

## 10th Circ. Limits Diversity Jurisdiction For MLPs

*Law360, New York (November 13, 2015, 5:27 PM ET)* -- Although master limited partnerships (MLPs) first came into existence in the early 1980s, there has been no definitive guidance from the U.S. Supreme Court or Congress on the method for determining an MLP's citizenship for purposes of diversity jurisdiction. Recently, however, the Tenth Circuit Court of Appeals, in *Grynberg v. Kinder Morgan*, became the first federal appellate court to examine the MLP structure as it relates to citizenship, and ruled that the citizenship of an MLP consists of each of its individual unitholder's citizenship.[1] In many cases, this may involve tens or hundreds of millions of units owned by individuals across most, if not all, of the 50 states. If the Tenth Circuit's holding in *Grynberg* is adopted by other circuit courts or the U.S. Supreme Court, federal lawsuits by or against MLPs based on diversity jurisdiction may be few and far between.



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### Overview of MLPs

In the last decade, MLPs have become an increasingly popular structure for companies in the oil and natural gas industry. Similar to limited partnerships, MLPs have one or more general partners, as well as any number of limited partners. The general partners manage the partnership's affairs, while limited partners, known as unitholders, provide capital to the partnership and have no role in management. MLPs are distinct from traditional limited partnerships and similar to public corporations in that ownership interests in MLPs are publicly traded on exchanges, such as the New York Stock Exchange and Nasdaq. When an investor buys units in an MLP, that individual becomes a limited partner of the MLP.

Energy companies with MLP status and their investing unitholders achieve significant tax and investment benefits. Unlike a C corporation, which is taxed at the corporate level and separate from its owners, MLPs are classified as partnerships, which allows for pass-through tax treatment on income. While the MLP's ownership interests — or common units — are publicly traded like corporate stock, the MLP pays no tax on its earnings, but instead pays earnings as cash distributions to investors.

The Internal Revenue Code limits MLP status to entities that generate at least 90 percent of their gross income from qualifying sources, such as natural resource activities, interest, dividends, real estate rents, gain from sales of real property, and income and gain from commodities or commodity futures. Natural resource activities include the “exploration, development, mining or production, processing, refining, [or] transportation ... of any mineral or natural resource,” such as petroleum and natural gas. 26 U.S.C. § 7704(d)(1)(E). Many MLPs are involved in the energy markets, given the code’s definition of qualifying income.

### **Citizenship of Unincorporated Associations**

To maintain a lawsuit in federal court pursuant to the diversity statute, 28 U.S.C. § 1332, the amount in controversy must exceed \$75,000 and no plaintiff may be a citizen of the same state as any defendant. A corporation is a citizen of (1) its state of incorporation and (2) the state where its principal place of business is located, which is the state in which the corporation’s nerve center is located. The Supreme Court, however, has “firmly resisted extending that treatment to other entities,”[2] and ruled that the citizenship of limited partnerships is determined by the citizenship of all its partners. Although the Supreme Court’s Carden decision involved the citizenship of limited partnerships, federal courts have applied the Carden rationale to other forms of unincorporated associations, including limited liability companies.[3]

Under the Supreme Court’s Carden decision and its progeny, only incorporated entities possess legal personhood, and unincorporated entities are citizens of the various states of their constituent partners or members. For example, the citizenship of an LLC is not determined by the state in which the LLC is organized. Rather, the citizenship of each of the LLC’s members must be examined. While this may be a simple proposition if an LLC has a single member that is an individual or corporation, the analysis can become much more convoluted if the LLC has multiple members that are, themselves, unincorporated associations (e.g., additional LLCs or limited partnerships). In these circumstances, courts have held that the citizenship of an LLC is determined by an upstream analysis of the entities’ organizational structure.[4] In complex organizational structures, an analysis of multiple layers may be necessary to determine whether parties to a lawsuit are diverse.

### **Grynberg v. Kinder Morgan: Unitholders’ Citizenship Determines MLP Citizenship**

In Grynberg, the plaintiffs petitioned the U.S. District Court for the District of Colorado to vacate an arbitration award that was entered against them and in favor of two Kinder Morgan entities, one of which was an MLP, and the other a limited partnership. The plaintiffs invoked the court’s diversity jurisdiction on the basis that the plaintiffs were citizens of Colorado, the Kinder Morgan MLP was a Delaware MLP, and the Kinder Morgan limited partnership was a Texas limited partnership whose sole partner was the Kinder Morgan MLP.

