part III below.

As of now, no other circuit appears to have adopted the *Emerald Investors* approach.[138] However, several district courts outside of the

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[132] *Id.* While the *Emerald Investors* court also argued that because the term "members" has not historically been used in the trusts context, *Carden* might be inapplicable to trusts, *id.*, by its own terms, *Carden* applies to all artificial entities. *See* Carden v. Arkoma Assocs., 494 U.S. 185, 195 (1990) (describing the rule for determining "the [diversity] citizenship of an artificial entity"). As discussed above, whether a trust is an artificial entity depends on whether it is a traditional or business trust. *Compare supra* note 55 and accompanying text (noting that the traditional trust is not historically a legal person), *with supra* notes 66, 77 and accompanying text (describing the business trust as a type of business organization that may be given legal personality).

[133] *Emerald Investors*, 492 F.3d at 205 (emphasis added) (quoting *Carden*, 494 U.S. at 195).

[134] *See id.* ("If a trustee is not a 'member,' then rather than looking to 'less than all of the entity's members,' we are looking beyond that criterion because of the unique characteristics of a trustee . . . .").

[135] *Id.* at 205–06.

[136] *Id.* at 203–04.

[137] *Id.* at 204 (quoting Carlsberg Res. Corp. v. Cambria Sav. & Loan Ass'n, 554 F.2d 1254, 1256 (3d Cir. 1977)).

[138] The only other court of appeals that has cited the *Emerald Investors* opinion is the Tenth Circuit, but in that case the parties agreed that citizenship was determined by the trustees, destroying diversity. Ravenswood Inv. Co. v. Avalon Corr. Servs., 651 F.3d 1219, 1222 n.1 (10th Cir. 2011).

Third Circuit have found the dual approach to be the most compelling choice in the current three-way split.[139]

### *4. Another Alternative: The Wright and Miller Approach*

An alternative to the methods listed above—one briefly mentioned in *Emerald Investors*[140]—is the approach taken by Wright and Miller in *Federal Practice and Procedure*.[141] The Wright and Miller approach does not apply a blanket rule to all trusts, nor does it distinguish between the types of trusts discussed earlier in this Note.[142] Instead, their proposal bases the trust's citizenship on the role of the trustees. If the trust is "*active*," meaning that "the trustee has some affirmative duty of management or administration besides the obligation to transfer the property to the beneficiary,"[143] the citizenships of the trustees control.[144] If the trust is "*passive*," meaning "the trustee has no duty other than to transfer the property to the beneficiary,"[145] the citizenships of the beneficiaries control.[146]

Despite the respect generally afforded to Wright and Miller by the federal courts, it appears that no court has yet adopted this approach.[147] *Emerald Investors* criticizes the test for placing an undue burden on courts because its outcome is conditional on whether the trustees are active or passive.[148] This disapproval fits within the courts of appeals' general resistance "to bas[ing] determinations of citizenship on functional considerations."[149]

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139 *See, e.g.*, Poulos v. GeoMet Operating Co., No. 1:12CV00094, 2013 WL 2456044, at *2 (W.D. Va. June 6, 2013) (adopting the *Emerald Investors* dual trustee-beneficiary approach); Mills 2011 LLC v. Synovus Bank, 921 F. Supp. 2d 219, 226 (S.D.N.Y. 2013) (same); 1963 Jackson, Inc. v. De Vos, No. 1:10–01206–STA–dkv, 2010 WL 5093354, at *3 (W.D. Tenn. Oct. 8, 2010) (same).

140 *See* 492 F.3d at 202 (describing the approach taken by Wright and Miller as "a less definite, case-by-case rule").

141 13E CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3606 (3d ed. 1998).

142 *See supra* Part I.B (discussing and differentiating traditional and business trusts).

143 BLACK'S LAW DICTIONARY, *supra* note 46, at 1741.

144 WRIGHT ET AL., *supra* note 141, § 3606 ("The citizenship of an active trustee, rather than that of the beneficiaries or of the grantor, is decisive . . . .").

145 BLACK'S LAW DICTIONARY, *supra* note 46, at 1745.

146 *See* WRIGHT ET AL., *supra* note 141, § 3606 ("[A] different result is reached with regard to a passive trustee who has only a naked legal title to the property in dispute.").

147 *Cf., e.g.*, Mills 2011 LLC v. Synovus Bank, 921 F. Supp. 2d 219, 225–26 (S.D.N.Y. 2013) (rejecting the Wright and Miller approach).

148 Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 203 (3d Cir. 2007).

149 *Id.* (quoting May Dep't Stores Co. v. Fed. Ins. Co., 305 F.3d 597, 599 (7th Cir. 2002)).

