Washington Law Review

Volume 40 | Number 4

10-1-1965

Unincorporated Association—A Legal Entity for Purposes of Diversity Jurisdiction

anon

UNINCORPORATED ASSOCIATION—A LEGAL ENTITY FOR PURPOSES OF DIVERSITY JURISDICTION

Plaintiff, a citizen of New Jersey, commenced a personal injury action in the federal district court for the Southern District of New York against American Express Company, an unincorporated joint stock association organized under New York laws. Jurisdiction was alleged solely on the basis of diversity of citizenship. The district court held that the defendant association was itself incapable of being a citizen and, since some member shareholders were shown to be citizens of plaintiff's state, the complaint was dismissed for lack of total diversity.[1] On appeal to the Court of Appeals for the Second Circuit, reversed. *Held:* An unincorporated New York joint stock association may possess sufficient characteristics of a legal entity to be treated as a "citizen" of New York for purposes of federal diversity jurisdiction. *Mason v. American Express Co.*, 334 F.2d 392 (2d Cir. 1964).

Before the Supreme Court's decision in *Puerto Rico v. Russell*,[2] there seemed little doubt that the citizenship of an unincorporated association for purposes of diversity jurisdiction was to be determined by the domicile of its individual members. In 1889, the Supreme Court specifically refused, in *Chapman v. Barney*,[3] to extend citizenship status beyond corporations[4] so as to include a New York joint stock association.[5] In the *Russell* case, however, the Court held that a *sociedad* (an unincorporated association under civil law), because it possessed characteristics similar to those of a corporation, was to be treated like a corporation for purposes of diversity jurisdiction. Although several commentators considered *Russell* a major departure from the rule of *Chapman*,[6] the federal courts prior to the present case

[1] Mason v. American Express Co., 224 F. Supp. 288 (S.D.N.Y. 1963).

[2] 288 U.S. 476 (1933), 33 COLUM. L. REV. 540, 47 HARV. L. REV. 135.

[3] 129 U.S. 677.

[4] In 1844, the United States Supreme Court had declared in *Louisville C. & C. R.R. v. Letson*, 43 U.S. (2 How.) 478, that for purposes of diversity, a corporation was an artificial entity capable of citizenship in the state of its creation. See McGouney, *A Supreme Court Fiction: Corporations in the Diverse Citizenship Jurisdiction of the Federal Courts* (pts. 1-3), 56 HARV. L. REV. 853, 1090, 1225 (1943). See also Moore & Weckstein, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited*, 77 HARV. L. REV. 1426 (1964).

[5] The *Chapman* decision was applied to other unincorporated associations in the Federal courts. See, *e.g.*, Thomas v. Board of Trustees, 195 U.S. 207 (1904) (board of trustees); Great So. Fireproof Hotel v. Jones, 177 U.S. 449 (1900) (limited partnership); Russell v. Central Labor Union, 1 F.2d 412 (E. D. Ill., 1924) (labor union), 38 HARV. L. REV. 510 (1925).

[6] *E.g.*, HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 917-18 (1953); 3 MOORE, FEDERAL PRACTICE ¶ 17.25, at 1413 (3d ed. 1948); WRIGHT, FEDERAL COURTS 78-79 (1963).

interpreted *Russell* as a special fact situation and continued to follow *Chapman*.[7]

The court in the principal case justified its departure from the *Chapman* rule on the ground that *Chapman* was impliedly overruled when the Supreme Court adopted the flexible approach of *Russell*. The court considered *Chapman* to be superficially brief and to establish a mechanical rule, whereas *Russell* involved a close factual analysis of the principal legal characteristics[8] of the *sociedad* in finding it to be a juridical entity and—like a corporation—capable of citizenship. The court in the principal case then followed what it considered to be the *Russell* "approach" to determine whether the "essential legal characteristics" of the New York joint stock association brought defendant within federal diversity jurisdiction. The court concluded that the defendant association was sufficiently endowed with the essential characteristics[9] to be a "legal personality apart from its individual

