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# JURAL ENTITIES, REAL PARTIES IN CONTROVERSY, AND REPRESENTATIVE LITIGANTS: A UNIFIED APPROACH TO THE DIVERSITY JURISDICTION REQUIREMENTS FOR BUSINESS ORGANIZATIONS

Charles A. Szypszak\*

## INTRODUCTION

The rules that make the federal courts available for the resolution of controversies between citizens of different states have often been described as placing an undue burden on the federal system.<sup>1</sup> Congress has for the most part turned a deaf ear to calls by jurists and commentators for reform or even abolition of federal diversity jurisdiction, leaving the courts to struggle with difficult issues about the proper contours of the jurisdictional requirements.<sup>2</sup>

One recurring difficult issue is the manner in which citizenship is to be attributed to the investors who compose various business organizations. The general rule has been that corporations are to be treated as having an existence and citizenship separate from their investors; only the entity has had to satisfy the diversity of citizenship requirements.<sup>3</sup> The rule is not so clear for other organizations, however, even those that share many, or nearly all, of the corporation's fundamental characteristics. Consideration of policy arguments against expansion of diversity jurisdiction has often been implicit, and sometimes even explicit, in the determination of how such unincorporated associations are to be treated.<sup>4</sup> Recently, a nar-

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1. See, e.g., Larry Kramer, *Diversity Jurisdiction*, 1990 B.Y.U. L. REV. 97; RICHARD A. POSNER, *THE FEDERAL COURTS: CRISIS AND REFORM* (1985); Felix Frankfurter, *Distribution of Judicial Power Between United States and State Courts*, 13 CORNELL L.Q. 499 (1928); George Cochran Doub, *Time for Re-Evaluation: Shall We Curtail Diversity Jurisdiction?*, 44 A.B.A. J. 243 (1958). The debate has not been completely one-sided; persuasive cases have been made for the retention or extension of diversity jurisdiction. See, e.g., John P. Frank, *The Case for Diversity Jurisdiction*, 16 HARV. J. ON LEGIS. 403 (1979); William L. Marbury, *Why Should We Limit Federal Diversity Jurisdiction?*, 46 A.B.A. J. 379 (1960).

2. Although there have been refinements in the diversity rules since their inception in 1789, there has not been any truly substantial retrenchment of diversity jurisdiction's availability. See *infra* note 13 (discussing the diversity statute's history).

3. See, e.g., *Carden v. Arkoma Assocs.*, 494 U.S. 185, 189 (1990) ("the rule regarding the treatment of corporations as 'citizens' has become firmly established").

4. See, e.g., *id.* at 197 (1990) (stating that expansion of entity treatment for busi-

row majority of the United States Supreme Court sent a clear message that the Court will not expand diversity jurisdiction for use by an unincorporated association, even if the association seems to have the same fundamental characteristics as a corporation.<sup>5</sup>

Evidently, concern about the burdens of diversity jurisdiction—not sound doctrinal analysis—governs how citizenship will be attributed to business organizations. The Supreme Court has created a “doctrinal wall”<sup>6</sup> around corporations that enables courts to avoid persuasive arguments that other business organizations should also be able to qualify for diversity jurisdiction as entities apart from their investors.

Moreover, the rules are not as tidy as the declaration of a “doctrinal wall” would suggest. The Supreme Court has applied a “real party in controversy” test<sup>7</sup> to permit one type of organization—a business trust—to qualify for diversity based on the trustees’ citizenship alone, thereby overcoming any lack of diversity due to common citizenship of the trust’s beneficiary investors.<sup>8</sup> The rules governing business organizations’ access to the federal courts are further complicated by a procedural mechanism found in Federal Rule of Civil Procedure 23.2,<sup>9</sup> which enables suits to be brought by

ness organizations is a matter for Congress, not the courts); *Carlsberg Resources Corp. v. Cambria Sav. & Loan Ass’n*, 554 F.2d 1254, 1256-57 (3d Cir. 1977) (stating that federalism concerns and the federal courts’ heavy workload require that jurisdiction not be permitted on the basis of diversity “unless there has been a definitive determination that diversity of citizenship is present”).

5. In *Carden v. Arkoma Assocs.*, 494 U.S. 184 (1990), the Court insisted that all investors in a modern limited partnership must satisfy the diversity requirement notwithstanding fundamental similarities between limited partners and corporate shareholders. Justice Scalia wrote that the Court’s resolutions “can validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization,” but “[w]e have long since decided that, having established special treatment for corporations, we will leave the rest to Congress . . .” *Id.* at 196-97.

6. The term “doctrinal wall” was first used in *United Steelworkers of Am. v. R.H. Bouligny, Inc.*, 382 U.S. 145, 151 (1965), to describe the rule stated in *Chapman v. Barney*, 129 U.S. 677, 682 (1889), in which the Court said that only business organizations that are in fact corporations are to be treated as such for diversity jurisdiction purposes.

7. See *infra* text accompanying notes 57-60 for a description of the “real party in controversy” test.

8. See *infra* text accompanying notes 72-79.

9. FED. R. CIV. P. 23.2, Actions Relating to Unincorporated Associations, reads as follows:

An action brought by or against the members of an unincorporated association as a class by naming certain members as representative parties may be maintained only if it appears that the representative parties will fairly and adequately protect the interests of the association and its members. In the conduct of the action the court may make appropriate orders corresponding with those described in Rule 23(d), and the procedure for dismissal or compromise of the action shall correspond with that provided in Rule 23(e).

or against an organization's designated representatives. Some courts have interpreted Rule 23.2 as giving access to the federal courts solely for the purpose of providing a convenient procedure for designating representative litigants when state law does not provide one.<sup>10</sup> Other courts refuse to allow Rule 23.2 to be employed in this role, on the ground that to do so is inconsistent with the judicial policy of interpreting the availability of diversity jurisdiction narrowly.<sup>11</sup> The very existence of Rule 23.2, as well as the real party in controversy test, makes it possible for some business organizations to gain access to the federal forum regardless of where they are found in relation to the Supreme Court's entity status "doctrinal wall." As a result, potential litigants may be unable to predict confidently whether they can sustain a suit in federal court.

This Article discusses the evolution of the entity treatment, real party in controversy, and Rule 23.2 representative litigant rules as they are applied to business organizations, and argues for a predictable, theoretically sound approach that is based not on an apologetically offered arbitrary line, but rather on investor expectations viewed in the context of diversity jurisdiction's underlying purposes. Part I discusses the "doctrinal wall" erected by the Supreme Court around corporations and the Court's refusal to extend similar entity treatment to unincorporated associations. Part II discusses the real party in controversy test and reveals its inappropriateness in the business organization context. Part III considers whether there is, after all, a sound analytical basis for distinguishing among the various business organizations in establishing diversity requirements. Part IV examines representative suits and the circuits' conflicting interpretations of Rule 23.2, and urges alignment of the Rule with the treatment given to corporations under the Supreme Court's entity status analysis.

#### I. ENTITY TREATMENT FOR BUSINESS ORGANIZATIONS AND THE "DOCTRINAL WALL" AROUND CORPORATIONS

The Judiciary Act of 1789 invoked the constitutional grant of federal judicial authority over "Citizens of different states"<sup>12</sup> by empowering federal courts to hear a suit "between a citizen of the State where the suit is brought, and a citizen of another State."<sup>13</sup> In com-

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10. See *infra* text accompanying notes 186-97.

11. See *infra* text accompanying notes 175-82.

12. U.S. CONST. art. III, § 2, cl. 1.

13. Judiciary Act of 1789, ch. 20, § 11, 1 Stat. 73, 78 (1789). The Act provided: That the circuit courts shall have original cognizance, concurrent with the courts of the several States, of all suits of a civil nature at common law or in equity, where the matter in dispute exceeds, exclusive of costs, the sum or value of five hundred dollars, and the United States are plaintiffs, or petitioners; or an alien is a party, or the suit is between a citizen of the State where the suit is brought, and a citizen of another State.

mon usage the term "citizen" evokes notions of a singular natural person, but redress in the courts is also sought by groups of individuals who have organized in a common business enterprise. Congress has never said directly how such organizations are to be treated for diversity jurisdiction purposes. The Supreme Court has been left to struggle with this often complex question.

### A. Corporations

Business corporations became an important organizational form in the United States by the beginning of the nineteenth century.<sup>14</sup> When first squarely confronted with the issue of a corporation's citizenship for jurisdictional purposes, the Supreme Court, in *Bank of the United States v. Deveaux*,<sup>15</sup> said that all investors composing the entity are "citizens" and must each satisfy the diversity requirements. Regarding the corporate entity, the Court said: "That invisible, intangible and artificial being, that mere legal entity, a corporation aggregate, is certainly not a citizen . . ."<sup>16</sup>

A few years after *Deveaux* was decided, the Supreme Court concluded that its opinion had been unsatisfactory,<sup>17</sup> and the Court reversed its position on a corporation's citizenship. In *Louisville Railroad Co. v. Letson*,<sup>18</sup> the Court said that

a corporation created by and doing business in a particular state, is to be deemed to all intents and purposes as a person, although an artificial person, an inhabitant of the same state, for the purposes of its incorporation, capable of being treated as a citizen of that state, as much as a natural person.<sup>19</sup>

The Court recited the famous passage in *Trustees of Dartmouth College v. Woodward* that "a corporation is an artificial being, invisible, intangible, and existing only in contemplation of law."<sup>20</sup> To skirt the analytical difficulties that stem from the reality that a

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*Id.*

In 1875, the diversity provision was substantially altered to give circuit courts jurisdiction over cases exceeding \$500 "in which there shall be a controversy between citizens of different States or . . . between citizens of a State and foreign states, citizens or subjects . . ." Act of March 3, 1875, ch. 137, § 1, 18 Stat. 470 (1875). The minimum jurisdictional amount has been raised a number of times, and currently is \$50,000. 28 U.S.C. § 1332 (1988). For a thorough history of the diversity provision, see generally 1 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 0.71 (1991) [hereinafter 1 MOORE'S FEDERAL PRACTICE].

14. 1 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2 (perm. ed. rev. vol. 1990).

15. 9 U.S. (5 Cranch) 61 (1809).

16. *Id.* at 86.

17. See *Louisville R.R. Co. v. Letson*, 43 U.S. (2 How.) 497, 555 (1844).

18. 43 U.S. (2 How.) 497 (1844).

19. *Id.* at 558.

20. *Id.* (quoting *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819)).

“corporation can have no legal existence out of the boundaries of the sovereignty by which it is created,”<sup>21</sup> the Court adopted a fiction to treat shareholders collectively, so that those who act for the corporation shall “be justly presumed to be resident in the State which is the necessary *habitat* of the corporation . . . .”<sup>22</sup> Thus, the citizenship of the corporation is “conclusive as to the residence or citizenship of those who use the corporate name and exercise the faculties conferred by it . . . .”<sup>23</sup> The Court thereby made the corporate entity the focus of the diversity jurisdiction analysis without having to give the entity full citizenship status for other purposes.<sup>24</sup>

Congress has never explicitly sanctioned the Supreme Court’s treatment of a corporation as a jural entity whose citizenship is the exclusive measure of diversity. Neither has it rejected the approach. There has been acknowledgment in the diversity statute’s legislative history of a “now established doctrine that a corporation, for the purposes of jurisdiction, is deemed a citizen of the State in which it is incorporated.”<sup>25</sup> In 1958, Congress implicitly affirmed treatment of a corporation as a citizen when it directed how that citizenship should be determined: “a corporation shall be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business.”<sup>26</sup> The purpose of this legislation, however, does not appear to have been to approve the citizenship treatment being accorded to corporations, but rather to curtail diversity jurisdiction as it applies to corporations by giving a corporation dual citizenship when its principal place of business is in a different state than its state of incorporation.<sup>27</sup> Consequently, the

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21. *Marshall v. Baltimore & Ohio R.R. Co.*, 57 U.S. (16 How.) 314, 328 (1853) (quoting *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 517, 596 (1839)).

22. *Id.* at 328.

23. *Id.* at 329. According to one commentator, the Court was concerned about the potential “objection that citizenship cannot reside in a being that lacks humanity because it is a mere abstraction . . . ,” so it adopted a fiction that it was the citizenship of the shareholders that counted, but their citizenship was conclusively presumed to be the corporation’s residence. Frederick Green, *Corporations as Persons, Citizens, and Possessors of Liberty*, 94 U. PA. L. REV. 202, 220-21 (1946).