### C. Conflating Traditional and Business Trusts

The federal courts are divided over the legal rule for determining the citizenship of a trust that sues or is sued in its own name, but an even deeper problem exists in the law of diversity citizenship for trusts: the failure of any of these approaches to distinguish between traditional and business trusts. Ignoring this distinction causes the citizenship rules mentioned above to contradict Supreme Court case law governing either diversity jurisdiction for traditional trusts or the diversity citizenship of unincorporated associations.[150] Nevertheless, this problem remains practically unnoticed by the federal courts of appeals.

The *Emerald Investors* decision contains the clearest failure to distinguish between traditional and business trusts. In a footnote, and without citation, the court stated that "[o]ur research . . . has not led us to conclude that the type of trust calls for a difference in treatment when determining a trust's citizenship for diversity of citizenship jurisdictional purposes."[151] As such, the court did not conduct an inquiry into what type of trust was at issue.[152] Several district courts have subsequently cited *Emerald Investors* as justification for applying a single rule to both traditional and business trusts.[153]

This confusion might even originate with *Navarro*, where the trust in question was a Massachusetts business trust.[154] Despite the nature of the trust, the *Navarro* court keyed in on the trustees' "real and substantial" control and noted that the business trust "depart[ing] from conventional forms in other respects has no bearing upon this determination."[155] However, *Carden* specifically noted that "*Navarro* had nothing to do with the citizenship of the 'trust,' since it was a suit by the trustees in their own names."[156] Despite the *Navarro* rule's application to both business and traditional trusts, that decision should not be read to foreclose a rule that distinguishes between traditional and business trusts when determining the citizenship of the trust itself.

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150 For a description of the rule demanded by this existing Supreme Court precedent, see *infra* Part III.A–B.

151 *Emerald Investors*, 492 F.3d at 198 n.10.

152 *Id.*

153 *See, e.g.*, Yueh-Lan Wang *ex rel.* Wong v. New Mighty U.S. Trust, 841 F. Supp. 2d 198, 206 (D.D.C. 2012) (citing *Emerald Investors* in support of not distinguishing between different types of trusts); 1963 Jackson, Inc. v. De Vos, No. 1:10–cv–01206–STA–dkv, 2010 WL 5093349, at *3 (W.D. Tenn. Dec. 8, 2010) (same).

154 Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 459 (1980).

155 *Id.* at 465.

156 Carden v. Arkoma Assocs., 494 U.S. 185, 192–93 (1990).

Though no court has yet explicitly held that there is a difference between traditional and business trusts for determining diversity citizenship, two courts—one circuit and one district—have alluded to this possibility. In *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*—the key case in the shareholders-only line[157]—the court's holding was limited to business trusts.[158] Likewise, in *Thales Alenia Space France v. Thermo Funding Co.*, the court held that traditional trusts take the citizenship of their trustees only after first discussing the differences between traditional and business trusts and classifying the trust at issue as traditional.[159]

Despite this confusion—and despite the vast differences in the current legal rules used in determining trust citizenships—there is one option that is reconcilable with current Supreme Court case law and the key principles surrounding trusts and diversity jurisdiction. That option, along with several arguments supporting it, is described in Part III.

## III
## Determining the Citizenship of Trusts

Having discussed the background of diversity jurisdiction and trusts, as well as the current divide in the courts, the central question of this Note remains unanswered: Given the current state of the law, namely *Navarro* and *Carden*, how should federal courts determine the citizenship of trusts? In this Part, I describe a simple method for determining the diversity citizenship of trusts that is compatible with current Supreme Court case law.

This method begins by recognizing the important difference between traditional trusts and business trusts.[160] The traditional trust, fundamentally an agreement between the settlor and the trustee,[161] is a tool for gifting the trust property (or benefits derived therefrom) from the settlor to the beneficiary by way of the trustee.[162] In sharp

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157 For more on this case and its successors, see *supra* Part II.B.2.

158 *See* Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 292 F.3d 1334, 1338 (11th Cir. 2002) ("[T]he incorporated/unincorporated distinction applies specifically to Massachusetts business trusts, requiring their citizenship to be determined on the basis of the citizenship of their shareholders."), *abrogated on other grounds by* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71 (2006).

159 Thales Alenia Space Fr. v. Thermo Funding Co., 989 F. Supp. 2d 287, 299–300 (S.D.N.Y. 2013).

160 For more on this distinction, see *supra* Part I.B.

161 *See* Langbein, *supra* note 38, at 650 (describing "the trust, like the contract, [as] a consensual juridical relationship" between the settlor and the trustee).

