Bad-Faith Litigation

Fraudulent Joinder of Insurance Employees

By Kyle M. Heisner

To defeat diversity jurisdiction and removal to federal court, plaintiffs' attorneys have increasingly attempted to join the claims professional who handled a plaintiff's claim as a defendant to litigation.

Any allegations of bad faith against an insurance carrier are inextricably tied to the actions of one or more of the individuals who work for that carrier. With this in mind, states have drafted statutory bad-faith laws that allow punitive damages against insurance carriers for bad-faith claim handling by their employees. Only two states—Alaska and New Hampshire—recognize a duty of care owed by a claims professional to an insured. Nevertheless, there is a growing trend by plaintiffs to join claims professionals as defendants under alternative theories in bad-faith cases.

Plaintiffs bringing these causes of action face a difficult hurdle in proving personal liability against the claims professional. Even if they are successful in proving liability, it is unlikely that they will make a significant financial recovery from that individual. Given these obstacles, what incentive do plaintiffs have for pursuing these actions?

The answer lies in 28 U.S.C. §1332, which grants original jurisdiction to United States District Courts for cases in which there is diversity of citizenship between the plaintiffs and all defendants and the amount in controversy exceeds $75,000. Insurance disputes most often take place between a single plaintiff, or multiple plaintiffs from the same household, and a single insurance company, which is a citizen of its state of incorporation. As a result, most bad-faith lawsuits involve plaintiffs suing national insurance companies that are not citizens of the same state. When a claim for punitive damages is being made in addition to the economic claim for insurance benefits, the amount in controversy will often exceed the $75,000 threshold due to damage multipliers. These factors result in an insurer defendant being permitted to seek removal from state to federal court based upon diversity jurisdiction.

In a preemptive strike against the removal of a bad-faith case to federal court, plaintiffs have increasingly joined employees of the insurance company—typically a claims professional who handled their claim—as defendants along with the insurer under tort theories such as negligent misrepresentation, conspiracy, or intentional infliction of emotional distress. The objective in doing so is to defeat complete diversity between a local plaintiff and a national insurance carrier defendant by also naming an employee of the insurance carrier from a local office.

Claims against individual employees of insurance companies are rarely,

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if ever, successful and serve as thinly veiled vehicles to destroy diversity jurisdiction. Nevertheless, recent court decisions have emboldened this strategy by granting motions to remand even when the claims against an employee are dubious at best. Insurers must be wary of this growing tactic and prepare to argue against the merits of a plaintiff's case against these individual defendants in the initial stages of litigation, without the benefit of full discovery.

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Perceived Benefits of State and Federal Court Systems

The motive behind joining claims professionals as defendants in bad-faith lawsuits is not ultimately to recover damages against the individual being sued. In fact, because the standard bad-faith statute is drafted to permit only an award of punitive damages against an "insurer," plaintiffs must bring a separate cause of action against a claims professional, often of questionable merit. After the deadline for removal has passed, most plaintiffs will abandon their effort to show personal liability of such a claims professional and focus on the deeper pockets of the insurance carrier. The rationale for this strategy lies in the perceived advantages and disadvantages of state and federal courts, respectively, for plaintiffs.

Among both the plaintiffs' and the defense bars, the general school of thought is that state courts are more favorable to plaintiffs and federal courts to defendants. A basis for the notion that state courts are better jurisdictions for plaintiffs is that forum shopping allows them to target more specific state venues and corresponding jury pools than they could in federal courts, which encompass entire states or regions. For example, Philadelphia is considered one of the most plaintiff friendly venues in the nation, and it has a jury pool of approximately 1.5 million residents. The Eastern District of Pennsylvania, however, encompasses nine total counties and adds approximately 4.5 million residents from the surrounding suburbs to the jury pool. This dilutes the Philadelphia residents to only 25 percent of the potential jury pool. Additionally, many plaintiffs' attorneys spend the bulk of their time in a particular state court and may wish to keep the case in state court to maintain a "home-court" advantage.

On the defense side, these perceived advantages to plaintiffs serve as an incentive for insurance carriers to remove cases from state to federal courts for the sake of eliminating any such advantages. A defendant could benefit from removing a case from a particularly plaintiff friendly venue or a venue where the plaintiff's attorney is well-known and well connected. More practical benefits of federal court are that the docket is often less crowded, which results in a faster track to the summary judgment stage and a more structured discovery format.

The federal courts' practice of assigning a judge to handle a case from inception to conclusion, which is not a universal practice among state courts, also makes the summary judgment process more effective. In federal cases, the judge reviewing a summary judgment motion has more experience with the background, procedural history, and facts of a case than a judge assigned solely for the purpose of reviewing and ruling upon such a motion. Particularly in venues with less crowded dockets than their state counterparts, this allows more time to analyze and weigh the merits of the case than might be possible in state court.

A more involved summary judgment process can favor defendants because, historically, defendants have had much greater success in having motions for summary judgment granted than plaintiffs. Summary judgment plays a particularly significant role in jurisdictions where the judge may dismiss a bad-faith claim if the evidence does not show that the insurance carrier committed malfeasance—rather than nonfeasance, *i.e.*, failure to perform a contractual duty—and meet the heightened "clear and convincing" burden of proof standard for bad-faith claims. It should be noted, however, that the standard to prove bad faith can vary from jurisdiction to jurisdiction.