24. See 1 MOORE’S FEDERAL PRACTICE, *supra* note 13, ¶ 0.76[5] at 800.74 n.3. Corporations have been treated as constitutional “persons” for such purposes as protection against unreasonable searches and seizures, *G.M. Leasing Corp. v. United States*, 429 U.S. 338 (1977); protection against burdens on interstate commerce, *Allenberg Cotton Co. v. Pittman*, 419 U.S. 20 (1974); the Fourteenth Amendment’s Due Process and Equal Protection Clauses, *Munn v. Illinois*, 94 U.S. 113 (1877); and First Amendment commercial expressions, *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976).

25. S. REP. NO. 1830, 85th Cong., 2d Sess. 2 (1958), *reprinted in* 1958 U.S.C.A.N. 3099, 3101 (citation omitted).

26. Act of July 25, 1958, Pub. L. No. 85-554, 72 Stat. 415 (codified at 28 U.S.C. § 1332(c) (1988)).

27. See 1 MOORE’S FEDERAL PRACTICE, *supra* note 13, ¶ 0.77[1.-2]. One commentator has said that the Supreme Court should not feel constrained by the 1958 amend-

entity status accorded to corporations continues to rest on the Supreme Court's application of a legal fiction.

### B. *Unincorporated Associations*

According to the Supreme Court, "[t]he tradition of the common law is to treat as legal persons only incorporated groups and to assimilate all others to partnerships."<sup>28</sup> With one noteworthy exception, which is discussed below, the Court has refused to treat any business organization other than the corporation as a singular jural entity for diversity jurisdiction purposes, regardless of the degree of similarity between the association's structure and the corporate form.

The Supreme Court's first real treatment of the issue as it applies to an unincorporated association was in *Chapman v. Barney*,<sup>29</sup> in which the Court held that a joint stock company was not to be treated as a legal personality.<sup>30</sup> The Court said that "the express company cannot be a citizen of New York, within the meaning of the statutes regulating jurisdiction, unless it be a corporation."<sup>31</sup> The Court drew a bright line; since the group was "not a corporation," it had to be "a mere partnership."<sup>32</sup>

The unique status ascribed to the corporate entity in *Chapman v. Barney* withstood a challenge in *Great Southern Fire Proof Hotel Co. v. Jones*,<sup>33</sup> where an early incarnation of the limited partnership form was held not to have citizenship status for diversity jurisdiction purposes.<sup>34</sup> In *Fire Proof Hotel*, a Pennsylvania "limited partnership association" sought to collect on a debt. The association had many corporate characteristics; state law gave it entity status, and the organization had a single class of partners with voting power over management, all of whom had limited liability.<sup>35</sup> The Supreme

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ment in considering entity citizenship because the amendment was plainly directed to the separate issue of eliminating abuses of the presumption of shareholder citizenship; the amendment can easily be held to leave unimpaired the Court's power to construe "citizen" according to statutory purpose, or even to express concurrence with the Court's original view that associations having the characteristics of citizens should be treated as such.

David P. Currie, *The Federal Courts and the American Law Institute*, 36 U. CHI. L. REV. 1, 35-36 (1968).

28. *Puerto Rico v. Russell & Co.*, 288 U.S. 476, 480 (1933).

29. 129 U.S. 677 (1889).

30. *Id.* at 682.

31. *Id.*

32. *Id.*

33. 177 U.S. 449, 454 (1900).

34. *Id.* at 450-51.

35. *Id.* at 456 (discussing Pennsylvania cases that address the nature of the limited partnership associations). See also *Hill, Keiser & Co. v. Stetler*, 127 Pa. 145, 161-62 (1888) (discussing the characteristics of limited partnership association); *Oak Ridge Coal Co. v. Rogers*, 108 Pa. 147, 150-51 (1884) (same); *Robert J. Kopecky*,

Court refused, however, to compare this association with a corporation, noting that having "some of the characteristics" of a corporation was insufficient to warrant treating something other than a corporation as if it were a corporation for diversity purposes.<sup>36</sup>

In 1933, the Supreme Court led some to believe that possibly other business organizations should share the corporation's favored status.<sup>37</sup> In *Puerto Rico v. Russell & Co.*,<sup>38</sup> the Court held that a *sociedad en comandita*, an unincorporated association organized under Puerto Rico law, should enjoy the same citizenship treatment as a corporation.<sup>39</sup> The *sociedad's* dispositive characteristics, according to the Court, were its contractual powers, right to own property, right to sue and be sued, continuity of existence apart from its members, centralized management, and limited liability for some investors<sup>40</sup>—all characteristics generally shared by corporations.<sup>41</sup>

*Russell* suggested that courts should compare an unincorporated entity's salient characteristics with those of a corporation, and if these characteristics were functionally identical, then the unincorporated entity should be treated as a citizen in its own right for diversity jurisdiction purposes. The Second Circuit adopted this approach in *Mason v. American Express Co.*,<sup>42</sup> in which the court held that an unincorporated joint stock association's essential characteristics "sufficiently invest it with a legal personality apart from its individual members, so that it is just and sensible to regard it as a separate entity for purposes of diversity of citizenship jurisdic-

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Comment, *Limited Partnerships and Federal Diversity Jurisdiction*, 45 U. CHI. L. REV. 384, 389 n.36 (1978) (same).

36. *Great S. Fire Proof Hotel Co. v. Jones*, 177 U.S. at 455-56.

37. See Note, *Federal Diversity Jurisdiction—Citizenship for Unincorporated Associations*, 19 VAND. L. REV. 984, 985 (1966) (observing that some courts viewed the Supreme Court's opinion in *Puerto Rico v. Russell & Co.*, 288 U.S. 476 (1933); see *infra text* accompanying notes 38-41, as potential justification for a change to the rule requiring separate citizenship consideration of each member in an unincorporated association).

38. 288 U.S. 476 (1933).

39. "The issue in *Russell* was not diversity, but whether the suit against the *sociedad en comandita* could be removed from the Insular District Court to the United States District Court for Puerto Rico . . ." *Carden v. Arkoma Assocs.*, 494 U.S. 185, 207 (1990) (O'Connor, J., dissenting); see also *id.* at 190 n.2 (the majority acknowledging Justice O'Connor's characterization of *Russell*). The citizenship analysis employed in the removal analysis was identical to the diversity analysis, however. See *id.*; *Puerto Rico v. Russell & Co.*, 288 U.S. at 480-82.

40. One class of members was contingently liable for the entity's debts if the entity's assets were insufficient to satisfy them. *Puerto Rico v. Russell & Co.*, 288 U.S. at 481. The Court said that "this liability is of no more consequence for present purposes than that imposed on corporate shareholders by the statutes of some states." *Id.* The modern corporate shareholder has no such contingent liability.

41. *Id.* at 480-82.

42. 334 F.2d 392 (2d Cir. 1964).



tion."<sup>43</sup> The Second Circuit thought that with *Russell*

the Supreme Court . . . abandoned the artificial and mechanical rule of *Chapman v. Barney* in favor of a more flexible test for capacity for citizenship, a test which demands that consideration be given to whether an organization's essential characteristics sufficiently invest it, like a corporation, with a complete legal personality distinct from that of the members it represents.<sup>44</sup>

The characteristics that persuaded the court to give entity treatment to the joint stock association were its creation by the filing of articles of association, the issuance of capital stock, an existence that withstood individual investor departure, centralized management, rights to own property and to sue and be sued, and some limitations on liability.<sup>45</sup>

In the Supreme Court session immediately following the *Mason* decision, the Court expressly rejected any tendency toward expansion of entity treatment for the purposes of diversity citizenship. In *United Steelworkers of America v. R.H. Bouligny, Inc.*,<sup>46</sup> the Court refused to consider an unincorporated labor group as having its own citizenship. Corporations, the Court said, were susceptible of a particular "certainty of application," but in attempting to fashion a citizenship analysis for a labor union, the Court said it "would be faced with difficulties which [it] could not adequately resolve."<sup>47</sup> These matters were "suited to the legislature and not the judicial

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43. *Id.* at 400.

44. *Id.* at 393.

45. *Id.* at 399-400. Members did have individual liability, but the court was willing to overlook this distinction from a corporation because the individual liability was contingent on exhaustion of relief against the entity, and this was similar to the extent of individual liability imposed on corporate shareholders in some circumstances at the time. *Id.* at 401. *Mason* has been criticized for the way it compared the joint stock association to the *Russell sociedad*, rather than to a corporation, thereby threatening a "chain reaction" in which associations could obtain entity status by comparison to organizations that have achieved such status based in turn on their similarity to corporations. See Stephen H. Hutzelman, Note, *Federal Procedure: Diversity Jurisdiction: Unincorporated Associations: United Steelworkers of America v. R.H. Bouligny, Inc.*, 382 U.S. 145 (1965), 51 CORNELL L.Q. 827, 830 (1966).

There are only a few other instances where courts have deemed certain organizations to merit entity treatment for diversity purposes. See *Swan v. First Church of Christ, Scientist*, 225 F.2d 745 (9th Cir. 1955) (unincorporated religious society deemed to be body corporate); *Van Sant v. American Express Co.*, 169 F.2d 355 (3d Cir. 1947), *reh'g granted*, 169 F.2d 370 (3d Cir. 1948) (joint stock association given entity treatment); *Andrews Bros. Co. v. Youngstown Coke Co.*, 86 F. 585 (6th Cir. 1898) (equating a Pennsylvania limited partnership to a corporation); *Liverpool, Brazil & River Platte Navigation Co. v. Agar & Lelong*, 14 F. 615 (C.C.E.D. La. 1882) (Louisiana civil law partnership equated to a corporation); *Luce & Co. v. Alimentos Borinquenos, S.A.*, 276 F. Supp. 94 (D.P.R. 1967) (Puerto Rico civil law partnership given entity status for diversity jurisdiction purposes).

46. 382 U.S. 145 (1965).

47. *Id.* at 152.

branch.”<sup>48</sup>

In 1990, in *Carden v. Arkoma Associates*,<sup>49</sup> the Court once again addressed the issue of entity status for an unincorporated business organization. In *Carden*, the Court considered the status of the modern limited partnership. The limited partnership sought not to have the citizenship of its limited partners counted in the diversity analysis. The Court acknowledged that “limited partnerships are functionally similar to ‘other types of organizations that have access to federal courts,’ ” and perhaps “[c]onsiderations of basic fairness and substance over form require that limited partnerships receive similar treatment.”<sup>50</sup> Yet the Court remained steadfast with its “doctrinal wall of *Chapman v. Barney*”<sup>51</sup> and instructed that

[t]here could be no doubt, after *Boulogny*, that at least common-law entities (and likely all entities beyond the Puerto Rican *sociedad en comandita*) would be treated for purposes of the diversity statute pursuant to what *Russell* called “[t]he tradition of the common law,” which is “to treat as legal persons only incorporated groups and to assimilate all others to partnerships.”<sup>52</sup>

This “doctrinal wall” restatement leaves open the possibility that there could be statutorily created organizations that qualify for entity treatment. In rejecting expansion of entity treatment, the Court referred specifically only to “common-law entities” and suggested that the *sociedad* in all likelihood established the outermost boundary for these kinds of organizations. Yet when the opinion is read as a whole, the Court appears unwilling to extend entity treatment beyond corporations no matter what form the organization takes. The Court acknowledged that its opinion “can validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization.”<sup>53</sup> But abstention from expansion of diversity jurisdiction was deemed more important than perceived faithfulness to organizational realities. The Court’s closing remarks appear to shut the door to further consideration of the issue:

The 50 States have created, and will continue to create, a wide assortment of artificial entities possessing different powers and characteristics, and composed of various classes of members with varying degrees of interest and control. Which of them is entitled to be considered a “citizen” for diversity purposes, and which of their

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48. *Id.* at 153.

49. 494 U.S. 185 (1990).

50. *Id.* at 196 (quoting Respondent’s Brief at 33, *Carden v. Arkoma Assocs.* (No. 88-1476)).

51. *Id.* at 189 (quoting *United Steelworkers of Am. v. R.H. Boulogny, Inc.*, 382 U.S. 145, 151 (1965)).

52. *Id.* at 190 (quoting *Puerto Rico v. Russell & Co.*, 88 U.S. 476, 480 (1933)).