[7] See, *e.g.*, R. H. Bouligny, Inc. v. United Steelworkers of America, 336 F.2d 160 (4th Cir. 1964), *cert. granted*, 379 U.S. 958 (1965) (labor union); Hanson v. Chicago B. & O. RR., 282 F.2d 758 (7th Cir. 1960), *cert. denied*, 365 U.S. 850 (1960) (labor union); Brocki v. American Express Co., 279 F.2d 785 (6th Cir. 1960), *cert. denied*, 364 U.S. 871 (1960) (New York joint stock association); Arbuthnot v. State Automobile Insurance Ass'n, 264 F.2d 260 (10th Cir. 1959), 46 VA. L.REV. 346 (1960) (inter-insurance exchange); Underwood v. Maloney, 256 F.2d 334 (3rd Cir. 1958), *cert denied*, 358 U.S. 864 (1958) (labor union); Swain v. First Church of Christ Scientist, 225 F.2d 745 (9th Cir. 1955) (church association); Hettenbaugh v. Airline Pilots Ass'n, 189 F.2d 319 (5th Cir. 1951) (airline pilots association).

[8] Among the characteristics of the *sociedad* under Puerto Rican law which the Supreme Court listed as important indicia of that organization's status as a distant legal person were the following: its creation by articles of association filed as public records; its capacity to contract, own property, transact business, and sue and be sued in its own name and right; its ability to endure for a prescribed period regardless of the death or withdrawal of individual members; the preference granted its creditors to reach its property and assets ahead of the creditors of its individual members; and the vesting of the powers of management over its affairs in the hands of managers who alone could perform acts legally binding on it. 334 F.2d at 395.

[9] Under New York law, a joint stock association is created pursuant to written articles of association which are filed, like a certificate of incorporation, as a public record; the association is authorized to have capital stock divided into shares, and to provide that upon the death of a shareholder or the transfer of his shares no dissolution is to be worked upon the association, N.Y. GEN. ASS'NS LAW § 3(1); management of its affairs can be concentrated in the sole hands of directors, N.Y. GEN. ASS'NS LAW 3(2); the association can purchase, hold, and convey real property in the name of its president, N.Y. GEN. ASS'NS LAW § 6; it can sue and be sued in the name of its officers without joining as parties the shareholder members, N.Y. GEN. ASS'NS LAW §§ 12, 13; the shareholders may be sued without prior action against the association, N.Y. GEN. ASS'NS LAW § 17. The difference in personal liability between a corporation stockholder and an unincorporated association member was thought to be insignificant. 334 F.2d at 401. In *Russell* the Supreme Court had also recognized that a *sociedad* differed from a corporation in that *sociedad* members were personally liable in the event that the organization's assets were insufficient to satisfy such debts. In rejecting this distinction as insignificant, the Supreme Court said, "this liability is of no more consequence for present purposes than that imposed on corporate stockholders by the statutes of some states." Puerto Rico v. Russell & Co., 288 U.S. 476, 481 (1933).

members," and therefore it was "just and sensible to regard it as a separate entity"[10] for purposes of diversity jurisdiction.

Unincorporated associations have been treated as "legal personalities" apart from their individual members for purposes of venue,[11] service of process,[12] taxation,[13] bankruptcy,[14] and miscellaneous federal regulations.[15] Treatment as a legal entity for some purposes, however, does not necessitate treatment as an entity for all purposes. For example, a corporation has been recognized as a "person" within the meaning of fifth amendment due process[16] and fourth amendment search and seizure,[17] but not a person within the meaning of fifth amendment self-incrimination[18] or a citizen under the privileges and immunities clause of the fourteenth amendment.[19] Similarly, unincorporated associations have been held to be separate legal entities for some purposes but not others.[20] In deciding whether to treat a corporation as a separate entity for purposes other than diversity, courts have generally looked to the legal effect of such treatment rather than to the legal characteristics of the corporation.[21] Justification for extending entity status to unincorporated associations for diversity purposes should also be based upon reasons distinct from the characteristics of the association.

The court in the principal case justified its decision on the basis that all the reasons for extending citizenship status to corporations for diversity purposes apply with equal force to the defendant joint stock association.[22] However, diversity was extended to corporations due to fear of prejudicial treatment by local courts, and access to federal courts was thought necessary to encourage corporate growth and

---

[10] 334 F.2d at 400.