162 *See supra* notes 38–44 and accompanying text (describing the mechanism of traditional trusts and the trusts-as-gifts concept).

contrast, the business trust is an alternative to incorporation[163] that is far closer to the types of unincorporated associations covered by *Carden* and its lineage than to a traditional trust.[164] Accordingly, while traditional trusts should take the citizenship of their trustees, business trusts take the citizenship of their beneficial owners—the beneficiaries. This rule complies with existing Supreme Court case law regarding diversity citizenship for traditional trusts while also fitting within the *Carden* framework, which provides that the citizenship of unincorporated business entities is the citizenship of all of the entity's members.

In formulating a legal rule to determine the citizenship of trusts, it is important to understand the holding of *Navarro* and recognize the limitations on rules that the lower courts can prescribe. *Navarro*—which involved a business trust[165]—held that when the trustees "are active trustees whose control over the assets held in their names is real and substantial,"[166] and the trustees sue in their own names, the trustees are entitled "to sue in their own right, without regard to the citizenship of the trust beneficiaries."[167] *Carden* subsequently prevented any broader reading of *Navarro*, noting that "*Navarro* had nothing to do with the citizenship of the 'trust,' since it was a suit by the trustees in their own names."[168]

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163 *See* 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8227 (describing the business trust as "an organizational alternative to the corporate form").

164 *See Thales*, 989 F. Supp. 2d at 295 ("Business trusts are more akin to business entities—such as limited partnerships, LLCs, or even corporations—than to . . . traditional trusts . . . .").

165 *See* Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 458 (1980) ("The question is whether the trustees of a business trust may invoke the diversity jurisdiction of the federal courts on the basis of their own citizenship, rather than that of the trust's beneficial shareholders.").

166 *Id.* at 465. The Court also noted that the trustees "ha[d] legal title," "manage[d] the assets," and "control[led] the litigation." *Id.*

167 *Id.* at 465–66.

168 Carden v. Arkoma Assocs., 494 U.S. 185, 192–93 (1990). Some scholars have argued that in light of the modern use of business trusts, either the Supreme Court or Congress should set aside *Navarro* and instead apply either *Carden* or even the corporations rule in all cases involving business trusts. *See* Christy, *supra* note 24, at 151–53 (arguing that either Congress should amend the diversity statute or federal courts should switch to a "systemic approach" under which "courts will find that a number of non-corporate entities, and particularly the business trust, are functionally indistinguishable from corporations themselves" and should thus take the corporate citizenship rule); Thomas E. Rutledge & Christopher E. Schaefer, *The Trust as an Entity and Diversity Jurisdiction: Is* Navarro *Applicable to the Modern Business Trust?*, 48 REAL PROP. TR. & EST. L.J. 83, 102–03 (2013) ("[T]he approach of *Navarro* will not be applicable to the modern form of the business trust, and citizenship for purposes of diversity jurisdiction will not be restricted to the citizenship of the trustees. Rather, the broader rule of *Carden* will apply . . . ."). While such approaches may indeed be preferable to the current law of diversity jurisdiction, they are outside the scope of this Note. I instead focus on the approach that lower courts should

Given *Navarro*'s clear holding that trustees, when real parties to the controversy, can invoke diversity jurisdiction based on their own citizenships if suing in their own names—even for business trusts—the only question open to the lower courts is how to determine diversity citizenship when the citizenship of the trust itself is at issue. This question can arise in one of two situations. The first is when the law of the state in which the district court is seated allows the trust to sue in its own name,[169] which is most commonly seen when business trusts are at issue.[170] The second is when the party to the action is neither the trust nor its trustees, but instead another unincorporated business entity—like a limited liability company—and a membership interest in that entity is part of the trust property.[171]

In the remainder of this Part, I discuss the rules that apply when the trust's citizenship is in question. In Part III.A, I discuss the diversity citizenship of traditional trusts, concluding that they should take the citizenships of their trustees. In Part III.B, I conduct the same analysis for business trusts, but instead find that they should take the citizenships of their beneficiaries—the beneficiaries in this case being the "members" under *Carden* and its family tree. Given the difference in outcome based on the type of trust, I then explain in Part III.C how to distinguish between traditional and business trusts, using a test that considers the primary purpose for which the trust was organized.

### *A. The Trustees Determine Diversity Citizenship for Traditional Trusts*

The traditional trust—fundamentally a nexus of agreement or fiduciary relationships[172]—is not a legal person.[173] It cannot own

take given current Supreme Court case law, or the approach that the Supreme Court should take if it does not wish to partially overturn either *Navarro* or *Carden*.

169 *See* FED. R. CIV. P. 17(b)(3) ("Capacity to sue or be sued is determined . . . by the law of the state where the court is located . . . .").