53. *Id.* at 196.

members' citizenship is to be consulted, are questions more readily resolved by legislative prescription than by legal reasoning, and questions whose complexity is particularly unwelcome at the threshold stage of determining whether a court has jurisdiction. We have long since decided that, having established special treatment for corporations, we will leave the rest to Congress; we adhere to that decision.<sup>54</sup>

## II. REAL PARTIES IN CONTROVERSY AND EXCLUSION OF CERTAIN MEMBERS

In *Carden*, the Supreme Court described *Chapman v. Barney* as having created a "doctrinal wall" around corporations that could "not be breached."<sup>55</sup> Some circuits have understood this to mean "that considerations of varying membership status should not bear on the fundamental inquiry whether diversity exists."<sup>56</sup> But contrary to the doctrinal purity that such statements suggest, there have been instances when courts, including the Supreme Court, have embarked on fact-specific examinations of the composition of business organizations.

The modern limited partnership, which has two categories of investor—general and limited partners—is an organizational variation whose structure suggests that it may be possible to avoid the "doctrinal wall" for entity treatment. This could be accomplished by ignoring the citizenship of certain potentially non-diverse members of the organization on the ground that they are not the "real parties in controversy." In *Colonial Realty Corp. v. Bache & Co.*,<sup>57</sup> the Second Circuit held that limited partners' citizenship was irrelevant to the determination of diversity jurisdiction. According to the court, only the general partners mattered for this purpose. The basis for this conclusion was that under New York limited partnership law a limited partner was "not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership."<sup>58</sup>

The *Colonial Realty* analysis was a departure from the entity approach that had been employed by the Supreme Court since the Court gave corporations entity status in *Louisville Railroad Co. v. Letson*.<sup>59</sup> The analysis focused on state law characteristics given to

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54. *Id.* at 197.

55. *Carden v. Arkoma Assocs.*, 494 U.S. 185, 189 (1990) (citing *United Steelworkers of Am. v. R.H. Bouligny, Inc.*, 382 U.S. 145, 151 (1965)).

56. *Carlsberg Resources Corp. v. Cambria Sav. & Loan Ass'n*, 554 F.2d 1254, 1259 (3d Cir. 1977). *See also, e.g.*, *New York State Teachers Retirement Sys. v. Kalkus*, 764 F.2d 1015, 1019 (4th Cir. 1985); *Elston Investment Ltd. v. David Altman Leasing Corp.*, 731 F.2d 436, 439 (7th Cir. 1984).

57. 358 F.2d 178 (2d Cir. 1966).

58. *Id.* at 183 (quoting N.Y. PARTNERSHIP LAW § 115 (McKinney 1988)).

59. 43 U.S. (2 How.) 497 (1844).

particular investors and asked who were the proper parties to the proceeding, and, by extension, who needed to be considered for purposes of determining whether there was complete diversity.<sup>60</sup>

The Fifth Circuit apparently saw the real party in controversy test, as employed by the Second Circuit, as a means for avoiding the analytical shortcomings of the Supreme Court's "doctrinal wall" approach to determining a business organization's citizenship. In *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*,<sup>61</sup> the Fifth Circuit suggested that courts who clung to the conception of a doctrinal wall were motivated by a "disinclination to expand diversity jurisdiction."<sup>62</sup> The Fifth Circuit found this concern "irrelevant,"<sup>63</sup> and held that because the limited partnership's general partners "alone as against the limited partners, control and manage assets, [and] conduct all business and control all litigation," only the general partners were the real parties in controversy.<sup>64</sup>

The Fifth Circuit followed its *Mesa Operating* ruling in *Arkoma Associates v. Carden* in 1988, again holding that limited partners' citizenship was not relevant to the diversity analysis.<sup>65</sup> On appeal, four Supreme Court justices defended the logic of the real party in controversy test and expressed approval of the Fifth Circuit's approach—that is, that the entity's status as a citizen was not the proper focus.<sup>66</sup> The majority, however, rejected this leap over the entity analysis as a "fallacy" and insisted that the Court first "must decide . . . the quite different question of how the citizenship of that single artificial entity is to be determined . . ."<sup>67</sup> The Court reiterated that limited partnerships would not be accorded entity status,<sup>68</sup> and then considered whether the limited partners' citizenship could be disregarded, leaving only the general partners to sat-

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60. *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d at 183-84.

61. 797 F.2d 238 (5th Cir. 1986).

62. *Id.* at 241.

63. *Id.*

64. *Id.* at 242-43. The court distinguished *Great S. Fire Proof Hotel Co. v. Jones*, 177 U.S. 449 (1900), in which the Supreme Court had refused to grant citizenship status to a limited partnership association, by pointing to the fact that the limited partnership association in that case had only one class of partners, while the modern limited partnership has two. *Mesa Operating Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d at 241. If the court applied the entity-comparison approach, this distinction would argue against entity treatment for modern limited partnerships because the limited partnership association, with a single investor class, is more closely analogous to a corporation than is the two-class modern limited partnership. The real party in controversy approach avoids this issue.

65. 874 F.2d 226, 228-29 (5th Cir. 1988), *rev'd sub nom. Carden v. Arkoma Assocs.*, 494 U.S. 185 (1990).

66. *Carden v. Arkoma Assocs.*, 494 U.S. at 198-209 (O'Connor, J., dissenting, joined by Brennan, J.; Marshall, J.; and Blackmun, J.).

67. *Id.* at 188 n.1.

68. *Id.* at 189 (citing *Great S. Fire Proof Hotel Co. v. Jones*, 177 U.S. 449, 456-57 (1900)).

isfy the complete diversity requirement.<sup>69</sup> The Court rejected any test that would evaluate a limited partner's role in the organization to determine whether that role is significant enough to warrant citizenship attributes: "We have never held that an artificial entity, suing or being sued in its own name, can invoke the diversity jurisdiction of the federal courts based on the citizenship of some but not all of its members."<sup>70</sup> The Court thus refused to assess the significance of the limited partner's role in the enterprise on the ground that it had never before engaged in this kind of analysis.<sup>71</sup>

While the *Carden* majority was certainly correct when it noted that the Court has never held that *an entity* can invoke diversity jurisdiction based on some of its members' citizenship, the Court had held, in *Navarro Savings Ass'n v. Lee*,<sup>72</sup> that some of a business organization's *participants* can invoke diversity jurisdiction on behalf of the organization's investors. In *Navarro*, the Court held that the trustees of a Massachusetts business trust were the real parties in a controversy over an alleged breach by a lender to make a take-out loan to a firm that had borrowed from the trust.<sup>73</sup> Some of the trust's beneficiaries were citizens of the same state as the lender.<sup>74</sup> The Court acknowledged that the business trust resembled business organizations in which each member is taken into account in the diversity analysis.<sup>75</sup> The Court said, however, that the trust was "neither an association nor a corporation," but rather was "an express trust."<sup>76</sup> The Court held that "[f]or more than 150 years, the law has permitted trustees who meet this standard to sue in their own right, without regard to the citizenship of the trust beneficiaries. We find no reason to forsake that principle today."<sup>77</sup>

*Navarro* contains language suggesting that the Supreme Court did not want the real party in controversy test to be applied to any business organization other than one formed according to trust principles. The Supreme Court was careful to say that it

never has analogized express trusts to business entities for purposes of diversity jurisdiction. Even when the Court espoused the view that a corporation lacked citizenship, Mr. Chief Justice Marshall explained that the doctrine had no bearing on the status of trustees. "When [persons suing by a corporate name] are said to be substantially the parties to the controversy, the court does not mean to liken it to the case of a trustee. A trustee is a real person

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69. *Id.* at 192.

70. *Id.*

71. *Id.*

72. 446 U.S. 458 (1980).

73. *Id.* at 459-60.

74. *Id.* at 460.

75. *Id.* at 461.

76. *Id.* at 462.

77. *Id.* at 465-66.

capable of being a citizen . . . , who has the whole legal estate in himself. At law, he is the real proprietor, and he represents himself, and sues in his own right."<sup>78</sup>

Thus, the Court's refusal to treat business trusts as business entities can be attributed more to adherence to trust law principles than to the realities of business organizations. Justice Blackmun, who dissented in *Navarro*, said he was

troubled by the Court's intimation that business trusts are to be treated differently from other functionally analogous business associations—partnerships, limited partnerships, joint stock companies, and the like. I fear that, at bottom, the Court's distinction between business trusts and these other enterprises hinges on the locus of title to the trust assets, a formalistic criterion having little to do with a realistic assessment of the respective degrees of control over the trust's activities that may be exercised by shareholders and trustees.<sup>79</sup>

The *Navarro* majority's disclaimer of having conducted any functional analysis, and the dissent's contention that the beneficiaries in that case acted like partners, illustrate a serious deficiency of the real party in controversy test: the manner in which it complicates the jurisdictional issue.

This complication defeats the historical purpose of the real party in controversy test, which is to simplify and prevent jurisdictional disputes. At common law, holders of equitable or beneficial interests could not sue; the holder of the legal interest was the "real party in interest."<sup>80</sup> Accordingly, someone who stood to benefit from the outcome of litigation, but who did not have a legally protected right at risk, was not a "real party."<sup>81</sup> The Federal Rules of Civil Procedure

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78. *Id.* at 463 n.10 (quoting *Bank of United States v. Deveaux*, 9 U.S. (5 Cranch) 61, 91 (1809)) (alteration in original) (citation omitted).

79. *Id.* at 475-76 (Blackmun, J., dissenting) (citation omitted). Justice Blackmun examined the business trust's organization and concluded that the beneficial shareholders' citizenship should be counted because of the amount of control the shareholders had over the trustees' actions. *Id.* at 476. This conclusion, if correct, and if applied by analogy to the limited partnership, could result in a determination that limited partners' citizenship should be taken into account for diversity purposes under the real party in controversy analysis. Compare Justice Blackmun's analysis, *id.*, with *Carden v. Arkoma Assocs.*, 494 U.S. at 204-06 (1990) (O'Connor, J., dissenting) (arguing that the citizenship of limited partners should not be counted because they are so similar to the beneficiaries of a business trust).

80. See 3A JAMES W. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* ¶ 17.08 (2d ed. 1991) (discussing the common law and equity background of the real party in interest rule).

81. *E.g.*, *New Orleans Pub. Serv., Inc. v. United Gas Pipe Line Co.*, 732 F.2d 452, 466 (5th Cir. 1984) (city with only an economic interest in natural gas supply dispute is not a real party in interest), *cert. denied*, 469 U.S. 1019 (1984); *Kidwell v. Meikle*, 597 F.2d 1273, 1287 (9th Cir. 1979) (parties who neither bought nor sold securities could not bring securities violation suit).

address this issue in Rule 17(a), which states that "[e]very action shall be prosecuted in the name of the real party in interest."<sup>82</sup> According to the advisory committee, the function of this Rule "is simply to protect the defendant against a subsequent action by the party actually entitled to recover, and to ensure generally that the judgment will have its proper effect as *res judicata*."<sup>83</sup>

The real party in controversy diversity requirement closely parallels Rule 17(a),<sup>84</sup> although the two are not identical.<sup>85</sup> Thus, for example, executors and administrators,<sup>86</sup> guardians,<sup>87</sup> and bailees<sup>88</sup> have been held to be the real parties in controversy for diversity purposes. The Rule 17(a) real party in interest analysis is necessarily independent of the diversity analysis, however, because the Federal Rules cannot affect the court's jurisdiction or venue.<sup>89</sup>

The real party in controversy test does not simplify the jurisdictional analysis as it is supposed to. Instead, the test greatly complicates diversity questions. Determinations about who has the "real and substantial" interest are necessarily specific to the particular entity involved.<sup>90</sup> When the entity is statutory and governed by uniform rules that have been adopted nationally, as with a business trust, a single assessment of which classes of members are real parties in controversy might be generally applicable to other similarly structured organizations. But any material variations among the states within the same general structure, and any structures not previously considered, especially in non-statutory organizations, will

A federal statute directly addresses attempts to become—or to avoid becoming—a real party in interest by assignment of rights: "A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court." 28 U.S.C. § 1359 (1988).

82. FED. R. CIV. P. 17(a).

83. FED. R. CIV. P. 17(a) advisory committee's note to 1966 amendment.

84. See *Navarro Savings Ass'n v. Lee*, 446 U.S. 458, 462 n.9 (1980).

85. The Supreme Court has observed that "[i]n appropriate circumstances, for example, a labor union may file suit in its own name as a real party in interest under Rule 17(a). To establish diversity, however, the union must rely upon the citizenship of each of its members." *Id.*

86. *New Orleans v. Gaines's Adm'r*, 138 U.S. 595, 606-07 (1891).