[11] *E.g.*, Rutland Ry. v. Brotherhood of Locomotive Eng'rs, 307 F.2d 21 (2d Cir. 1962), *cert. denied*, 372 U.S. 954 (1963).

[12] FED. R. CIV. P. 4(d)(3).

[13] INT. REV. CODE OF 1954 § 7701(a)(3).

[14] Bankruptcy Act, 30 Stat. 544 (1898), as amended, 11 U.S.C. § 1(6) (1958).

[15] See, *e.g.*, Federal Trade Commission Act, 38 Stat. 719 (1914), 15 U.S.C. § 44 (1958); Federal Power Act, 41 Stat. 1063 (1920), 16 U.S.C. § 796(3) (1958).

[16] Sinking Fund Cases, 99 U.S. 700 (1878).

[17] Hale v. Henkel, 201 U.S. 43, 76 (1906).

[18] Wilson v. United States, 221 U.S. 361, 382 (1911).

[19] Hemphill v. Orloff, 277 U.S. 537, 548 (1928).

[20] See, *e.g.*, Fray v. Amalgamated Meat Cutters, 9 Wis. 2d 631, 101 N.W.2d 782, 786 (1960), where the court pointed out that generally a union member cannot sue his union because it has no separate entity, but that there may be fact situations when it would be "unjust" or "unrealistic" to apply this rule. In such cases the court should regard a union in legal contemplation as separate from its members.

[21] See, *e.g.*, Wilson v. United States, 221 U.S. 361 (1911); Western Turf Ass'n v. Greenberg, 204 U.S. 359 (1907); Hale v. Henkel, 201 U.S. 43 (1906).

[22] 334 F.2d at 402.

nationwide expansion, and to protect interstate commerce.[23] Current bias toward out-of-state business associations cannot be accurately gauged, but the probability of prejudicial treatment is slight.[24] If prejudicial treatment should occur, constitutional protections are available.[25] One study has specifically indicated that fear of local bias is rarely a consideration when litigants decide to invoke diversity jurisdiction.[26]

As the court in the principal case pointed out, *Puerto Rico v. Russell*[27] created doubts about the continued vitality of the *Chapman* rule. The Court's analysis in *Russell* represented a distinct departure from the formula adopted in *Chapman*. *Russell*, however, might be limited to its facts; the question at issue in *Russell* did not involve diversity within the meaning of Article III of the Constitution, but rather interpretation of Puerto Rico's Organic Act.[28] In fact, the effect of the *Russell* analysis was to deprive the parties in that case of federal

---

[23] In *Bank of United States v. Deveaux*, 9 U.S. (5 Cranch) 37 (1809), Chief Justice Marshall had observed that the framers of the Constitution had "entertained fears and apprehensions of possible local bias in the state courts," (*Id.* at 50) and therefore federal tribunals were provided for controversies between citizens of different states. *Cf.* Martin v. Hunter's Lessee, 14 U.S. (1 Wheat) 141, 160 (1816), where Mr. Justice Story said:

> . . . the Constitution has presumed (whether rightly or wrongly, we do not inquire) that state attachments, state prejudices, state jealousies, and state interests, might sometimes obstruct, or control, the regular administration of justice . . . . No other reason that that which has been stated can be assigned, why some, at least, of those cases should not have been left to the cognizance of the state courts.

See also Frank, *Historical Bases of the Federal Judicial System*, 13 LAW & CONTEMP. PROB. 3, 14-28 (1948); ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 50-51 (Tent. Draft. No. 2, 1964).

[24] See Wechsler, *Federal Jurisdiction and the Revision of the Judicial Code*, 13 LAW & CONTEMP. PROB. 216 (1948); Warren, *New Light on the History of the Federal Judiciary Act of 1789*, 37 HARV. L. REV. 49, 83 (1923). *But see* Brown, *The Jurisdiction of the Federal Courts Based on Diversity of Citizenship*, 78 U. PA. L. REV. 179 (1929). Labor unions, however, may frequently encounter hostile state courts, particularly in the South. See Comment, *Unions as Juridical Persons*, 66 YALE L.J. 712, 745 (1957).