170 *Compare* sources cited *supra* note 55 (noting that traditional trusts cannot typically sue or be sued in their own names), *with* sources cited *supra* note 77 (describing how, in many cases, business trusts can sue or be sued in their own names).

171 *See, e.g.*, Hicklin Eng'g, L.C. v. Bartell, 439 F.3d 346, 347–48 (7th Cir. 2006) (determining the citizenship of a limited liability company when one of the LLC's members was a trust); Johnson v. Columbia Props. Anchorage, LP, 437 F.3d 894, 899 (9th Cir. 2006) (same).

172 *See* Langbein, *supra* note 38, at 650 (describing the trust as a "deal between settlor and trustee"); *supra* note 48 and accompanying text (describing trusts as fiduciary relationships).

173 *See, e.g.*, N. Sec. Ins. Co. v. Doherty, 987 A.2d 253, 256 (Vt. 2009) ("[A]t common law, trusts are not independent legal entities . . . .").

property.[174] It cannot typically sue or be sued.[175] Its interaction with the outside world is conducted through its trustees.[176]

Because a suit against a "trust" is targeting the trust property, which is owned by the trustee, an action against a traditional trust ordinarily must name the trustee, and not the trust, as the defendant.[177] Accordingly, it is the trustees' citizenships that are relevant for diversity purposes. The same holds true when a membership interest in a party business entity is part of the trust property, since again, "[t]he trust itself cannot own anything"[178]—the trust property, and thus the membership interest, is owned by the trustee.

Even in states that allow a traditional trust to sue or be sued in its own name,[179] it is still not an entity capable of owning property,[180] nor is it an association that would have members under *Carden*. That case, along with the other cases in its line, involved business organizations or similar entities[181]: They are voluntary associations, often with transferable membership interests, and the members of these entities also constitute their owners.[182] The traditional trust is vastly different,

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174 *See supra* note 43 and accompanying text (noting the trustee's ownership of the trust property as central to the concept of a traditional trust); *cf.* 1 SCOTT ET AL., *supra* note 38, § 3.1 ("Usually, a trust comes into existence upon the transfer of property . . . to another, as trustee.").

175 *Supra* note 55 and accompanying text.

176 *See* 5 SCOTT ET AL., *supra* note 38, § 28.1 ("The trustee is in many respects a buffer between the beneficiaries and the outside world.").

177 *See, e.g.*, Coverdell v. Mid-South Farm Equip. Ass'n, 335 F.2d 9, 13 (6th Cir. 1964) (dismissing an action with leave to amend when the trust and not the trustee was named as the defendant); Kerrigan v. Villei, No. CIV. A. 95–4334, 1996 WL 84271, at *2 (E.D. Pa. Feb. 28, 1996) ("With regard to the Trust, it is unclear how the Trust could ever be a party. . . . As a general rule, the trustee is the proper person to sue or be sued on behalf of a trust."); Colo. Springs Cablevision, Inc. v. Lively, 579 F. Supp. 252, 254 (D. Colo. 1984) (holding that the trustee—not the trust—was the proper party because "[a] trust is merely the description of a relationship between the legal and equitable owners of property"); Hershel Cal. Fruit Prods. Co. v. Hunt Foods, Inc., 119 F. Supp. 603, 607 (N.D. Cal. 1954) (same as *Coverdell*).

178 *Lively*, 579 F. Supp. at 254.

179 *See* FED. R. CIV. P. 17(b)(3) (stating that a trust's capacity to sue is determined by the law of the state in which the district court is located).

180 *See* sources cited *supra* note 55 (noting that traditional trusts are not jural entities).

181 *See, e.g.*, Carden v. Arkoma Assocs., 494 U.S. 185, 186 (1990) ("The question presented in this case is whether, in a suit brought by a limited partnership, the citizenship of the limited partners must be taken into account to determine diversity of citizenship among the parties."); United Steelworkers of Am. v. R.H. Bouligny, Inc., 382 U.S. 145, 146–47 (1965) (holding that a labor union takes the citizenship of its members); Chapman v. Barney, 129 U.S. 677, 682 (1889) (holding the same for a joint-stock company); Handelsman v. Bedford Vill. Assocs. Ltd. P'ship, 213 F.3d 48, 51–52 (2d Cir. 2000) (holding the same for LLCs).