87. *Mexican Cent. Ry. v. Eckman*, 187 U.S. 429, 434 (1903).

88. *Bradley v. St. Louis Terminal Warehouse Co.*, 189 F.2d 818, 823 (8th Cir. 1951).

89. FED. R. CIV. P. 82. See 6A CHARLES A. WRIGHT, ET AL., *FEDERAL PRACTICE AND PROCEDURE* § 1564 (1990).

90. See, e.g., *Wilsey v. Eddingfield*, 475 U.S. 1130 (1985), *denying cert. to* 780 F.2d 614 (7th Cir. 1986), in which three members of the Supreme Court wanted the opportunity to review the Seventh Circuit's holding that the statutory beneficiaries in a wrongful death action were real parties in controversy. The Justices thought this might conflict with *Navarro*, and observed that the Seventh Circuit's approach "could make for a difficult and time-consuming determination in ascertaining diversity for jurisdictional purposes." *Id.*

have to be decided on a case-by-case basis.

The case-specific nature of the real party in controversy approach is the foundation of its apparent usefulness as a mechanism for taking into account certain commercial realities of business organizational structure, rather than relying solely on entity characterization.<sup>91</sup> The real party in controversy rule looks to the state statute pursuant to which the organization was created, or the state contract law under which the organization was formed, to determine how the organization's members should be treated for jurisdictional purposes.<sup>92</sup>

But any approach that purports to decide who, among the members of an investment group, are the "real parties" to the controversy will not necessarily reflect commercial reality. Roles assigned to categories of investment interests, such as trust beneficiaries or limited partners, need not represent who actually stands to win or lose by the controversy's resolution. This point is well illustrated by the anomalous treatment given to business trusts by the Court's real party analysis in *Navarro*. Prior to the Supreme Court's decision in *Navarro*, some federal courts had decided that business trusts were to be treated as unincorporated associations and thus, under *United Steelworkers of America v. R.H. Bouligny, Inc.*,<sup>93</sup> each of the beneficiary investors had his own citizenship for diversity purposes.<sup>94</sup> These courts observed that business trusts do not in fact resemble ordinary trusts,<sup>95</sup> and that there is an analytical consistency to looking beyond the trust form for diversity purposes when it is ignored for tax purposes.<sup>96</sup> In addition, there are state law jurisdictional

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91. Several commentators have made a case for the real party in controversy test. See Rachel F. Best, Note, *Who Are the Real Parties in Interest for Purposes of Determining Diversity Jurisdiction for Limited Partnerships?*, 61 WASH. U. L.Q. 1051, 1066-67 (1984); Jim Breckenridge, Note, *Diversity Jurisdiction over Unincorporated Business Entities: The Real Party in Interest as a Jurisdictional Rule*, 56 TEX. L. REV. 243, 249-50 (1978) [hereinafter *Jurisdiction over Unincorporated Entities*]; Robert J. Kopecky, Comment, *Limited Partnerships and Federal Diversity Jurisdiction*, 45 U. CHI. L. REV. 384, 418 (1978).

92. See *Jurisdiction over Unincorporated Business Entities*, *supra* note 91, at 247-50 (arguing that the real party in controversy rule should govern because "diversity jurisdiction intimately involves state law with federal law" and thus state law should be the focus).

93. 382 U.S. 145 (1965). See *supra* text accompanying notes 46-48.

94. *E.g.*, *Belle View Apartments v. Realty Refund Trust*, 602 F.2d 668, 669 (4th Cir. 1979); *Riverside Memorial Mausoleum, Inc. v. UMET Trust*, 581 F.2d 62, 65 (3d Cir. 1978); see also *Navarro Sav. Ass'n v. Lee*, 446 U.S. at 466 n.1 (Blackmun, J., dissenting) (citing cases).

95. *Carey v. U.S. Industries, Inc.*, 414 F. Supp. 794, 795 (N.D. Ill. 1976); *Jim Walters Investors v. Empire-Madison, Inc.*, 401 F. Supp. 425, 428 (N.D. Ga. 1975).

96. *Larwin Mortgage Investors v. Riverdrive Mall, Inc.*, 392 F. Supp. 97, 100 (S.D. Tex. 1975) (discussing *Morrissey v. Commissioner*, 296 U.S. 344 (1935)). But see *Navarro Sav. Ass'n v. Lee*, 446 U.S. at 465 n.15 (dismissing the *Morrissey* tax ruling as "simply irrelevant").



rules that do not distinguish business trusts from unincorporated associations.<sup>97</sup>

The *Navarro* majority chose not to acknowledge these realities. They may have been unwilling to relinquish a simple rule—that trustees are the real parties—for the organization analysis approach urged upon the Court, which the Court said entailed “serious difficulties” because it required a case-by-case examination of the investors’ roles in the business decisions.<sup>98</sup> The Court’s reliance on trust principles, however, overlooks the commercial reality that business trusts are fundamentally different from traditional trusts. Business trusts “have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking.”<sup>99</sup> A business trust contains only one class of investors, the beneficiaries, for whose benefit the trustees manage the assets.<sup>100</sup> Indeed, the trustees’ fiduciary obligations prohibit them from profiting at the beneficiaries’ expense.<sup>101</sup> Although the beneficiaries have been determined not to be the proper parties to bring suit because they do not hold legal title to the property and their participation in trust affairs is greatly limited, it is their interests, and their interests alone, that are served by the organization. Consequently, the real party in controversy rule as applied in *Navarro* gives unwarranted preferential diversity treatment to business trusts.<sup>102</sup>

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97. *E.g.*, *Shaw v. Cousins Mortgage & Equity Invs.*, 236 S.E.2d 919, 922 (Ga. App. 1977); *Loomis Land & Cattle Co. v. Diversified Mortgage Investors*, 533 S.W.2d 420, 426 (Tex. Civ. App. 1976); *Grenco Real Estate Inv. Trust v. Brooker*, 211 S.E.2d 33, 34 (Va. 1975).

98. *See Navarro Sav. Ass’n v. Lee*, 446 U.S. at 464 n.13 (“The relative simplicity of this established principle . . . is one of its virtues. . . . The analysis proposed by the dissent . . . could present serious difficulties for district courts called upon to determine questions of diversity jurisdiction.”) (citations omitted).

99. *Morrissey v. Commissioner*, 296 U.S. 344, 360 (1935).

Traditional trusts, on the other hand, exist to conserve the property for the beneficiaries in accordance with the settlor’s estate planning purposes; investment gains are incidental to the traditional trust’s purpose. 3 ZOLMAN CAVITCH, *BUSINESS ORGANIZATIONS* § 43.03 (1991).

100. 3 CAVITCH, *supra* note 99, § 43.16[2].

101. *See, e.g.*, *Terrydale Liquidating Trust v. Barnes*, 642 F. Supp. 917, 919 (S.D.N.Y. 1986) (applying Missouri law); *Flynn v. La Salle Nat’l Bank*, 137 N.E.2d 71, 77 (Ill. 1956) (discussing the trustee’s duty to maximize the beneficiaries’ profit).

102. According to the real party in controversy test urged upon the Court in *Carden*, only the general partner in a limited partnership would be said to be the real party. But the general partner in a limited partnership may be nothing more than a corporation formed solely for shielding the limited partner from liability. An attractive way to structure a limited partnership is for a limited partner investor to form a corporation and hold all of the corporation’s stock. The corporation is then used as the sole general partner. Provided proper capitalization and other formalities are maintained, this structure gives the limited partner investor the same limited liability as if a corporation had been formed, without adverse corporate tax consequences. *See H. HAYNSWORTH, SELECTING THE FORM OF A SMALL BUSINESS ENTITY* § 3.06, at 102-03

A rule that requires the court to examine in each case who is really behind the lawsuit is overly burdensome and analytically unnecessary if a clear distinction can be made based on the choice of organizational form. Rather than pretend to make meaningful distinctions about who, among the limitless varieties of investors in particular business organizations, really constitute the "citizens" in the controversy, a more workable approach is to focus on what investors should expect from their choice of business entity. The following discussion demonstrates that such a distinction can be made and that it is consistent with the purposes of diversity jurisdiction and with investor expectations.

### III. BUSINESS ORGANIZATIONS AND THE PURPOSES OF DIVERSITY JURISDICTION

The preceding discussion suggests that the courts' various approaches to defining the diversity jurisdiction requirements for business organizations are confusing and analytically flawed. A unified approach that takes into account business organizational realities and the purposes of diversity jurisdiction is needed.

#### A. *The Purposes of Diversity Jurisdiction*

When Chief Justice Marshall wrote the opinion in *Bank of the United States v. Deveaux*,<sup>103</sup> in which the Supreme Court held that a corporation "is certainly not a citizen"<sup>104</sup> for jurisdictional purposes, he observed that:

However true the fact may be, that the tribunals of the states will administer justice as impartially as those of the nation, to parties of every description, it is not less true that the constitution itself either entertains apprehensions on this subject, or views with such indulgence the possible fears and apprehensions of suitors, that it has established national tribunals for the decision of controversies between aliens and a citizen, or between citizens of different states.<sup>105</sup>

This fear of state court discrimination against non-citizens is the "traditional, and most often cited, explanation of the purpose of diversity jurisdiction . . . ."<sup>106</sup> Some commentators believe that while

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(1985). In this scenario, the corporate general partner is not truly a "real" party behind the enterprise.

103. 9 U.S. (5 Cranch) 61 (1809).

104. *Id.* at 86.

105. *Id.* at 87.

106. 13B CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3601 (1984). Justice Frankfurter, a leading critic of diversity jurisdiction, found "the desire of the Framers to assure out-of-state litigants courts free from susceptibility to potential local bias" to be the overriding reason for diversity jurisdiction. *Lumbermen's Mut. Casualty Co. v. Elbert*, 348 U.S. 48, 54-55 (1954) (Frankfurter, J., concurring).

fears of local bias in general played a part in the creation of diversity jurisdiction, the more precise reason for diversity jurisdiction was to facilitate interstate commerce.<sup>107</sup> Apparently, the Constitution's framers had reason to be concerned about protectionist debtor relief legislation,<sup>108</sup> and diversity jurisdiction has been credited with "fostering . . . investment in the emergent nation."<sup>109</sup> Some have doubted that justice is really served by providing out-of-state litigants with a federal forum option that in-state litigants do not have.<sup>110</sup> Yet diversity jurisdiction's continued existence clearly must

107. See James W. Moore & Donald T. Weckstein, *Diversity Jurisdiction: Past, Present, and Future*, 43 TEX. L. REV. 1, 16 (1964).

108. See POSNER, *supra* note 1, at 141-42; Henry J. Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483, 496-97 (1928).

109. Moore & Weckstein, *supra* note 107, at 17.

Many other arguments have been made to justify diversity jurisdiction, among them a contention that the federal courts offer "a better quality of justice than state courts." 1 MOORE'S FEDERAL PRACTICE, *supra* note 13, ¶ 0.71[3.-2], at 716. One noteworthy response to this contention is that if the federal courts do provide a superior quality of justice, then the goal should be to use them as a model to improve the state courts, not to expand federal jurisdiction. Kramer, *supra* note 1, at 118. Concerns such as these need to be taken into account in deciding whether there is a continued need for diversity jurisdiction in general. If, as a policy matter, one assumes that the federal courts need to be made available to as wide a group as possible, then concerns such as these argue for the most unrestrictive diversity rules. In the business organization context, this goal would be facilitated by giving citizenship status to unincorporated associations, thereby permitting courts to exclude investor citizenship from the diversity analysis.

Of course, this approach would expand the federal court caseload and require the courts to deal with difficult threshold jurisdictional questions every time a group claims to have qualifying association status. In view of the strong opposition in the courts and among commentators against imposing such burdens on an already over-taxed system, this Article assumes that the preferred result is a rule that is as narrow as possible but nevertheless is consistent with investor expectations.

110. Justice Frankfurter concluded that diversity jurisdiction actually discriminated "against citizens of the [forum] State in favor of litigants from without the [forum] State." *Lumbermen's Mut. Casualty Co. v. Elbert*, 348 U.S. 48, 55 (1954) (Frankfurter, J., concurring). His view was that "[i]nstead of protecting out-of-state litigants against discrimination by state courts," diversity jurisdiction enables litigants to avoid state court when the named opponent, by "fortuitous circumstance," is deemed to have out-of-state citizenship by operation of the diversity rules. *Id.* at 55-57.