[25] See Wechsler, *supra* note 24, at 235-36.

[26] Summers, *Analysis of Factors that Influence Choices of Forum in Diversity Cases*, 47 IOWA L. REV. 933 (1962). *Cf.* Lumbermen's Mut. Cas. Co. v. Elbert, 348 U.S. 48, 53 (1954) (Frankfurter, J., concurring). Diversity jurisdiction, however, may still be useful in protecting out-of-state persons against infirmities and injustices of local practices and procedures. Moore & Weckstein, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited*, 77 HARV. L. REV. 1426, 1449 (1964). *But see* 1 BARRON & HOLTZOFF, FEDERAL PRACTICES § 9 (1960, Supp. 1964); Fowks & Harvey, *The New Kansas Code of Civil Procedure*, 36 F.R.D. 51 (1964).

[27] 288 U.S. 476 (1933).

[28] The Organic Act confers jurisdiction on the United States District Court for Puerto Rico in "all controversies where all of the parties on either side of the controversy are citizens or subjects of a foreign state or states, or citizens of a state, "Territory or District of the United States not domiciled in Puerto Rico . . . ." 39 Stat. 915-66 (1917), as amended, 48 U.S.C. § 863 (1958). *Cf.* U.S. CONST. art. III, § 2: "The Judicial power shall extend to all Cases . . . between Citizens of different States. . . ."

jurisdiction.[29] Moreover, the Court explicitly distinguished between the capacity for citizenship of an unincorporated association under our common law, and the status of a *sociedad* under the civil law of Puerto Rico.[30]

By extending diversity jurisdiction, the application of the *Russell* approach to the facts in the principal case ignores the restrictive attitude of both the Supreme Court and Congress. Individual justices on the Court have been outspoken critics of diversity jurisdiction.[31] Mr. Justice Frankfurter, concurring in *Lumberman's Mut. Cas. Co. v. Elbert*,[32] advocated abolishment of diversity jurisdiction because it had outlived its usefulness. In another case, the dissenting opinion of Mr. Justice Brennan accused the majority of a "distaste for diversity jurisdiction."[33] Mr. Justice Black has characterized the Court as having adopted the corollary position of extending permissible state jurisdiction:

> . . . a trend is clearly discernible toward expanding the permissible scope of state jurisdiction over foreign corporations and other nonresidents. In part this is attributable to the fundamental transformation of our national economy over the years.[34]

Previous decisions of the Court of Appeals for the Second Circuit

[29] See HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 917-18 (1953); Mason v. American Express Co., 334 F.2d 392, 398 (2d Cir. 1964).

[30] The Supreme Court stated in *Russell*, 288 U.S. at 480:

> The tradition of the common law is to treat as legal persons only incorporated groups and to assimilate all others to partnerships. . . . The tradition of the civil law, as expressed in the Code of Puerto Rico, is otherwise.

At least two federal courts have distinguished the *Russell* case because the decision is based upon Puerto Rico civil law. R. H. Bouligny, Inc. v. United Steelworkers of America, 336 F.2d 160 (4th Cir. 1964), *cert. granted*, 379 U.S. 958 (1965); Gaunt v. Lloyds America of San Antonio, 11 F. Supp. 787 (W.D. Tex. 1935). *Cf.* Sutherland v. United States, 74 F.2d 89, 93 (8th Cir. 1934).

[31] See, *e.g.*, Louisiana Power & Light Co. v. Thibodaux City, 360 U.S. 25, 41 (1959) (Brennan, J., dissenting); Lumbermen's Mut. Cas. Co. v. Elbert, 348 U.S. 48, 53, 59-60 (1954) (Frankfurter, J., concurring); Burford v. Sun Oil Co., 319 U.S. 315, 334, 336 (1943) (Douglas, J., concurring); Frankfurter, J., dissenting); Indianapolis v. Chase Nat'l Bank, 314 U.S. 63, 76, 84 (1941) (Jackson, J., dissenting); JACKSON, THE SUPREME COURT IN THE AMERICAN SYSTEM OF GOVERNMENT 38 (1955).

