A LOOK AT SECURITIZED TRUSTS AND DIVERSITY JURISDICTIONS

In a good news ruling for Investors in mortgage real estate trusts, the Ninth Circuit Court of Appeals has published a decision which allows securitized trusts to stay in federal court based on diversity jurisdiction. The Court rejected an argument that would have jeopardized the ability of investment trusts to ever remove a lawsuit to federal court on diversity jurisdiction grounds. *See Demarest v. HSBC Bank USA, N.A. as Tr. for registered holders of Nomura Home Equity Loan, Inc., Asset-Backed Certificates, Series 2006-HE2*, No. 17-56432, 2019 WL 1510430 (9th Cir. Apr. 8, 2019). Federal Courts are preferred for those with mortgage investment interests for a number of reasons, such as locale, court processes, efficiency, and quality.

The *Demarest* case involved a borrower, Joan Demarest, who initiated several suits to stall foreclosure on property securing her loan after she defaulted on her loan. Demarest filed her latest suit against "HSBC Bank USA, N.A.," the entity serving as trustee for an investment trust (the "Trust") to which Demarest's note and deed of trust had been transferred. The defendant in the suit removed the case to federal court, identifying itself as "HSBC Bank USA, N.A., as Trustee for the Registered Holders of Nomura Home Equity Loan, Inc., Asset-Backed Certificates, Series 2006-HE2," providing the full name of the Trust. The Trust's removal notice advised that removal was proper based on diversity jurisdiction because Demarest was a California citizen and HSBC was a national banking association considered a citizen of Virginia for diversity jurisdiction purposes.

Demarest did not challenge the removal during the trial court proceedings. However, when the Trust later prevailed on summary judgment, Demarest appealed, asserting for the first time that an investment trust could only establish diversity jurisdiction by showing that the citizenship of all of its beneficiaries – not just its trustee – was diverse from the plaintiff.

Although the Ninth Circuit has ruled for decades that a trust's citizenship is that of its trustee, Demarest argued that this precedent had been overturned three years ago, when the U.S. Supreme Court considered the case, *Americold Realty Trust v. Conagra Foods, Inc*., 136 S. Ct. 1012 (2016). In *Americold*, the Supreme Court was asked to determine whether diversity jurisdiction existed in a case involving an unincorporated real estate investment trust created under Maryland law, which had brought suit in its own name, as it was authorized to do pursuant to Maryland statute. The *Americold* Court concluded that the Maryland trust's citizenship for diversity jurisdiction purposes was that of the trust's members rather than its

trustees, likening the Maryland trust to a limited partnership or joint-stock company, artificial entities whose citizenship is determined by its members or shareholders. *Id*. at 1016-1017.

Since *Americold*, courts determining the citizenship of a trust for purposes of assessing diversity jurisdiction have applied different tests, but typically consider both the identity of the party actually named in the suit, as well as evaluate the type of trust involved. *See, e.g., Bynane v. Bank of New York Mellon for CWMBS, Inc. Asset-Backed Certificates Series 2006-24*, 866 F.3d 351, 357 (5th Cir. 2017) **("Where a trustee has been sued or files suit in her own name, the only preliminary question a court must answer is whether the party is an active trustee whose control over the assets held in its name is real and substantial**"); *Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017) (holding where a party trust was created "from trust agreements establishing only traditional fiduciary relationships" and is not a distinct entity under state law, legal proceedings were properly brought against the trustee and the trustee's citizenship controlled). Until *Demarest*, the Ninth Circuit had not yet weighed in on the issue. Accordingly, Joan Demarest argued that *Americold* constituted a "sea change" in how courts determine the citizenship of a trust, and required the Ninth Circuit to find that an investment trust's citizenship was that of all of its beneficiaries.

Had Demarest prevailed in her argument, an investment trust's ability to remove a case on diversity jurisdiction grounds would have been precluded unless the trust could prove that no beneficiaries of the trust resided in the same state as the borrower – a potentially formidable task, as the beneficiaries of these trusts presumably reside in many states across the country. The Ninth Circuit rejected the argument, however, finding that the citizenship of an investment trust, sued in its own name, and arising out of a trust agreement containing typical fiduciary powers, is the citizenship of its trustee.

The Court's decision was premised on two separate grounds. First, the Court distinguished *Americold* from *Demarest* on the grounds that the trust in *Americold* had brought suit in the trust's own name, as it was allowed to under Maryland law. In contrast, Demarest had brought suit against "HSBC Bank, N.A.," itself, naming the Trustee only and not the Trust. The Demarest Court noted that *Americold*, as well as other prior Supreme Court precedent, supported the ruling that **"when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes."** *Demarest*, 2019 WL 1510430, at *5

(citing *Americold*, 136 S. Ct. at 1016; *Navarro Savings Assn. v. Lee*, 446 U.S. 458, 462-466, 100 S. Ct. 1779 (1980)).

Second, the Ninth Circuit distinguished the mortgage-backed investment trust in *Demarest* from the Maryland investment trust in *Americold*, finding that the Trust in *Demarest* was, "under any criteria, properly characterized as a traditional trust." 2019 WL 1510430, at *5. The Court noted that traditionally a trust was not considered a distinct legal entity capable of suing and being sued, and that the Maryland trust in *Americold* therefore differed from a traditional trust because it was authorized by statute to sue in its own name. Further, the Trust Agreement governing the Trust in *Demarest* indicated that it was a common law trust governed by New York law and provided that HSBC as Trustee had the power to hold the Trust's assets, sue in its own name, transact the Trust's business, and engage in other necessary activities. HSBC as Trustee was therefore the real party in interest for the Trust, given it possessed "certain customary powers to hold, manage, and dispose of assets for the benefit of others." 2019 WL 1510430, at *5. The Court held that, as the real party in interest, a trustee's citizenship controlled for purposes of the diversity jurisdiction analysis.

In sum, the *Demarest* Court concluded that *Americold* was limited in application, and did not upset Ninth Circuit or prior U.S. Supreme Court precedent holding that **WHERE A TRUSTEE IS SUED IN ITS OWN NAME OR WHERE IT IS A TRADITIONAL TRUST THAT IS SUED, THE CITIZENSHIP OF THE TRUST REMAINS THAT OF ITS TRUSTEE.**