Justice Frankfurter's criticisms were made before the 1958 modification of the federal statute by which a corporation is deemed to have citizenship in the state in which "it has its principal place of business" as well as in its state of incorporation. Act of July 25, 1958, Pub. L. No. 85-554, § 2, 72 Stat. 415, 415 (codified as amended at 28 U.S.C. § 1332(c) (1988)). This amendment softens, but does not entirely eliminate, the force of his comment that:

There is, to be sure, a kind of irony for corporate defendants to discover that two can play at the game of working, to use a colloquial term, the perverse potentialities of diversity jurisdiction. But it is not the less unreasonable and no greater fairness for a citizen of the forum to gain a discriminatory advantage over fellow citizens of his State, than it is for an out-of-state

turn on a perceived need for a neutral forum to mitigate state court unfairness.

If protection from local bias and commercial favoritism are the main reasons why federal courts are made available on the basis of diversity of citizenship, then distinctions among various business organizations should be based on meaningful differences in investors' expectations about entitlement to such protection. Yet the courts seem to have concluded that business organizations have become too complex and conceptually interrelated to permit any meaningful and sustainable distinctions. They have struggled with shaky doctrinal walls and determinations of real parties in making their distinctions, often citing burdens on the federal courts, rather than analytical conviction, as their rationale.<sup>111</sup> The Supreme Court itself was compelled to acknowledge that its resolutions "can validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization."<sup>112</sup>

An examination of why investors choose a particular business organization, however, shows that the special treatment accorded by the courts to corporate shareholders is, in fact, consistent with modern investor expectations. Incorporation is a different undertaking than the formation of any other business organization. Investors who do not incorporate are choosing, for one reason or another, an organizational form that does not analytically distinguish the investors from their enterprise, which is a distinction with important practical consequences. Investors expect that the choice to incorporate or not to incorporate will fundamentally affect the extent to

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citizen to secure more than the same treatment given local citizens, by going to a federal court for the adjudication of state-created rights.

*Lumbermen's Mut. Casualty Co. v. Elbert*, 348 U.S. at 57 (Frankfurter, J., concurring). Frankfurter was not persuaded that the option of a federal forum for corporate plaintiffs was sufficient reason to warrant continuance of diversity jurisdiction:

[N]o great public interest or libertarian principle is at stake in the desire of a corporation which happens to have been chartered in the District of Columbia, to pursue its claim against a citizen of Maryland in the federal court in Maryland on the theory that the right of this artificial citizen of the District of Columbia cannot be vindicated in the State courts of Maryland.

*National Mut. Ins. Co. v. Tidewater Transfer Co.*, 337 U.S. 582, 651 (1949) (Frankfurter, J., dissenting). Justice Frankfurter's views have been bolstered by recent commentary that questions whether local bias is real or merely perceived, and that observes that "many other types of bias are far more prevalent today and far more likely to influence litigation than bias against citizens of other states." Kramer, *supra* note 1, at 120. The availability of insurance is one such bias. *Id.* Also, federal court juries are drawn from the same populace from which state court juries are drawn, and there is reason to doubt that federal judges will necessarily be more neutral than state judges. *Id.*

111. See, e.g., cases cited *supra* note 4.

112. *Carden v. Arkoma Assocs.*, 494 U.S. 185, 196 (1990).

which they will be treated as individuals with an existence apart from their enterprise. This choice provides a sound basis for determining when the investor should be excused from the complete diversity requirements, and when the protections of the federal forum should be made available based solely on the imputed citizenship of the collective entity.

*B. Business Organizations, Investor Expectations, and the Purposes of Diversity Jurisdiction*

The Supreme Court observed in *Carden* that there is "a wide assortment of artificial entities possessing different powers and characteristics . . . composed of various classes of members with varying degrees of interest and control."<sup>113</sup> Investors trying to select a form of business entity find that the various forms share many important characteristics to one degree or another. The corporation, however, can be analytically separated from other business forms by its unique, separate existence from its investors.

1. "Corporateness"

The essence of "corporateness" is an entity's existence apart from its investors. The notion that a separate jural personality can emerge from a group of natural persons doing business dates back to several centuries before Christ.<sup>114</sup> Although incorporation suffered from some initial distrust in the United States,<sup>115</sup> by the beginning of the nineteenth century it was a widely accepted legal form for doing business. Chief Justice Marshall described the essence of "corporateness" in the famous *Trustees of Dartmouth College*<sup>116</sup> case as follows:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities, that

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113. *Id.* at 197.

114. See 1 WILLIAM BLACKSTONE, COMMENTARIES 468 (T. Cooley 3d ed. 1884).

115. See 1 FLETCHER, *supra* note 14, § 2.

116. *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

corporations were invented, and are in use.<sup>117</sup>

The historical uniqueness of the corporate form has modern ramifications.<sup>118</sup> Incorporation enables investors to be shielded from personal liability; provided that the corporate form is duly formed and legitimately maintained, shareholders are not liable for corporate debts beyond the extent of their investment in the enterprise.<sup>119</sup> Jural status also follows from the separate entity concept and is an integral element of the corporate form.<sup>120</sup>

From an investor's perspective, probably the most important ramification of separate entity status is treatment of the corporation as a separate taxpayer.<sup>121</sup> The law governing corporate taxation differs in many ways from the rules governing individual taxpayers, including the tax rates imposed.<sup>122</sup> The most significant difference is a double tax on profits. One tax is imposed on the entity for its earnings, and then the corporation's shareholders are taxed at individual rates on the same earnings to the extent the shareholders receive them as distributions.<sup>123</sup> The entity-level corporate tax is in a sense the quid pro quo for the advantages of entity status. In *Flint v. Stone Tracy Co.*,<sup>124</sup> the imposition of the corporate tax was held to be constitutional because it was "laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals."<sup>125</sup> Thus, the special advantages of "corporateness" make the double tax permissible.

The entity-level tax has been described as "the weightiest criti-

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117. *Id.* at 636.

118. The first uniform legislation for corporations was proposed by the Commissioners on Uniform State Laws in 1928. 1 FLETCHER, *supra* note 14, § 2.10. The Commissioners' Uniform Business Corporation Act was adopted by only a few states; in 1943 it was renamed as a "Model Act," and in 1969 it was extensively revised. *Id.*; *see id.* § 2.20. In 1984, the Revised Model Business Corporation Act was adopted by the American Bar Association's Committee on Corporate Laws, of the Section of Corporations, Banking and Business Law. *Id.* § 2.20. Fifteen states have adopted the Revised Act wholesale; most other states have substantially adopted it or have incorporated many of its provisions into versions of the former Model Act. *Id.*; 1 Model Business Corp. Act Ann. xxxiv—xxxiv.viii (Prentice Hall Supp. 1991).

119. Revised Model Business Corp. Act § 6.22 (1984).

120. *Id.* § 3.02(1) (1984).

121. *See* 1 CAVITCH, *supra* note 99, § 3.01 (stating that tax factors are often the prevailing factor in the choice of entity).

122. Currently, the corporate tax rate is higher than the individual rate for taxable income greater than \$143,525. Tax Rate Differences, [1991 Index] Stand. Fed. Tax Rep. (CCH) (U.S. Tax Cas.) ¶ 227.02 (1991). While this suggests that the corporate form may be desirable for small-scale enterprises, the tax laws make this determination far more complex than a simple application of tax rates.

123. *See generally* HOWARD E. ABRAMS & RICHARD L. DOERNBERG, FEDERAL CORPORATE TAXATION ¶ 1.01 (1987).

124. 220 U.S. 107 (1911).

125. *Id.* at 162.

cism of the corporate form of business organization . . . ."<sup>126</sup> The impact of double taxation can be outweighed by other considerations, especially for large enterprises that can take advantage of deductions for salaries, fringe benefits, and other expenses that offset earnings.<sup>127</sup>

Corporations clearly stand alone at one end of the business organization spectrum.<sup>128</sup> Indeed, the goal of investors who choose other organizational forms is often to enjoy as closely as possible the unique advantages of the corporate form, especially limited liability, while avoiding as much as possible its adverse consequences, especially entity-level taxation. While investors in other business organizations try to approximate "corporateness," they are nonetheless choosing an entity that differs from a corporation in important theoretical and practical ways.

## 2. *Unincorporated Organizations*

The partnership form of business organization has never been reified to the extent of the corporation.<sup>129</sup> In partnership analysis,

126. 1 CAVITCH, *supra* note 99, § 3.04[1].

127. See HAYNSWORTH, *supra* note 102, § 4.06.

One notable exception to the entity approach to corporate taxation is "Subchapter S" status. Small scale enterprises can enjoy the benefits of incorporation without the disadvantages of double taxation and other unfavorable features of otherwise applicable corporate tax rules if they qualify for this status. There are several eligibility requirements, including a limit to thirty-five shareholders and only one class of stock. I.R.C. § 1361(b)(1)(A), (D) (West Supp. 1991). These and other restrictions functionally limit Subchapter S status to relatively "small" businesses. See *id.* § 1362(a)(1); see generally RICHARD D. BLAU ET AL., S CORPORATIONS: FEDERAL TAXATION §§ 1.01, 7.02-.04 (1990) (discussing the attractiveness of Subchapter S status for small-scale enterprises). This special tax incentive given to small businesses does not fundamentally undercut the overall different approach corporations receive because of their separate entity status.

128. Corporations have become the entity of choice for large-scale, interstate enterprises. According to government statistics, 87% of enterprises with income of \$1 million or more are corporations. BUREAU OF THE CENSUS, U.S. DEPARTMENT OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 521 (1990) (In 1986, 562,000 corporations, 44,000 partnerships, and 38,000 sole proprietorships had income of \$1 million or more.). On the whole, corporate income accounts for almost 10 times as much as all other forms of organization combined, *id.* (\$8,282 billion for corporations; \$938 billion for all others), even though other business forms outnumber corporations by four-to-one, *id.* (14,097,000 partnerships and sole proprietorships, 3,429,000 corporations). Most of the shareholders in these large-scale enterprises would tend to be passive investors, who do not expect to play any role in the characterization of a corporation's jurisdictional status.

129. "Reification" is the theoretical process by which an abstraction becomes material. As one commentator aptly summarized:

We first perceive *the associates*, human beings, engaged in a common enterprise with a common purpose. Thereupon, in our consideration of them we reify them as a group, and we get "it," the "association as such." By this instinctive process the association becomes an entity, a thing separate and

there has been a tension between the "entity theory," such as that employed with corporations, and the "aggregate theory," by which all partnership investors are treated as individual entities. When the uniform partnership law was taking shape, the choices were described as follows:

Under the entity theory the partnership is a legal person distinct from the members of the firm. Many of the principles of the law of corporations become applicable and, indeed, the law of partnership would logically become a branch of the law of corporations if this theory were adopted and consistently followed.

Under the aggregate theory, on the other hand, the partners are joint owners of the partnership property, and joint obligors and obligees of claims due from or to the partnership, though some modifications of the ordinary rules of joint ownership may be necessary because of the particular character of partnership business.<sup>130</sup>

Some argued that the entity theory should be adopted for partnerships, but opponents prevailed and generally the partnership retained its "pluralistic" form.<sup>131</sup> The partnership does have some entity-like features, however. For instance, the partnership can own property,<sup>132</sup> and partnership property is applied to satisfy partnership indebtedness before the individual partners' assets can be reached.<sup>133</sup> But each partner is jointly and severally liable for partnership obligations,<sup>134</sup> and the uniform partnership laws do not give the partnership entity status for purposes of suing and being sued.<sup>135</sup>

The partnership also receives both entity and aggregate treatment in the manner in which it is taxed. Partnership taxation is a notoriously complex subject, and the mixing of entity and aggregate con-

distinct from the associates.

Wesley A. Sturges, *Unincorporated Associates as Parties to Actions*, 33 YALE L.J. 383, 397 (1924).

130. Samuel Williston, *The Uniform Partnership Act, With Some Remarks on Other Uniform Commercial Laws*, 63 U. PA. L. REV. 196, 207 (1915).

131. In *Helvering v. Smith*, 90 F.2d 590 (2d Cir. 1937), Learned Hand described how Dean Ames led the struggle in attempting to give the partnership form jural existence, and how the struggle died with him. See also *United States v. A & P Trucking Co.*, 358 U.S. 121, 127-28 (1958) (Douglas, J., dissenting in part) ("In this country the entity theory has not in general been extended to the partnership."). For a general discussion of the Uniform Partnership Act and the entity theory, see, e.g., A. Ladru Jensen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377 (1963); Judson A. Crane, *The Uniform Partnership Act and Legal Persons*, 29 HARV. L. REV. 838 (1916).