[32] 348 U.S. 48, 53 (1954). Mr. Justice Frankfurter said:

> [B]y overruling the doctrine of *Swift v. Tyson*, despite its century-old credentials, this Court uprooted the most noxious weeds that had grown around diversity jurisdiction. What with the increasing permeation of national feeling and the mobility of modern life, little excuse is left for diversity jurisdiction, now that Erie Railroad Co. v. Tompkins, 304 U.S. 64, has put a stop to the unwarranted freedom of federal courts to fashion rules of local law in defiance of local law. *Id.* at 56.
>
> Can it fairly be said that state tribunals are not now established on a sufficiently "good footing" to adjudicate state litigation that arises between citizens of different States, including the artificial corporate citizens. . . . *Id.* at 59.

[33] Louisiana Power & Light Co. v. Thibodaux City, 360 U.S. 25, 41 (1959).

[34] McGee v. International Life Ins. Co., 355 U.S. 220, 222 (1957).

have also recognized " 'doctrinal trends' in the Supreme Court... manifesting a marked disposition not to enlarge but to reduce federal jurisdiction...."[35]

In 1958 Congress amended section 1332 of the Judicial Code[36] to provide that a corporation shall be deemed a citizen of any state in which it is incorporated and also of the state in which it maintains its principal place of business. This provision was intended to limit the availability of federal courts when the sole basis for federal jurisdiction is diversity of citizenship,[37] as diversity will rarely occur when a corporation is a citizen of both the state of incorporation and the state where it conducts its principal activities.

There are several reasons why the Supreme Court and Congress wish to limit federal jurisdiction. The caseload of the federal judiciary is critically overburdened.[38] The feeling exists that the time and energy of the federdal judiciary should be preserved for resolving those controversies in which federal interests are at stake.[39] Because these matters were not taken into consideration, the "legal characteristics" test of the principal case is subject to the same criticism as *Chapman, i.e.,* a mechanical approach which fails to consider the underlying reasons for extending or limiting diversity jurisdiction.

The test of the principal case will be difficult to apply because of conflicting definitions of "essential legal characteristics." Defendant association, for example, was previously found *not* to possess the essential characteristics of a legal entity by the Court of Appeals for the

---

[35] Zalkind v. Scheinman, 139 F.2d 895, 903 (2d Cir. 1943). See Kresberg v. International Paper Co. 149 F.2d 911, 913 (2d Cir. 1945).

[36] 28 U.S.C. § 1332(c) (1958).

[37] S. REP. No. 1830, 85th Cong., 2d Sess. 3 (1958); H.R. REP. No. 1706, 85th Cong., 2d Sess. 2-3 (1958). See generally Moore & Weckstein, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited,* 77 HARV. L. REV. 1426, 1431-33 (1964); Note, 44 MINN. L. REV. 308, 310-14 (1959).

[38] At the forty-second annual meeting of the American Law Institute, Chief Justice Warren commented:

> I have had to report to you the ever-increasing workload of our federal courts and the backlogs which have occurred in judicial process. It had been my expectation that with the authorization of 73 new judgeships in 1961, we would by this time have seen a substantial decline in these serious backlogs. I must admit to disappointment and grave concern, however, that we have made so little progress in conquering this situation . . . I must . . . express to you my feeling of alarm that our solution to the mounting workload of the courts seems to depend so largely on the creation of additional judgeships. 33 U.S.L. WEEK 2613 (1965).

See also ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS, 167, 175 (Tent. Draft No. 2, 1964). For earlier data see Wechsler, *supra* note 24, at 234; Clark, *Diversity of Citizenship Jurisdiction of the Federal Courts,* 19 A.B.A.J. 499 (1933).

[39] See generally Lumbermen's Mut. Cas. Co. v. Elbert, 348 U.S. 48, 53 (1954) (Frankfurter, J., concurring). See also Wechsler, *supra* note 24, at 238.