182 *See* Cosgrove v. Bartolotta, 150 F.3d 729, 731 (7th Cir. 1998) (describing the partners of a partnership and the members of an LLC as the owners of their respective entities).

since the beneficiaries of such a trust do not opt or buy in—their interests in the trust are only what the settlor chooses to give them.[183]

Analyzing the consequences of alternative rules further supports counting only the trustees of a traditional trust. First, prescribing any other rule would allow different courts (or even the same court in different situations) to ascribe different citizenships to the same trust. When the trust has no capacity to sue, the trustee is the sole determinant of citizenship.[184] Since the law of the forum state determines a trust's capacity to sue or be sued in federal court,[185] counting the beneficiaries when determining the citizenship of the trust itself could encourage forum shopping to make or break diversity. Results might further differ depending on whether the suit is directly against a trustee (e.g., in a state that does not allow traditional trusts to sue or be sued) or if it is against another unincorporated association with a trust-held membership interest. In contrast, a trustees-only rule for traditional trusts would ensure uniform results in all diversity actions involving that form.

Second, counting the beneficiaries toward a traditional trust's citizenship can lead to illogical results. A hypothetical concerning the structure of these trusts illustrates the problem. Suppose a settlor wants to establish a trust to avoid probate in gifting her estate. The settlor provides for twenty beneficiaries in the declaration of trust. However, if anyone is to receive the estate, the settlor wants only that person to get the whole amount. For this reason, each beneficiary's receiving the trust property is contingent on all the beneficiaries ranked before her predeceasing the settlor.

In this example, it makes little sense for the citizenship of the twentieth beneficiary to potentially destroy diversity. Such a beneficiary, with an extremely remote interest in the outcome of the litigation, cannot be seen as a "real part[y] to the controversy" under *Navarro*.[186] Moreover, counting such a person toward the citizenship of the trust is unlikely to further the purposes of diversity jurisdiction: If state courts are in fact biased against outsiders, it is unlikely that

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183 *See* 1 SCOTT ET AL., *supra* note 38, § 2.2.4 ("For the most part, the settlor, in creating a trust, can make such provisions with respect to . . . the rights of the beneficiaries as the settlor wishes.").

184 *Supra* note 177 and accompanying text.

185 *See* FED. R. CIV. P. 17(b)(3) ("Capacity to sue or be sued is determined . . . by the law of the state where the court is located . . . .").

186 Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465 (1980). This criticism also applies to the Wright and Miller approach, which would base citizenship on the beneficiaries in such a case when the trustee's sole responsibility is to transfer the estate. *See* WRIGHT ET AL., *supra* note 141, § 3606 (basing diversity citizenship for passive trusts on the citizenship of the beneficiaries).

this bias will subside because one remote beneficiary is a resident of the venue state.[187] This is especially true when, as in some cases, the amounts given to the beneficiaries are "dependent upon the trustee's discretion."[188]

The illogical outcomes caused by counting a traditional trust's beneficiaries toward its citizenship are exacerbated by the fact that the beneficiaries may not even know that the trust exists.[189] This scenario actually occurred in one recent district court case: In *Thales Alenia Space France v. Thermo Funding Co.*, the beneficiary who would destroy diversity "did not know of the Trust's existence or that she was a beneficiary of it" before the litigation began.[190] The court argued that "[i]t would be illogical to bar jurisdiction based on the citizenships of beneficiaries who may not even know that the trust in question exists, when the citizenship of the trustee—'a real party to th[e] controversy'—would permit subject-matter jurisdiction."[191]

For all of these reasons, when a traditional trust is at issue, the relevant diversity citizenship is that of the trustee. This method of citizenship determination complies with the historical rule, "more than 150 years" old, permitting trustees to sue "without regard to the citizenship of the trust beneficiaries."[192] The trustees "are the real plaintiffs in any suit brought to enforce a claim accruing to them in the execution of their trust . . . . [T]hey control the litigation, and are charged with the responsibility of conducting it."[193]

### *B. The Beneficiaries are the "Members" of Business Trusts*

While *Carden* is inapplicable to traditional trusts, the same cannot be said for business trusts. The business trust is a substitute for incorporation.[194] It is designed for profit-making through the combination of capital from several investors,[195] and is "established to run a business enterprise."[196] The beneficiaries are referred to as share-

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187 *Cf.* Friendly, *supra* note 16, at 492 (discussing the state court–bias justification for diversity jurisdiction).

188 1 SCOTT ET AL., *supra* note 38, § 1.1.

189 *See id.* § 5.6 ("It is possible to create a trust in favor of beneficiaries who have no notice of the creation of the trust.").

190 989 F. Supp. 2d 287, 300 (S.D.N.Y. 2013).

191 *Id.* (second alteration in original) (quoting Andrews v. Modell, 636 F. Supp. 2d 213, 220 (S.D.N.Y. 2008)).

192 Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465–66 (1980).

193 Knapp v. W. Vt. R.R. Co., 87 U.S. (20 Wall.) 117, 123 (1873).

194 *See* 16A FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS, *supra* note 65, § 8227 (describing the business trusts as "an organizational alternative to the corporate form").