132. UNIF. PARTNERSHIP ACT § 8, 6 U.L.A. 115 (1969).

133. *Id.* § 38, 6 U.L.A. at 456-57.

134. *Id.* § 15, 6 U.L.A. at 174.

135. State law does sometimes give partnerships jural status. This is for procedural convenience, however, and is not an integral element of the partnership form. See *infra* notes 206-10 and accompanying text.



cepts is blamed for the resultant confusion.<sup>136</sup> The entity concept prevails in the way certain transactions between partners and partnerships are treated as if they were between an entity and its investors.<sup>137</sup> The partnership possesses the additional entity characteristics of having its own tax year<sup>138</sup> and having its partnership taxable income computed separately.<sup>139</sup> But in the essential feature of who pays the tax, the partnership is not treated as an entity. The partnership is treated as a flow-through conduit, and the individual partners—not the partnership—are taxed.<sup>140</sup> Investors in a partnership, therefore, select a form of doing business that treats them in a fundamentally different way than corporations. They have a much more direct relationship to the income and losses that may result from their efforts.

The modern limited partnership<sup>141</sup> is a variation of the partnership form with some corporation-like features. Its existence depends on the filing of a certificate with the state,<sup>142</sup> and limited partner investors can bring a derivative action in the right of the limited partnership.<sup>143</sup> Similarities such as these have caused some to characterize the limited partnership as a “pseudo-corporation” that deserves “status for diversity purposes that is comparable to a corporation’s status.”<sup>144</sup>

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136. See generally 1 WILLIAM S. MCKEE ET AL., *FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS* ¶ 1.02 [3] (2d ed. 1990) (discussing the confusion that results from the blending of aggregate and entity concepts).

137. I.R.C. § 707 (1988).

138. *Id.* § 706(b)(1).

139. *Id.* § 703.

140. *Id.* § 701.

141. Although limited partnerships in various forms can be found at common law, they were first legislatively sanctioned in 1822 in New York. Act of Apr. 17, 1822, ch. CCXLIV, 1822 N.Y. Laws 259, repealed by Act of Dec. 10, 1828, ch. 21, 1828 N.Y. Laws 54. For a discussion of the limited partnership’s history, see, e.g., Lucille T. Freedberg, *The Shield of the Limited Partnership*, 28 N.Y.L. SCH. L. REV. 561, 564-65 (1983); Richard A. Mann & Barry S. Roberts, *Unincorporated Business Associations: An Overview of Their Advantages and Disadvantages*, 1978 TULSA L. J. 1, 28; Comment, *Standing of Limited Partners to Sue Derivatively*, 65 COLUM. L. REV. 1463, 1463-64 (1965). Limited partnerships offered an attractive limited liability alternative as opposed to corporations, especially during an era when much more was required to obtain a corporate charter than is necessary today. See Mann & Roberts, *supra*, at 28. A Uniform Limited Partnership Act was approved in 1916, UNIF. LIMITED PARTNERSHIP ACT, 6 U.L.A. 561 (1969), and was eventually adopted in all states except Louisiana. Freedberg, *supra*, at 565. A Revised Uniform Limited Partnership Act, REVISED UNIF. LIMITED PARTNERSHIP ACT, 6 U.L.A. 270 (Supp. 1991), was approved in 1976 and this revised act was amended in 1985. This structure has been adopted by all states except Alaska, Louisiana, Maine, and Vermont. 6 U.L.A. 190, 239-40 (Supp. 1991). Alaska, Maine, and Vermont retained the 1916 Act. *Id.* at 190.

142. REVISED UNIF. LIMITED PARTNERSHIP ACT § 201, 6 U.L.A. 292 (Supp. 1991).

143. *Id.* § 1001, 6 U.L.A. at 401.

144. G. David Porter, Note, “Incorporating” Limited Partnerships into Federal Diversity Jurisdiction: Correcting *Carden v. Arkoma Assocs.*, 65 NOTRE DAME L. REV.

Yet there are important distinctions between a limited partnership and a corporation. Unlike the uniform corporation laws, the Uniform Limited Partnership Act does not give the partnership the right to sue or be sued in its own name.<sup>145</sup> Limited partnerships also fall into the same category as general partnerships in the way they are taxed. Although both aggregate and entity concepts are employed, the limited partnership is a flow-through entity and, conceptually, the individual investors have a direct relationship to enterprise income and losses.<sup>146</sup>

The limited partnership's similarities to the corporate form have resulted in special rules for determining when the partnership loses this flow-through treatment. These regulations, which provide that a limited partnership that looks too much like a corporation will be taxed as such,<sup>147</sup> identify four distinguishing characteristics to be avoided by a limited partnership if it is not to be recharacterized and taxed at the entity level.<sup>148</sup> First, partnerships cannot have "continuity of life" in the same sense as corporations.<sup>149</sup> Second, a partnership is corporate in nature if the interests of its investors in the organization are freely transferable.<sup>150</sup> Third, a partnership must not insulate all of its members from personal liability for the organization's debts.<sup>151</sup> Finally, a partnership looks too much like a corporation if its management is so centralized that a single partner or group of partners has continuing exclusive authority over the part-

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287, 304 (1990). See also Justice O'Connor's comparison of business organizations in *Carden v. Arkoma Assocs.*, 494 U.S. 185, 202-03 (1990) (O'Connor, J., dissenting).

145. The Revised Uniform Limited Partnership Act requires the limited partnership to maintain a registered office and a registered agent, Revised Unif. Limited Partnership Act § 104, 6 U.L.A. 282 (Supp. 1991), but this does not give the limited partnership the right to sue and be sued as an entity. See *N.E. & R. Partnership v. Stone*, 745 S.W.2d 266, 267 (Mo. App. 1988) (construing the Missouri version of § 104).

146. The tax code does not distinguish between general and limited partnerships in overall tax treatment. I.R.C. § 761 (West 1988) (making no distinction between general and limited partnerships); 1 WILLIAM S. MCKEE ET AL., *FEDERAL TAXATION OF PARTNERSHIP AND PARTNERS* ¶ 2.01 [1], at 2-2 (1990) ("The distinctions between general and limited partnerships are based almost entirely on nontax considerations.")

147. Technically, the limited partnership is taxed as a corporation if it is classified as an "association," as opposed to a "partnership." Treas. Reg. § 301.7701-3(b)(1) (1991).

148. *Id.* § 301.7701-2(a)(3).

149. *Id.* § 301.7701-2(b)(1). To avoid recharacterization, partnerships must not provide for automatic continuance of the enterprise notwithstanding the departure or incapacity of any member, especially a general partner. *Id.*

150. *Id.* § 301.7701-2(e)(1).

151. *Id.* § 301.7701-2(d)(1). By definition, limited partners have limited liability, so the focus of this inquiry is on the general partners. As long as there is a general partner with substantial assets, who is more than an empty facade shielding the limited partners, the limited partners will be deemed not to have personal liability. This provides the creditors with at least some recourse to seek satisfaction of their claims. *Id.*; see *id.* § 301.7701-2(d)(1) & (2).

nership business.<sup>152</sup> Thus, in the very important area of taxation, the limited partnership must not be a "quasi-corporation" or else it will lose the important tax advantage of not being a corporation.

An unusual feature of limited partnerships is the class of limited partners themselves. Limited partners are permitted to avoid any risk beyond the amount of their investments.<sup>153</sup> They must not exert too much control over the organization if they wish to retain such limited liability. The line between passivity and too much control is "the single most difficult issue facing lawyers who use the limited partnership form of organization."<sup>154</sup> Consultation, participation in most significant business decisions, and even control of the general partner are all activities that do not constitute excessive involvement in the limited partnership.<sup>155</sup> Even a limited partner who is deemed to have participated in control is not personally liable unless the aggrieved party was misled into "reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."<sup>156</sup> Thus, a limited partner can remain an active, direct participant in the limited partnership's business. In this respect, limited partners are fundamentally different from shareholders, who must act through exercise of their voting power.

Notwithstanding the similarities that do exist between limited partnerships and corporations, there are fundamental theoretical and practical differences. Neither general nor limited partnerships exist apart from their investors, and their tax and other characteristics make them a clearly distinct investment option.<sup>157</sup>

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152. *Id.* § 301.7701-2(c)(1). General partners must have significant rights in the enterprise for the enterprise to avoid the risk of being deemed to have excessively centralized management. *Id.* § 301.7701-3(b)(2).

153. REVISED UNIF. LIMITED PARTNERSHIP ACT § 303, 6 U.L.A. 325 (Supp. 1991).

154. *Id.* prefatory note, 6 U.L.A. at 241 (Supp. 1991).

155. *Id.* § 303, 6 U.L.A. at 325.

156. *Id.*

157. A few states, in particular Michigan, New Jersey, and Ohio, have statutory partnership associations that very closely resemble corporations. MICH. STAT. ANN. §§ 20.91-20.106 (Callaghan 1990); N.J. STAT. ANN. §§ 42:3-1 to 3-29 (West 1940 & Supp. 1991-1992); OHIO REV. CODE ANN. §§ 1783.01-.12 (Baldwin 1985). The Supreme Court refused to grant entity status to a similar form of partnership in *Great S. Fire Proof Hotel Co. v. Jones*, 177 U.S. 449 (1900). *See supra* text accompanying notes 33-36. The statutory partnership association statutes give the association the capacity to sue and be sued, MICH. STAT. ANN. § 20.100; N.J. STAT. ANN. § 42:3-8; OHIO REV. CODE ANN. § 1783.06, and for the most part individual members are not personally liable for the partnership's debts, MICH. COMP. LAWS § 20.92; N.J. STAT. ANN. § 42:3-9; OHIO REV. CODE ANN. § 1783.08. At least one partnership association has been deemed to be so much like a corporation that it should be taxed as such. *See Giant Auto Parts, Ltd. v. Commissioner*, 13 T.C. 307 (1949), *modified by* 14 T.C. 579 (1950). In view of the possibility of tax recharacterization, the absence of modern case law defining the nature of this organizational form, and the availability of modern limited partnerships and Subchapter S corporations, the partnership association may be obsolete. New Jersey's laws confirm this conclusion by prohibiting the creation of new statu-

The same is true for other unincorporated organizations, including business trusts. Business trusts used to be a common organizational form for holding real estate. The Supreme Court has defined a business trust, also called a "Massachusetts Trust" because of its origins, as

consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may from time to time be the holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest in the property is divided.<sup>158</sup>

Business trusts apparently emerged as a mechanism for holding real estate when corporate charters were difficult to obtain for such purposes.<sup>159</sup> Business trusts offer the corporate-like advantages of centralized management, continuity of existence apart from their beneficiaries, and insulation of the beneficiaries from liability.<sup>160</sup> As a trust, the beneficiaries are not necessary parties to actions, and state laws permit suits to be brought against the trust by service upon the trustee.<sup>161</sup>

The similarities between business trusts and corporations once caused the trusts to be deemed "associations" and thus subject to tax at the entity level.<sup>162</sup> Corporate tax treatment, and the availability of sophisticated limited partnership syndicates, eventually made business trusts an unpopular form for doing business.<sup>163</sup> The trust form was reinvigorated in 1960, however, by the Internal Revenue Code provisions for real estate investment trusts (REITs),<sup>164</sup> which granted business trusts favorable tax treatment.<sup>165</sup> In general, the real estate investment trust provisions enable qualifying trusts to distribute investment income to the beneficiary investors without being subjected to an entity-level tax.<sup>166</sup>

Although business trusts share many organizational features with the corporate form, including the transferability of interests without affecting continuity, and the limitation on the personal liability of

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tory partnership associations. See N.J. STAT. ANN. § 42:3-1 (West Supp. 1991-1992).

158. *Hecht v. Malley*, 265 U.S. 144, 146-47 (1924).

159. *State Street Trust Co. v. Hall*, 41 N.E.2d 30, 34 (Mass. 1942).

160. 3 CAVITCH, *supra* note 99, § 43.05.

161. *E.g.*, MASS. GEN. LAWS ANN. ch. 182, § 6 (West 1987).

162. See *Morrissey v. Commissioner*, 296 U.S. 344 (1935).

163. 3 CAVITCH, *supra* note 99, § 44.01, at 134.

164. I.R.C. §§ 856-60 (West 1988 & Supp. 1991).

165. See generally 3 CAVITCH, *supra* note 99, §§ 44.01-05. (explaining that real estate investment trusts are taxable as corporations but can avoid the double tax by meeting certain minimum distribution requirements). See *id.* § 44.04.