Sixth Circuit.[40] In fact, neither *Russell* nor *Mason* specify the essential characteristics which are necessary to constitute an association a "legal entity separate from its individual members."[41] Application of the "essential legal characteristics" test to the largest class of unincorporated associations—labor unions—was explicitly rejected by the Fourth Circuit.[42] The Fourth Circuit limited *Russell* to its facts, and found that Congress, in amending section 1332 of the Judicial Code, had specifically restricted diversity jurisdiction to corporations.[43] The Supreme Court has granted certiorari on this decision, and it is scheduled for argument early in the October 1965 term.[44]

The American Law Institute has recently proposed that an unincorporated association capable of suing or being sued in its common name in the state where an action is brought shall be deemed a citizen for diversity purposes of the state where it has its principal place of business.[45] The ALI proposal is justified on the grounds that it will not force the association (particularly labor unions) to circumvent *Chapman* by way of a class action under rule 23(a) of the Federal Rules of Civil Procedure.[46] As this proposal disregards the "essential legal characteristics" of an association, many organizations that would qualify for diversity under the ALI proposal would not qualify under the test adopted in the principal case.

A possible alternative to the "legal characteristics" test of the principal case, and to the ALI proposal, would be to grant an unincorpo-

[40] Brocki v. American Express Co., 279 F.2d 785 (6th Cir. 1960), *cert. denied*, 364 U.S. 871 (1960).

[41] The *Russell* and *Mason* opinions may provide "guidlines" for determining when an association possess sufficient characteristics to be deemed a citizen (see notes 8 & 9 *supra*), but they did not specify whether all those standards were necessary characteristics. *Cf.* Comment, *Unincorporated Associations: Diversity Jurisdiction and the ALI Proposal*, 1965 DUKE L.J. 329, 337 (1965).

[42] R. H. Bouligny, Inc. v. United Steelworkers of America, 336 F.2d 160 (4th Cir. 1964), *cert. granted*, 379 U.S. 958 (1965).

[43] See *supra* note 37 and accompanying text. Other reasons may be more compelling for rejecting application of the principal case to labor unions. Extending federal jurisdiction solely on the basis of diversity may have created serious inconsistencies in the statutory scheme for labor regulation. See Note, 39 N.Y.U.L. REV. 1124, 1126 (1964).

[44] 379 U.S. 958 (1965). *Bouligny* will be the first case since 1904 in which the question of whether an unincorporated association shall be deemed a citizen for diversity purposes is directly presented before the Supreme Court. Previously, the Court had denied certiorari in cases which presented this question. See cases cited *supra* note 7.

[45] ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS § 1301(b)(2), at 8 (Tent. Draft No. 2, 1964). Most jurisdictions have statutes allowing unincorporated associations to sue or be sued as an entity. Comment, 66 YALE L.J. 712, 714 (1957).

[46] ALI, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURT 61-62 (Tent. Draft No. 2, 1964). *Cf.* Note, *The Problem of Capacity in Union Suits: A Potpourri of Erie, Diversity and the Federal Rules of Civil Procedure*, 68 YALE L.J. 1182, 1185 (1959).

rated association juridical status for diversity purposes whenever the circumstances of the particular case warranted such an approach. This "equitable result" test has been applied to a corporation in order to find it an association of persons rather than a legal entity as necessary to "promote justice" or to "obviate inequitable results."[47] Other legal fictions adopted by the common law (*e.g.*, "juridical entity", "piercing the corporate veil", "alter ego") have resulted in the court's losing sight of the basic rationale underlying the legal fiction. The analysis in the principal case follows this approach, and consequently fails to ask the critical question: is diversity jurisdiction justified in this case by local prejudice, economic considerations, or some other compelling reason?

[47] Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 HARV. L. REV. 1373, 1402 (1938) as quoted in LATTIN, CORPORATIONS 67 (1959). *Cf.* Wechsler, *Federal Jurisdiction and the Revision of the Judicial Code*, 13 LAW & CONTEMP. PROB. 216, 238-40 (1948). Professor Wechsler advocated that the diversity jurisdiction should be limited to "situations where it is in fact responsive to such need." *Id.* at 240.