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2022 HOT TOPICS

New Disclosure Requirements Under Federal Rule of Civil Procedure 7.1

Imran O. Shaukat
Moderator
SEMMES, BOWEN & SEMMES
Baltimore, Maryland
ishaukat@semmes.com

A. The Origins of Federal Rule of Civil Procedure 7.1

Upon its addition to the Federal Rules of Civil procedure in April 2002, Rule 7.1 has required nongovernmental corporate parties in federal court to file a disclosure statement that (1) identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock, or (2) states that there is no such corporation. *See* Fed. R. Civ. P. 7.1. The intent behind Rule 7.1 was to alert judges of potential financial interests that they may have in relation to a corporate party, and ultimately to facilitate a judge's determination of whether his or her recusal from the case was necessary. *See Ha v. Deutsche Bank New Jersey Services, Inc.*, 2005 WL 589408, at *2 (S.D.N.Y. Mar. 11, 2005) ("Recusal may be appropriate where a judge has a financial interest in the corporate party, its parent company, or in a publicly held corporation that holds a particular stock percentage in the party. Thus, the Rule gives notice and assurance to all parties that the companies listed on the Disclosure Statement are the only ones most likely to have some direct financial stake in the commenced litigation."). *See also* Fed. R. Civ. P. 7.1 Advisory Committee Notes (stating that the disclosures "are calculated to reach a majority of the circumstances that are likely to call for disqualification on the basis of financial information that a judge may not know or recollect.").[1]

At the time of its adoption, Rule 7.1's disclosure statement requirements were not intended to have a bearing on the issue of jurisdiction or removal. *Gosnell v. Interstate Dist. Co.,* 2009 WL 1346051, at *1 (E.D. Tenn. May 11, 2009) (noting there is no relationship between removal and corporate disclosure statement). *See also Inglis v. D.R. Horton, Inc.,* 2008 WL 4997611, at *1 (S.D. Cal. Nov. 24, 2008) (stating that the failure to file disclosure statement with a notice of removal is immaterial). In practice, however, federal courts look to disclosure statements to verify the existence of diversity jurisdiction. *See e.g. Turnage v. Chase Home Finance, LLC*, 2010 WL 11530719, at *3 (E.D. Tex. July 2, 2010) ("As demonstrated by Chase's Rule 7.1 Corporate Disclosure Statement and Exhibit I submitted by the Turnages, Chase is a Delaware Limited Liability Company, with its principal place of business in the State of New Jersey. Chase's sole member is Chase Home Finance, Inc., a Delaware corporation, with its principal place of business in State of New Jersey. . . Accordingly, complete diversity exists in the instant matter given that the Turnages are residents and citizens of Texas and Chase is a citizen of Delaware and New Jersey.")

Proposed amendments to Rule 7.1, which have been recommended by the United States Judicial Conference to the Supreme Court of the United States for approval, seek to formalize additional disclosure requirements and provide uniformity across all federal district courts in determining the citizenship attributed to every party, to ensure the existence of diversity jurisdiction.

B. Proposed Amendments to Federal Rule of Civil Procedure 7.1

Proposed new Federal Rule of Civil Procedure 7.1 states:

[1] Under 28 U.S.C.A. § 455(b)(4), a judge of the United States is required to be disqualified when "he knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding."

Rule 7.1. Disclosure Statement

(a) Who Must File; Contents.

> *(1) Nongovernmental Corporations*. A nongovernmental corporate party or a nongovernmental corporation that seeks to intervene must file a statement that: **(A)** identifies any parent corporation and any publicly held corporation owning 10% or more of its stock; or **(B)** states that there is no such corporation.
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> *(2) Parties or Intervenors in a Diversity Case*. In an action in which jurisdiction is based on diversity under 28 U.S.C. § 1332(a), a party or intervenor must, unless the court orders otherwise, file a disclosure statement. The statement must name—and identify the citizenship of—every individual or entity whose citizenship is attributed to that party or intervenor: **(A)** when the action is filed in or removed to federal court, and **(B)** when any later event occurs that could affect the court's jurisdiction under § 1332(a).

(b) Time to File; Supplemental Filing.

> A party, intervenor, or proposed intervenor must: (1) file the disclosure statement with its first appearance, pleading, petition, motion, response, or other request addressed to the court . . .

While the original intent of Rule 7.1 focused on a judge's prospective financial interest in litigation, the proposed additions to Rule 7.1 focus now on the determination of party citizenship for purposes of diversity jurisdiction. *See* Memorandum from Committee on Rules of Practice and Procedure to Scott S. Harris, Clerk, Supreme Court of the United States (Oct. 18, 2021) ("The proposed new Rule 7.1(a)(2) would create a new disclosure aimed at facilitating the early determination of whether diversity jurisdiction exists under 28 U.S.C. § 1332(a), or whether complete diversity is defeated by the citizenship of a nonparty individual or entity because that citizenship is attributed to a party.") Citizenship determination for individuals and many corporate entities is generally a clear-cut analysis unlikely to burden litigants. However, issues are likely to arise under proposed Rule 7.1 in determining the citizenship of unincorporated entities, whose citizenship is generally determined by the citizenship of its constituent owners or members. *See Americold Realty Trust v. Conagra Foods, Inc.*, 577 U.S. 378, 381 (2016) ("[W]e have identified the members of a joint-stock company as its shareholders, the members of a partnership as its partners, the members of a union as the workers affiliated with it, and so on.").