195 5 HESS ET AL., *supra* note 38, § 247.

196 *In re* Secured Equip. Trust of E. Air Lines, Inc., 38 F.3d 86, 90 (2d Cir. 1994).

holders, hold transferable certificates of ownership in the trust, and are often empowered to elect, control, and remove the trustees.[197] Thus, the business trust is "a form of 'voluntary association,'"[198] exactly like the others covered by *Carden*'s requirement that artificial entities take "the citizenship of 'all the members.'"[199]

Since *Carden* and its lineage are applicable to the business trust form, consistency requires that business trusts—when the citizenship of the trust itself is in question[200]—take the citizenship of their beneficiaries. For all other entities subject to *Carden*'s all-the-members rule, diversity citizenship is determined by their beneficial owners: for example, the partners in a partnership and the members in an LLC.[201] The beneficiaries or shareholders, as the beneficial owners of a business trust, should thus determine the trust's citizenship—an outcome in accord with the Eleventh Circuit and several district courts that considered the question.[202] The only other academic work to cover this question concurs in the beneficiaries-only outcome.[203]

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197 *See supra* notes 78–81 and accompanying text (discussing the role and powers of the beneficiaries of a business trust).

198 Jones et al., *supra* note 65, at 423.

199 Carden v. Arkoma Assocs., 494 U.S. 185, 195 (1990) (quoting Chapman v. Barney, 129 U.S. 677, 682 (1889)).

200 For a description of when this occurs, see *supra* notes 169–71 and accompanying text.

201 *See supra* notes 181–82 and accompanying text (describing the *Carden* rule and its application to several artificial entities).

202 *See, e.g.*, Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 292 F.3d 1334, 1339 (11th Cir. 2002) (holding that a business trust "is to be treated as a citizen of each state in which one of its shareholders is a citizen"); San Juan Basin Royalty Trust v. Burlington Res. Oil & Gas Co., 588 F. Supp. 2d 1274, 1280 (D.N.M. 2008) ("[T]he trust takes on the citizenship of its beneficiaries."); FMAC Loan Receivable Trust 1997–C v. Strauss, No. 03 Civ. 2190 (LAK), 2003 WL 1888673, at *1 (S.D.N.Y. Apr. 14, 2003) (holding that the beneficiaries or shareholders of a business trust determine the trust's diversity citizenship).

203 *See* Rutledge & Schaefer, *supra* note 168, at 102 ("[I]n the modern form of the business trust . . . the citizenship of only the beneficial owners of the venture should be considered."). However, the Rutledge and Schaefer article's conclusion is based on the authors' belief that "*Navarro*'s reference to the citizenship of the trustees and only the trustees does not apply to the modern form" of business trusts. *Id.* By *Navarro*'s own terms, this cannot be correct. *Navarro* applies to all trusts—and explicitly to business trusts—whenever the named parties "are active trustees whose control over the assets held in their names is real and substantial." Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 465 (1980). *Navarro*'s holding cannot be seen as categorically inapplicable to the very entity at issue in that case, even if the trustees of many modern business trusts will not be the "real parties to the controversy." *Id.* Moreover, the Rutledge and Schaefer piece dismisses *Navarro*'s applicability based on recent changes in the business trust form. *See* Rutledge & Schaefer, *supra* note 168, at 85 (asking how existing case law "should apply to the more modern incarnations of that organizational structure"). But the article attributes these changes to the Uniform Statutory Trust Entity Act, *id.*, a proposed piece of legislation that has only been adopted in the District of Columbia and Kentucky. *Legislative Fact Sheet - Statutory Trust Entity Act*, UNIFORM L. COMMISSION, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Statutory%20Trust%20Entity%20Act (last visited Nov. 11, 2014).

The *Carden* line also suggests that the trustees should not be counted in the case of the business trust, foreclosing the dual trustee-beneficiary approach taken by the Third Circuit in *Emerald Investors*.[204] As noted above, the trustees of a business trust share several similarities with the directors or managers of other business entities.[205] Neither *Carden* nor any of its related cases has endorsed counting *more than* the members of an unincorporated association,[206] and counting the trustees would sever the connection between beneficial ownership and the determination of diversity citizenship—a connection seen throughout the *Carden* line.[207]

This logic is also applicable to the case, discussed throughout this Part, in which the relevant party is another artificial entity whose membership interest is part of the trust property. Unlike the traditional trust, for which the trustee holds legal title to the trust property,[208] business trusts typically hold property in their own names.[209] In such a case, it is the citizenship of the trust itself—not that of the trustee—that is relevant for determining the existence of complete diversity.