166. See generally Thomas F. Allen & Frederick L. Fisher, *Real Estate Investment Trusts*, TAX MANAGEMENT PORTFOLIO (BNA 107-5th A-1 1990).

the participants,<sup>167</sup> investors in business trusts nonetheless choose a form with significantly different features than those of a corporation, chief among them unique and very complex tax consequences.<sup>168</sup> Indeed, the real value of the business trust is to enable real estate investors to obtain some corporation-like benefits without the corporate tax consequences. They choose the trust form precisely because it does not require them to account for the existence of a separate entity for tax purposes.

The foregoing discussion of various business organizations is not exhaustive. There are, of course, other choices available to investors.<sup>169</sup> All forms need not be envisioned to see that although there are similarities and distinctions among the various organizations, corporations clearly stand alone at one end of the organizational spectrum. Other business organizations may share some of the corporation's entity characteristics, but none has the special theoretical and practical distinction accorded to those who incorporate.

Thus, modern investor preferences and expectations provide strong theoretical support for the Supreme Court's longstanding rule that only corporations may avoid having their investors' citizenship considered in the diversity analysis. A clear reaffirmation of this rule would have the desirable result of making the diversity calculation predictable, which in turn would enable investors to understand more clearly the jurisdictional consequences of their choice of entity, and at the same time preserve judicial resources by avoiding case-specific examinations of particular entities' similarities to, or dissimilarities from, the corporate form.

#### IV. UNINCORPORATED ASSOCIATIONS AND REPRESENTATIVE LITIGANTS

Given most courts' demonstrated reluctance to struggle with the question whether a business organization should be treated as a separate entity for diversity jurisdiction purposes, one would think that a decision requiring all of an association's members to be treated as separate citizens would be dispositive of the federal forum's availability. But the matter is not that simple. The federal rules provide a mechanism that can be employed by at least some unincorporated entities to avoid the otherwise preclusive effect of the complete di-

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167. See *Morrissey v. Commissioner*, 296 U.S. 344, 359 (1935) (comparing a business trust with the corporate form).

168. See HAYNSWORTH, *supra* note 102, § 1.05(c) (discussing reasons for selecting a business trust).

169. Among the other various forms of entities, joint stock companies have received the most attention in the jurisdictional analysis. Joint stock companies are partnership-like groups with the corporate characteristic of transferrable ownership interests represented by shares. Some statutes give joint stock companies the power to sue and be sued as an entity; unlike a corporation, however, a joint stock company is formed by contractual agreement, not by grace of the state, and it does not have an existence distinct from its members. 2 CAVITCH, *supra* note 99, § 42.04[1]-[2].

versity requirement. The mechanism is designation of only some members of the association, namely those who can satisfy the diverse citizenship requirement, as representative litigants under the federal rules.<sup>170</sup> The mechanism can be employed in the designation of representative defendants as well as in the selection of representative plaintiffs.<sup>171</sup>

Rule 23.2 of the Federal Rules of Civil Procedure, "Actions Relating to Unincorporated Associations," provides that "[a]n action brought by or against the members of an unincorporated association as a class by naming certain members as representative parties may be maintained only if it appears that representative parties will fairly and adequately protect the interests of the association and its members."<sup>172</sup> Rule 23.2 was enacted with the entity status rules in mind. The advisory committee's note states that

[a]lthough an action by or against representatives of the membership of an unincorporated association has often been viewed as a class action, the real or main purpose of this characterization has been to give "entity treatment" to the association when for formal reasons it cannot sue or be sued as a jural person under Rule 17(b).<sup>173</sup>

For business organizations that have entity status under the federal diversity rules—namely corporations—complete diversity may be achieved notwithstanding common citizenship of some of the organization's members and the opposing party. Rule 23.2 can achieve the same result for business organizations that do not have entity status by selective designation of representative litigants.<sup>174</sup>

In some circuits, Rule 23.2 has been interpreted narrowly as being available only for use by unincorporated associations that are not allowed entity treatment under state law. Under Federal Rule of Civil Procedure 17(b), federal jural capacity is governed by forum state law.<sup>175</sup> According to the narrow interpretation of Rule 23.2, the

170. Diversity in a class action is determined by the citizenship of the named class representatives. See *Snyder v. Harris*, 394 U.S. 332, 340 (1969); *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356, 364-66 (1921).

171. FED. R. CIV. P. 23.2.

172. *Id.* For the complete text of Rule 23.2, see *supra* note 9.

173. FED. R. CIV. P. 23.2 advisory committee's note.

174. Two significant limitations on the use of Rule 23.3 are readily apparent. As a practical matter, only plaintiffs can use Rule 23.2 to achieve diversity, either with respect to themselves or the defendants, because only plaintiffs name the representative litigants. A second limitation is the minimum jurisdictional amount requirement. The Supreme Court has interpreted the diversity statute as requiring that each member of a class of plaintiffs satisfy the minimum jurisdictional amount "in controversy." *Snyder v. Harris*, 394 U.S. 332, 336-38 (1969). This requirement could keep organizations with many investors from suing as a class, because of the corresponding large minimum jurisdictional amount, thereby seriously undercutting Rule 23.2's usefulness as a procedural convenience.

175. The full text of the current version of FED. R. CIV. P. 17(b) provides that:

Rule was intended to give litigants who do not have the option of suing or being sued as an entity in state court the opportunity to avoid the problems associated with multiple litigants.<sup>176</sup> A recent First Circuit case considered Rule 23.2 in the context of the larger diversity jurisdiction picture and adopted this narrow view. In *Northbrook Excess & Surplus Insurance Co. v. Medical Malpractice Joint Underwriting Ass'n of Massachusetts*,<sup>177</sup> the court decided that the device of naming representative parties to achieve diversity jurisdiction, employed by the court in the 1959 case of *Oskoian v. Canuel*,<sup>178</sup> was no longer good law. *Oskoian* "pre-dated Rule 23.2 and therefore did not address the issue of whether the rule may be used to create diversity jurisdiction or used solely to give entity treatment to an unincorporated association that has no such status under state law."<sup>179</sup> According to the First Circuit, if jural status is recognized under state law for an unincorporated association, Rule 23.2 is not available.<sup>180</sup>

The First Circuit feared expansion of diversity jurisdiction. The *Northbrook* court repeated the refrain that "federal court jurisdiction is strictly limited by statute to cases meeting specific criteria"<sup>181</sup> under the statute and that "[p]leas for extension of diversity jurisdiction to hitherto uncovered broad categories of litigants ought to be made to Congress and not to the courts."<sup>182</sup>

A different line of opinions has been much more receptive to the class action mechanism for unincorporated associations. In *Oskoian*

The capacity of an individual, other than one acting in a representative capacity, to sue or be sued shall be determined by the law of the individual's domicile. The capacity of a corporation to sue or be sued shall be determined by the law under which it was organized. In all other cases capacity to sue or be sued shall be determined by the law of the state in which the district court is held, except (1) that a partnership or other unincorporated association, which has no such capacity by the law of such state, may sue or be sued in its common name for the purpose of enforcing for or against it a substantive right existing under the Constitution or laws of the United States, and (2) that the capacity of a receiver appointed by a court of the United States to sue or be sued in a court of the United States is governed by Title 28, U.S.C. §§ 754 and 959(a).

176. See *Underwood v. Maloney*, 256 F.2d 334, 341-42 (3d Cir. 1958), cert. denied, 358 U.S. 864 (1958); *Lang v. Windsor Mount Joy Mut. Ins. Co.*, 493 F. Supp. 97 (E.D. Pa. 1980); *Suchem, Inc. v. Cent. Aguirre Sugar Co.*, 52 F.R.D. 348 (D.P.R. 1971).

177. 900 F.2d 476 (1st Cir. 1990).

178. 269 F.2d 311 (1st Cir. 1959).

179. *Northbrook Excess & Surplus Ins. Co. v. Medical Malpractice Joint Underwriting Ass'n of Mass.*, 900 F.2d at 479.

180. *Id.*; see also *Peerless Ins. Co. v. Aetna Casualty & Sur. Co.*, 735 F. Supp. 452 (D.N.H. 1990).

181. *Northbrook Excess & Surplus Ins. Co. v. Medical Malpractice Joint Underwriting Ass'n of Mass.*, 900 F.2d at 478.

182. *Id.* (quoting *United Steelworkers of Am. v. R.H. Bouligny, Inc.*, 382 U.S. 145, 150-51 (1965)).

*v. Canuel*,<sup>183</sup> the First Circuit case predating Rule 23.2 that was distinguished in *Northbrook*, general class action rules were applied, and thirteen named defendants were sued as class representatives of an unincorporated labor organization having more than 50,000 members. The defendants argued that the case should be dismissed because the named defendants lacked the capacity to be sued as representatives of the union when the state statute permitted suit against an unincorporated association by naming its officers.<sup>184</sup> The court held, however, that because that provision was permissive, a common law action against named members, as representatives of the class, was still available. Thus, as a matter of federal law, the union members could be sued and bound by an action under the class action rule.<sup>185</sup>

Subsequent cases in some circuits followed the *Oskoian* approach. In *Kerney v. Fort Griffin Fandangle Ass'n, Inc.*,<sup>186</sup> the defendants, who were unincorporated association members, asserted that Rule 23.2 was unavailable to the plaintiff because forum state law permitted an association to be sued as an entity. They based their argument on the advisory committee note's reference to an intent to give "entity treatment" to associations that were not treated as entities under state law. The defendants asked the court to hold that Rule 23.2 could be used only when forum state law does not allow an unincorporated association to sue or be sued as an entity. The court refused to do so, however, holding that the plaintiff could amend his complaint to proceed against the association's members instead of against the entity itself.<sup>187</sup> Forum state law, while allowing entity suits, made clear that entity status did not affect the common law right to sue individual members.<sup>188</sup>

Similarly, in *Lumbermen's Underwriting Alliance v. Mobil Oil*

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183. 269 F.2d 311 (1st Cir. 1959).

184. *Id.* at 314.

185. *Id.* at 315. At the time, Rule 23(a), which applied to class actions generally, permitted suit by class representatives who would "fairly insure the adequate representation of all" when the right sought to be enforced was "joint, or common." The current Rule 23.2 was not added until after *Oskoian* was decided. Courts have generally not viewed the current rule as a departure from the prior rule. 7C CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1861 at 219-220 (2d ed. 1986) [hereinafter 7C FEDERAL PRACTICE] (Rule 23.2 does not represent a departure from the pre-1966 class action practice). The advisory committee's note accompanying Rule 23.2 cites *Oskoian* as authority for use of the class action device. At least one circuit holds the opinion that the current rule should be read as broadening the availability of representative actions for unincorporated associations. See *Kerney v. Fort Griffin Fandangle Ass'n, Inc.*, 624 F.2d 717, 720 (5th Cir. 1980) (purpose of Rule 23.2 "was clearly to enlarge, not contract, the authorization for class actions against unincorporated associations").

186. 624 F.2d 717 (5th Cir. 1980).

187. *Id.* at 719-20.

188. *Id.* at 720.



Corp.,<sup>189</sup> a federal district court rejected a restrictive view of the scope of Rule 23.2 and chose to follow *Kerney* and *Oskoian*.<sup>190</sup> The court ruled that as long as the members of an unincorporated association have the individual capacity under state law to sue or be sued, the class action device afforded by Rule 23.2 can appropriately be invoked. The *Lumbermen's* court concluded that

the broad interpretation of Rule 23.2 reflected in the *Kerney* and *Oskoian* decisions is correct. The language of Rule 23.2 suggests no "entity treatment" limitation, nor does the advisory committee reference to "entity treatment" specifically refer to capacity to sue or be sued as an entity. From the evolution of the legal identity of an unincorporated association it is apparent that entity treatment allowed a party suing or being sued by an unincorporated association to avoid the practical difficulties of joining all members of the association. Such "entity treatment" can be achieved by suing the association in its common name or by suing the members of the association individually as a class.<sup>191</sup>

The Second Circuit recently adopted this broad view of Rule 23.2 and applied it to a limited partnership. In *Curley v. Brignoli, Curley & Roberts Associates*,<sup>192</sup> three limited partners brought suit against their limited partnership, its corporate general partner, and the chief executive officer of the corporate general partner, alleging various breaches of fiduciary duty.<sup>193</sup> Because the plaintiffs were limited partners in the limited partnership defendant, there would be a failure of complete diversity unless the entity was deemed to have its own citizenship or a representative action could be brought.