The Advisory Committee on Civil Rules has recognized the challenges presented by attributed ownership, acknowledging that "the more elaborate LLC ownership structures may make it difficult, and at times impossible, for an LLC to identify all of the individuals and entities whose citizenships are attributed to it, let alone determine what those citizenships are." *See* Report of the Advisory Committee on Civil Rules (Dec. 9, 2020). Despite the difficulties of determining attributed citizenship in some cases, "the imperative of ensuring complete diversity requires a determination of all citizenships attributed to every party." *Id.* These difficulties are further complicated by the timing requirement under proposed Federal Rule of Civil Procedure 7.1(b), which requires parties to include the disclosure statement with the party's first federal court filing.

C. Rule 7.1's Potential Impact on Diversity Jurisdiction Removal

Once served with a legal pleading, a party will often contact counsel to investigate the veracity of the allegations and analyze the strength of the claims. Particularly if the claims are asserted in state court, counsel often will examine whether there is a way to remove the case to federal court.[2] For removal to be proper, a federal district court must possess subject-matter jurisdiction over the case. Primarily, federal district courts possess subject-matter jurisdiction over claims in which a plaintiff alleges a cause of action arising under federal law, *see* 28 U.S.C. § 1331 (federal question jurisdiction), and claims in which the matter in controversy exceeds $75,000, exclusive of interest and costs and is between citizens of different states, *see* 28 U.S.C. § 1332 (diversity jurisdiction).

As removal jurisdiction raises significant federalism concerns, removal is strictly construed. *See Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 108–09 (1941). "The burden of establishing federal jurisdiction is placed upon the party seeking removal." *Mulcahey v. Columbia Organic Chemicals Co., Inc.,* 29 F.3d 148, 151 (4th Cir. 1994) (citing *Wilson v. Republic Iron & Steel Co.,* 257 U.S. 92 (1921)). Under the federal removal statute, a defendant generally has thirty days after service of the initial pleading setting forth the claim to remove an action filed in state court to federal court. *See* 28 U.S.C. § 1446(b).[3]

As the clock ticks forward towards the removal deadline, a prospective removing defendant can lose valuable time determining its citizenship for purposes of establishing diversity jurisdiction. On the one hand, the determination of citizenship for a single-member LLC whose sole member is an individual may take relatively little time to ascertain, as the entity takes on the citizenship of the individual. On the other hand, the determination of citizenship for a large LLC with multiple members, some of which may themselves be corporations and even other LLCs, has the potential to send the removing defendant down a seemingly endless rabbit hole of citizenship determination.[4] Moreover, LLC's attributed citizenship of its members can also implicate prohibitions on removal under the Forum Defendant Rule if one of the members of the LLC is a citizen of the state where the action is brought. *See* 28 U.S.C. § 1441(b)(2).

The Advisory Committee on Civil Rules recognized that proposed amended Rule 7.1 "does not address the questions that may arise when a disclosure statement or discovery responses indicate that the party or intervenor cannot ascertain the citizenship of every individual or entity whose citizenship may be attributed to it." *See*

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[2] The benefits of proceeding in federal court not only include pooling juries from larger geographic ranges to mitigate local biases, but can also entail cost savings of pre-discovery disclosures and discovery limitations among numerous other benefits.

[3] *See also* *Adams v. Aero Services Intern., Inc.*, 657 F. Supp. 519, 521 (E.D.Va 1987) ("Because the statutory time limitation is mandatory and must be strictly complied with, noncompliance is sufficient to render removal improper and to require remand.").

[4] For each member of an LLC that is itself an LLC, its members and their citizenship must be identified and traced up the chain of ownership until one reaches only individuals and/or corporations. *Lewis v. Allied Bronze, LLC*, 2007 WL 1299251 (E.D. N.Y. May 2, 2007); *see also Mullins v. TestAmerica, Inc.*, 564 F.3d 386, 397 (5th Cir. 2009) (to discern the citizenship of an LLC, the court must trace citizenship "down the various organizational layers"); *Feaster v. Grey Wolf Drilling Co.*, 2007 WL 3146363, at *1 (W.D. La. Oct. 25, 2007) ("citizenship must be traced through however many layers of members or partners there may be").

Excerpt from Report of the Advisory Committee on Civil Rules, 159. What Rule 7.1 does address, however, is that the removing party must file, at the time of removal, its disclosure statement identifying the citizenship of every individual or entity whose citizenship is attributed to that party. To avoid risking an untimely removal and remand back to state court, it would be prudent for potential litigants, and especially those who are unincorporated entities, to maintain up-to-date records of the citizenship of every individual or entity whose citizenship is attributed to it for purposes of establishing diversity jurisdiction.