It is true that the *Emerald Investors* rule—counting both the trustees and the beneficiaries—would most limit the jurisdiction of the federal courts, and thus best preserve the power of the state courts.[210] However, "[t]he duties of [the] court, to exercise jurisdiction where it is conferred, and not to usurp it where it is not conferred, are of equal

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[204] *See* Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 203 (3d Cir. 2007) (counting both the trustees and the beneficiaries toward a business trust's citizenship).

[205] *Supra* note 75 and accompanying text.

[206] *But see Emerald Investors*, 492 F.3d at 205 ("[B]ecause *Carden* was dealing with a partnership, the Court did not deal with the entirely separate question of whether citizenship treatment may extend to individuals in addition to 'members' with respect to other entities . . . .").

[207] *Cf.* Rutledge & Schaefer, *supra* note 168, at 109 ("[U]nder *Carden* no basis exists for applying to a new model business trust the citizenship of a trustee who is not also a beneficial owner.").

[208] *See supra* note 178 and accompanying text (noting that the trust property of a traditional trust—including any membership interests held therein—is owned by the trustee).

[209] *See, e.g.*, DEL. CODE ANN. tit. 12, § 3801(g) (2013) (allowing Delaware statutory trusts to be organized "for the purpose of holding or otherwise taking title to property"). Though Delaware law also allows the property to "be held in the name of any trustee of the statutory trust, in its capacity as such," the effects of this are to be the same "as if such property were held in the name of the statutory trust." *Id.* § 3805(f).

[210] *See Emerald Investors*, 492 F.3d at 204 (arguing that the dual trustee-beneficiary rule "best accommodates . . . due respect for the principles of federalism" (internal quotation marks omitted)). This effect comes from the fact that counting both the trustees and beneficiaries results in the greatest likelihood that one of their citizenships will destroy complete diversity.

obligation."[211] Adopting a more restrictive rule solely to limit the exercise of diversity jurisdiction would ignore this reciprocal duty, while also disrupting the clear trajectory of the *Carden* line. Basing the citizenship of business trusts on their beneficiaries or shareholders instead creates a clear rule—no more expansive than the current exercise of diversity jurisdiction—that is in accord with the citizenship rules for all other unincorporated associations.[212]

### *C. Classifying the Trust*

Since the citizenship rules differ between traditional and business trusts, it is important to clarify how trusts are placed into these categories. A common theme in the modern literature on business trusts is to differentiate these entities based on the primary purpose for which the trusts are organized—a test that is relatively simple to apply. In this Subpart, I describe this primary purpose test and its application, and then conclude by reviewing other factors that courts could consider if a trust's primary purpose is unclear.

#### *1. The Primary Purpose Test*

The primary purpose test for determining the type of trust relies on the fact that the traditional trust is typically a gift or estate planning tool,[213] while the business trust is an alternative form of business organization.[214] Thus, "the primary purpose of the Massachusetts or business trust is to conduct a business for profit while the object of the traditional trust is to hold and conserve particular property."[215] As stated in Bogert's treatise, "the business trust is organized not as a means of effecting a gift or transfer but as a device for profit making through the combination of capital contributed by a number of investors."[216] Accordingly, a court conducting the primary purpose test first determines whether a trust is primarily designed for gift, transfer, or estate-planning purposes, or whether it is designed to accumulate capital from investors in order to conduct business.

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211 Bank of the U.S. v. Deveaux, 9 U.S. (5 Cranch) 61, 87 (1809), *overruled in part by* Louisville, Cincinnati, & Charleston R.R. Co. v. Letson, 43 U.S. (2 How.) 497 (1844).

212 *See supra* notes 181–82 and accompanying text (noting that the members under *Carden* are the entity's owners).

213 *Supra* notes 38–41 and accompanying text.

214 *See* Morrissey v. Comm'r, 296 U.S. 344, 357 (1935) ("In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains."); Jones et al., *supra* note 65, at 426 (describing business trusts as "an alternative to corporations").

215 13 AM. JUR. 2D *Business Trusts*, *supra* note 69, § 6.

216 5 HESS ET AL., *supra* note 38, § 247.