The *Curley* court observed that in *Carden* the Supreme Court had rendered invalid the Second Circuit's previously adopted rule in *Colonial Realty Corp. v. Bache & Co.*,<sup>194</sup> "that, in proceedings where a limited partnership was a party but its limited partners could not properly be joined under state law, only the citizenship of general partners was considered for diversity purposes."<sup>195</sup> On its own initiative, the court went on to consider whether Rule 23.2 was a viable alternative for meeting the diversity jurisdiction requirements. The court deemed that it was, expressly rejecting other courts' contrary interpretation.<sup>196</sup> The court said that if Rule 23.2 had been intended to be restricted to organizations not having entity status under state

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189. 612 F. Supp. 1166 (D. Idaho 1985).

190. *Id.* at 1170.

191. *Id.*

192. 915 F.2d 81 (2d Cir. 1990).

193. *Id.* at 82-83.

194. 358 F.2d 178 (2d Cir. 1966), *cert. denied*, 385 U.S. 817 (1966).

195. *Curley v. Brignoli, Curley & Roberts Assocs.*, 915 F.2d at 84.

196. Specifically, the court rejected the First Circuit's holding in *Northbrook Excess & Surplus Ins. Co. v. Medical Malpractice Joint Underwriting Ass'n of Mass.*, 900 F.2d 476 (1st Cir. 1990), discussed *supra* at text accompanying notes 177-82.

law, the text of the rule could have easily so provided, and the drafters "would have simply extended to the diversity realm rule 17(b)'s grant of association capacity in federal question cases."<sup>197</sup>

*Curley* is important for two reasons. First, it makes a strong case for reading Rule 23.2 as a mechanism for achieving complete diversity rather than as a narrow, special dispensation to business organizations that do not have entity capacity under state law. Second, *Curley* demonstrates how courts can see themselves as unduly constrained by the "doctrinal wall" of *Carden*. The *Curley* court found relief from this constraint in the representative litigant rules.

In *Curley*, the functional similarities between corporations and limited partners were apparent. The case had been brought as a derivative action, a mechanism deeply rooted in corporate law.<sup>198</sup> Perhaps the court's eagerness to examine Rule 23.2 was due in part to the inconsistency of refusing to give the limited partnership entity status for citizenship purposes when the nature of the action made it indistinguishable from comparable actions brought against corporations.

Although the *Curley* decision went against the trend that had been developing toward a narrow interpretation of Rule 23.2,<sup>199</sup> the conclusion reached in *Curley* is sound as a matter of rule interpretation. As the Second Circuit observed, it seems odd that the rulemakers would not have been explicit if they intended for state entity status to preclude use of Rule 23.2. The advisory committee's note does describe the "real or main purpose" of the class action provision as giving "'entity treatment' to the association when for formal reasons it cannot sue or be sued as a jural person under Rule 17(b),"<sup>200</sup> but it does not say this is the *only* purpose and that the Rule should not be interpreted as going any further.

Interpreted broadly in this manner, Rule 23.2 is a counterweight to the Supreme Court's rule that as a matter of federal law only corporations have entity treatment for diversity purposes. Corporations are citizens in their own right; any other association that hopes to use the federal forum must do so under Rule 23.2. Such a result

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197. *Curley v. Brignoli, Curley & Roberts Assocs.*, 915 F.2d at 87.

198. The stockholders' right to sue in behalf of the corporation was firmly established in this country by the middle of the 19th century. *Ross v. Bernhard*, 396 U.S. 531, 534 (1970).

199. See cases discussed *supra* in text accompanying notes 175-82; see also *National Bank of Washington v. Mallory*, 669 F. Supp. 22, 24-25 (D.D.C. 1987) ("[C]ase law has added a gloss to [Rule 23.2] so that it now appears that an unincorporated association may sue or be sued as a class only where state law does not allow suit by or against the group as an entity."); 7C FEDERAL PRACTICE, *supra* note 185, § 1861, at 223 ("the clear trend in cases decided since the adoption of Rule 23.2 has been to follow the pre-1966 Third Circuit approach to honoring the state law prohibition against suit").

200. FED. R. CIV. P. 23.2 advisory committee's note.

seems questionable in view of the policy concerns that have led to so much criticism of diversity jurisdiction and that have resulted in judicial reluctance to extend diversity jurisdiction in doubtful circumstances.<sup>201</sup>

Indeed, the contrary approach taken by the First Circuit in *Northbrook* is persuasive as a matter of federal policy. Although the First Circuit was not as vocal as other courts have been in articulating federalism concerns about diversity jurisdiction,<sup>202</sup> the *Northbrook* court adopted the language of the Supreme Court that "[p]leas for extension of the diversity jurisdiction to hitherto uncovered broad categories of litigants ought to be made to Congress and not to the courts."<sup>203</sup> Whether such restraint is in itself legislation from the bench can, of course, be debated; the Supreme Court, however, would probably sanction the First Circuit's approach in view of the strong position taken in *Carden* against any leniency in the rules governing diversity jurisdiction requirements for business organizations.

If Rule 23.2 is read narrowly—that is, as intended only to "give 'entity treatment' to the association when for formal reasons it cannot sue or be sued as a jural person"<sup>204</sup> under forum state law<sup>205</sup>—the rule becomes a mechanism for alleviating the problems of service and case management entailed in states that refuse to give entity treatment to unincorporated associations. State courts themselves recognize that a decision to afford such "entity treatment" is merely "a procedural convenience to litigants, not to affect the substantive rights, liabilities and duties of partners or partnerships."<sup>206</sup> Entity characterization "provides a simpler means for a plaintiff to sue [the association's members] as a group" and "relieves a plaintiff

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201. See *supra* note 4 and accompanying text.

202. See, e.g., *Carlsberg Resources Corp. v. Cambria Sav. & Loan Ass'n*, 554 F.2d 1254, 1256-57 (3d Cir. 1977).

203. *Northbrook Excess and Surplus Ins. Co. v. Medical Malpractice Joint Underwriting Ass'n of Mass.*, 900 F.2d at 478 (quoting *United Steelworkers of Am. v. R.H. Bouligny, Inc.*, 382 U.S. 145, 150-51 (1965)).

204. FED. R. CIV. P. 23.2 advisory committee's note.

205. Entity status under state law—as opposed to entity status under state or federal law—must be the standard. If Rule 23.2 were interpreted as being unavailable to an entity that has entity status under state or federal law, then a class action could never be brought when jurisdiction is based on a federal question because Rule 17(b) gives capacity in all such cases. Class action suits have been brought in federal question cases without serious question about their availability. See, e.g., *Management Television Sys., Inc. v. National Football League*, 52 F.R.D. 162 (E.D. Pa. 1971).

206. *Watson v. G.C. Assocs. Ltd. Partnership*, 691 P.2d 417, 419 (Nev. 1984). One state court described its state's entity capacity statute as "manifestly" having been "enacted for the practical convenience and benefit of the partnership[s], associations, and companies to which it relates, as well as for the convenience and benefit of creditors, in bringing and prosecuting suits." *F.R. Patch Mfg. Co. v. Capeless*, 63 A. 938, 939 (Vt. 1906).

from the task of having to name and personally serve process on each and every member of the association."<sup>207</sup> Many states have provided this convenience;<sup>208</sup> but some do so only for certain unincorporated organizations or only in limited circumstances,<sup>209</sup> and others cling to the common law view that only corporations have jural entity status.<sup>210</sup> Rule 23.2, therefore, becomes a curious procedural convenience for business organizations to which the states themselves would not extend such a courtesy. The existence of such a procedural convenience is anomalous in a federal court system where policy makers and the courts almost uniformly declare the need to make the federal courts available only when justice so demands.

Indeed, even if procedural convenience were a satisfactory basis for broad representative litigant rules, Rule 23.2 is overbroad in its failure to consider the litigants' need for such a mechanism. Organizations with many investors have a greater chance of shared citizenship, and thus complete diversity is less likely for such organizations. Yet the more investors there are, the more cumbersome the service procedures. Although Rule 23(a) restricts class actions to cases in which "the class is so numerous that joinder of all members is impracticable,"<sup>211</sup> Rule 23.2 apparently is not so restricted. Rule 23.2 has been interpreted as not incorporating the numerosity requirement for several reasons: the Rule does not use the words "class action" to define the nature of the action it creates, which suggests that the general class action requirements do not apply; it makes no reference to Rule 23, the general class action rule in which the numerosity requirement is set forth; and it expressly mentions one of the four general class action requirements—adequacy of representation—implying an intentional omission of the others, including numerosity.<sup>212</sup> Even when Rule 23.2's requirement that the rep-

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207. *Shortlidge v. Gutoski*, 484 A.2d 1083, 1087 (N.H. 1984).

208. *E.g.*, CAL. CIV. PROC. CODE § 388 (West 1973); VT. STAT. ANN. tit. 12, § 814 (1973); *see also Orser v. Vierra*, 60 Cal. Rptr. 708, 715-16 (1967) (describing the California law as "a procedural statute, creating a quicker, cleaner and simpler method of getting [association] members into court"). *See also supra* note 206.

209. *E.g.*, N.H. REV. STAT. ANN. § 510:13 (1983) (allowing suit to be brought against a partnership as an entity if it has more than four partners); MASS. GEN. LAWS ANN. ch. 182, §§ 1, 6 (West 1987) (allowing business trusts that meet state organizational requirements to be treated as entities); N.Y. CIV. PRAC. L. & R. 1025 (McKinney 1976) (allowing partnerships to be treated as entities, but according unincorporated associations such treatment only in very limited circumstances).

210. *E.g.*, *O & Y Landmark Assocs. of Va. v. Nordheimer*, 725 F. Supp. 578, 581 (D.D.C. 1989) (District of Columbia law); *Payne v. Sigma Phi Epsilon*, 569 F. Supp. 422, 425 (N.D. W. Va. 1983) (holding that under West Virginia law only cooperative agricultural marketing associations and common carriers are given entity treatment).

211. FED. R. CIV. P. 23(a).

212. *See* 3B JAMES W. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.2.02 (2d ed. 1991).

representative parties "will fairly and adequately protect the interests of the association and its members"<sup>213</sup> is interpreted as implicitly incorporating the concepts of Rule 23's restrictions on class actions, the numerosity restriction has been excluded.<sup>214</sup>

Rule 23.2 badly suffers from lack of clarity in application and in purpose. Rule 23.2 should not be so easily susceptible of contrary interpretations in view of the important policy and other concerns at stake with diversity jurisdiction. If Congress really wants the federal courts to be available to unincorporated business organizations that do not qualify for entity treatment under the Supreme Court's jurisprudence, which seems unlikely, it should confront the issue squarely and expressly overrule the Court's "doctrinal wall," or at least clarify the class action rules to make them available to all unincorporated organizations, regardless of state entity status.

If, on the other hand, Congress does not want diversity jurisdiction to be so widely available, it should eliminate the procedural convenience provided by Rule 23.2 and exclude business organizations from the class action rules. As discussed above in Part III, a restrictive approach to making the federal courts available to business organizations based on diversity of citizenship is justified by the nature of investor expectations and the purposes of diversity jurisdiction. Rule 23.2's "procedural convenience" mechanism is inconsistent with such an approach and is questionable federal policy.

## V. CONCLUSION

In *Carden*, the Supreme Court took refuge in its perceived constitutional role to avoid tough questions about how business organizations should be treated for diversity purposes. Corporations have been granted a special diversity status without a sound analytical basis for distinguishing among the various business organizations. Modern commercial realities, however, justify a rule that continues to treat corporations uniquely. There are meaningful theoretical and practical differences between corporations and other organizational forms. Corporations stand alone in their fictional entity status, and investors make a fundamentally different choice when they select another organizational regime. Thus, creating a doctrinal wall around corporations for diversity purposes is consistent with what investors anticipate when they choose their business form.

The lines drawn by the Court should be solidified. Such solidification requires attention to the other two relevant rules: the real party in controversy approach and Rule 23.2's representative litigant mechanism. These rules should be aligned with the entity approach

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213. FED. R. CIV. P. 23.2.

214. See *Management Television Sys., Inc. v. National Football League*, 52 F.R.D. 162, 164 (E.D. Pa. 1971).

that gives special treatment to corporations, by declaring the real party approach to be inapplicable in a business organization context, and by narrowing Rule 23.2's role as a procedural convenience.