The district court issued an order to show cause, stating that plaintiffs' petition did not allege diversity jurisdiction because it did not identify the citizenship of the Kinder Morgan MLP or the Kinder Morgan limited partnership. The court ordered the plaintiffs to identify all of the Kinder Morgan MLP unitholders, as well as the members of the Kinder Morgan limited partnership. After the plaintiffs explained that one defendant was a publicly traded MLP, and that the other defendant was wholly owned by the MLP, the plaintiffs argued that the Supreme Court's Carden ruling was inapplicable because Carden addressed traditional limited partnerships and did not apply to publicly traded entities with tens if not hundreds of thousands of unitholders. The plaintiffs argued that given the structure and function of MLPs, MLPs should be treated like corporations and their citizenship should be determined by their principal place of business and state of formation.

The district court disagreed, concluded that Carden controlled, and dismissed the action for lack of jurisdiction. The Tenth Circuit Court of Appeals affirmed, holding that "the citizenship of an MLP consists of its unitholders' citizenship."<sup>[5]</sup> In so ruling, the court held that the Carden rule applies to MLPs because they are unincorporated associations, formed under state law as limited partnerships or LLCs, and are classified as partnerships for federal tax purposes.

The plaintiffs also argued that application of Carden to MLPs would effectively preclude diversity jurisdiction over MLPs. The court noted the plaintiffs' public policy argument, but followed the Supreme Court's prior observation that whether certain unincorporated associations should be "assimilated to the status of corporations for purposes of diversity purposes, how such citizenship is determined, and what if any related rules ought to apply, are decisions ... suited to the legislative and not the judicial branch."<sup>[6]</sup>

### **Impact of Grynberg**

While MLPs bear certain characteristics of corporations, several district courts<sup>[7]</sup> and now a circuit court treat MLPs as LLCs and limited partnerships for purposes of determining citizenship. Plaintiffs seeking to invoke a federal court's diversity jurisdiction in claims against MLPs, and MLPs wishing to assert claims in federal court based on diversity, should engage in a probing analysis of the MLP unitholders' citizenship. In many cases, diversity may not exist in any federal court due to an MLP unitholder's presence in each of the 50 states. Further, to the extent claims based on diversity are brought by or against LLCs or limited partnerships that have members or partners that are publicly traded MLPs, federal courts may examine the citizenship of each unitholder to determine whether any unitholder's citizenship destroys diversity. Whether and to what extent the Supreme Court or Congress addresses this issue remains to be seen, but the recent trend in federal court jurisprudence suggests diversity jurisdiction over MLPs is extremely limited.

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[1] Grynberg v. Kinder Morgan Energy Partners LP, No. 14-1465, 2015 WL 6647045 (10th Cir. Nov. 2, 2015).

[2] Carden v. Arkoma Associates, 494 U.S. 185, 189 (1990).

[3] See, e.g., Cosgrove v. Bartolotta, 150 F.3d 729, 731 (7th Cir. 1998) (observing that an LLC “is like a limited partnership”); Zambelli Fireworks Mfg. Co. Inc. v. Wood, 592 F.3d 412, 420 (3d Cir. 2010).

[4] See, e.g., Mut. Assignment & Indemnification Co. v. Lind-Waldock & Co. LLC, 364 F.3d 858, 861 (7th Cir. 2004) (“[Defendant] is a limited liability company, which means that it is a citizen of every state of which any member is a citizen; this may need to be traced through multiple levels if any of its members is itself a partnership or LLC.”).

[5] Grynberg, 2015 WL 6647045, at \*2.

[6] Id. at \*5 (quoting United Steelworkers of Am., AFL-CIO v. R.H. Bouligny Inc., 382 U.S. 145, 153 (1965)).

[7] See, e.g., LL & E Royalty Tr. ex rel. Parsons v. Quantum Res. Mgmt. LLC, No. 14-cv-13833, 2015 WL 4274987, at \*5 (E.D. Mich. July 14, 2015); Great Lakes Gas Transmission LP v. Essar Steel Minn. LLC, No. 09-cv-3037, 2015 WL 2070558, at \*5 (D. Minn. May 4, 2015); Stevens Eng'rs & Constructors Inc. v. MarkWest Liberty Midstream & Res. LLC, No. 14-cv-00054-RBJ, 2014 WL 2922631, at \*2 (D. Colo. June 27, 2014); Gonyer v. Enbridge Energy Ltd. P'ship, No. 1:13-cv-796, 2014 WL 1255915, at \*1-2 (W.D. Mich. Mar. 26, 2014); Trafigura AG v. Enter. Prods. Operating LLC, 995 F. Supp. 2d 641 (S.D. Tex. 2014); Ada Cty. Highway Dist. v. Nw. Pipeline GP, No. 1:12-cv-00184-BLW, 2012 WL 4737869, at \*1 (D. Idaho Oct. 3, 2012); Vosburg v. Williams Field Servs. Co., No 3:11-cv-1624, 2011 WL 3881277, at \*2 (M.D. Pa. Sept. 2, 2011).