A valid criticism of any test that divides trusts into categories is that the burden on the courts may be greater than it would be with a uniform rule for all trusts, since courts must conduct this classification on a case-by-case basis.[217] However, in most instances the primary purpose of the trust should be undisputed—the organization and nature of traditional and business trusts generally differ so greatly as to render absurd any debate over their classification. *Thales Alenia Space France v. Thermo Funding Co.*,[218] a district court case involving the diversity citizenship of a traditional trust, provides an example. Although the court in that case allowed depositions as part of jurisdictional discovery,[219] this proved to stem from an abundance of caution. The trust agreement clearly and definitively provided the facts needed to classify the trust in that case as traditional.[220]

As exemplified in *Thales*, if the trust categorization is ever disputed, the answer will most likely be clear from the trust instrument. Declarations creating traditional trusts will name beneficiaries to whom the settlor intends to gift the trust property, while those creating business trusts will assign beneficial interests to the trust's investors. In the rare case that jurisdictional discovery is required, the discovery needed should be no more extensive than what is required for citizenship determinations of other entities.[221]

### 2. *Supplementary Factors*

Even if the primary purpose test is unable to clearly classify the trust, several other factors can assist the court in making its determination. Most of these characteristics are derived from the role of the trust's beneficiaries: If the beneficiaries constitute the trust's share-

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[217] *See* Emerald Investors Trust v. Gaunt Parsippany Partners, 492 F.3d 192, 203 (3d Cir. 2007) (criticizing Wright and Miller's proposed rule on these grounds). However, it is unclear whether the burdens caused by a category-based test (e.g., jurisdictional discovery, additional factual findings) would be any greater than those for a rule like the one in *Emerald Investors*, which would count both the trustees and the beneficiaries. *Id.* at 205. Classifying the trust seems no less onerous than determining the citizenship of the additional trustees or beneficiaries, especially if one of those persons is itself another artificial entity.

[218] 989 F. Supp. 2d 287 (S.D.N.Y. 2013).

[219] *See id.* at 291 n.8 (citing to deposition transcripts).

[220] *See id.* at 291–92 nn.11 & 13–17 (citing to the trust agreement to identify the trust as inter vivos and one that is designed to provide both incomes and the principal to the settlor's wife and several other named beneficiaries).

[221] *Cf., e.g.*, Rowen Petroleum Props., LLC v. Hollywood Tanning Sys., Inc., No. 08-4764 (NLH) (AMD), 2009 WL 1085737, at *7 n.11, *8 (D.N.J. Apr. 20, 2009) (ordering jurisdictional discovery to determine the citizenship of two LLCs); Kehrer Bros. Const., Inc. v. Custom Body Co., No. 05-cv-246-DRH, 2007 WL 118a9370, at *2 (S.D. Ill. Apr. 20, 2007) (inviting the plaintiff to request jurisdictional discovery to determine the membership and citizenship of a defendant LLC).

holders, possess transferable beneficial interests in the trust (e.g., certificates), and have the power to elect, control, or remove the trustees—or to amend the trust instrument—the trust in question is likely a business trust.[222] As mentioned above, centralized management, the continuous existence of the trust, and state registration requirements can also indicate a business trust.[223]

In sum, the primary purpose test allows courts to classify a trust with limited or no jurisdictional discovery. That test classifies all trusts organized for gift or estate-planning purposes as traditional trusts, and all trusts organized to conduct business for profit as business trusts. In the rare case that the primary purpose test cannot clearly classify a trust, several other factors can help the court determine the trust's proper classification.

## Conclusion

The law of diversity jurisdiction is undeniably—and perhaps unnecessarily—confusing, and its tortuous patchwork of case law is illustrated by the question of how to determine the diversity citizenship of trusts. Some courts view the key Supreme Court cases in the field as conflicting, and one of the forms at issue—the business trust—operates as a business entity while borrowing its terminology from the centuries-old law of trusts.

The result is mass confusion and dissension in the lower courts: The question of who determines a trust's citizenship has divided the circuits into a three-way split, with some circuits counting the trustees, another counting the beneficiaries, and yet another counting both. Meanwhile, all of these views fail to distinguish between traditional and business trusts, despite the radically different purposes and applications of these forms.

After reviewing the current state of the law concerning diversity jurisdiction for trusts, I have outlined a citizenship rule that is consonant with existing Supreme Court cases and preserves the law's internal consistency. That rule takes the citizenship of the trustees when dealing with a traditional trust, but turns to the citizenship of the beneficiaries (also called shareholders) when the entity in question is a business trust. To distinguish between the two types of trusts, courts should look to the primary purpose for which the trust was organized—a test that limits the burdens imposed on courts and litigants.

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[222] *See supra* notes 78–81 and accompanying text (describing these factors as specific to business trusts); *see also Thales*, 989 F. Supp. 2d at 296 (finding the same for some of these factors).

[223] *Supra* notes 82–84 and accompanying text.

While other rules—such as one that takes the citizenships of the trustees in all cases—may be somewhat easier to apply, only my proposal is consistent with the current law of diversity jurisdiction. The rule I have proposed is clear, simple to apply, and fits within the Supreme Court's decisions in *Navarro* and *Carden*. No rule in this area of law is perfect, but the one I have prescribed in this Note is the best currently available option.