Due to the weight given to the perceived benefits and disadvantages of the state and federal court systems by litigants, the first battle in a bad-faith lawsuit is often over a defendant's removal to federal court, which is followed by a plaintiff's motion to remand back to state court. The counterpunch to the tactic of joining claims professionals as defendants is to evaluate the basis set forth in the complaint for joinder of such an individual and where appropriate to raise the doctrine of fraudulent joinder to remove a case successfully despite an apparent lack of complete diversity.

Removal and the Doctrine of Fraudulent Joinder

Under 28 U.S.C. §1441(b), a civil action filed in state court may be removed to federal court when the requirements for diversity jurisdiction are met. Based upon the plain language of this statute, the joinder of a non-diverse claims professional in a bad-faith case serves to prevent an attempt by a defendant to remove the case to federal court. The doctrine of "fraudulent joinder" provides defendants with a vehicle to circumvent this tactic and to remove cases to federal court when the claim or claims against the non-diverse defendant are meritless.

To invoke the doctrine of fraudulent joinder, an insurance carrier must demonstrate that the plaintiff has not brought any cognizable claims against the non-diverse defendant. Specifically, the carrier must prove to the court that the plaintiff's jurisdictional allegations are fraudulent and made in bad faith or that the plaintiff has

no possibility of recovery against the non-diverse defendant. This latter scenario is the more common and does not involve any wrongdoing, per se, on the part of the plaintiff or the plaintiff's attorney despite the joinder's classification as "fraudulent." As explained by the Third Circuit in *Abels v. State Farm Fire and Cas. Co.,* 770 F.2d. 26, 32 (3d Cir. 1985), it simply means that there is no "reasonable basis in fact or colorable ground supporting the claim against the joined defendant." This same court, in *Batoff v. State Farm Ins. Co.,* 977 F.2d 848, 851 (3d Cir. 1992), added that there is a strong burden of proof imposed on a defendant alleging fraudulent joinder, and "if there is even a possibility that a state court would find that the complaint states a cause of action against any one of the resident defendants, the federal court must find that joinder was proper and remand to the state court."

Insurance carriers faced with the strong burden of proof to establish fraudulent joinder have come under increasing pressure to defend direct claims against their employees and to prove that no cause of action can be established against these individuals. At the initial pleading stage, the key to doing so is not to focus on the credibility of the allegations themselves, but rather, to focus on whether such allegations could result in a recovery against the defendant claims professional even if they proved to be true.

Jurisdictional Approaches to Joinder of Claims Professionals

Jurisdictions throughout the country have taken divergent approaches to the joinder of claims professionals in bad-faith cases in which the doctrine of fraudulent joinder has been invoked by a defendant seeking removal. Some courts are steadfast in holding that a claims professional cannot be personally liable for alleged bad faith, but others are reluctant to do this. Counsel must tailor their approach to removal of a state court complaint based upon the district in which the state court is located.

The prevailing view for decades following the enactment of bad-faith statutes was that bad-faith claims could only be brought against the insurance carriers and not individuals because the individuals were not parties to the insurance contract. This notion was reflected in the widely cited Supreme Court of California decision in *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973), which held that an investigator for the insurance company was not a party to the insurance contract and therefore not subject to an implied duty of good faith and fair dealing. The doctrine that a bad-faith claim was not colorable against an individual who did not have privity of contract with the plaintiff was widely accepted by courts as the majority view throughout the nation. Beginning in the 1990s, however, the protection afforded to employees of insurance carriers began to chip away.

In a seminal case from the Supreme Court of Texas, *Liberty Mutual Ins. Co. v. Garrison Contractors, Inc.*, 966 S.W.2d 482 (Tex. 1998), the court held that employees of an insurance company could be personally liable under the Texas Insurance Code if they engage in the business of insurance. Five years later, the highest court in West Virginia ruled, in *Taylor v. Nationwide Mutual Ins. Co.*, 589 S.E.2d 55 (W. Va. 2003), that a first-party claimant could potentially recover based on a bad-faith claim against a claims professional individually. A key issue in both of these cases was that the respective state bad-faith statutes specifically authorized bad-faith claims against an "individual." These two cases marked a trend that has since picked up momentum, even in states where the bad-faith statutes do not contemplate claims against individuals.

Texas

The trend toward personal liability of claims professionals is reflected in the Fifth Circuit opinion, *Gasch v. Hartford Accident & Indem. Co.*, 491 F.3d 278 (5th Cir. Tex. 2007), which held that the Southern District of Texas did not have diversity jurisdiction in a case in which a non-diverse claims professional was joined to the plaintiffs' complaint. In this case, the defendants argued that the plaintiffs did not present a colorable claim against the claims professional, a non-diverse defendant, because Texas law did not allow individual liability, and even if it did, the plaintiffs did not offer any evidence in support of their claim. The Fifth Circuit dismissed the first argument and cited the *Garrison Contractors* decision in holding that Texas does, in fact, allow a bad-faith claim against an individual claims professional in its bad-faith statute.

The Fifth Circuit in *Gasch* reached an interesting conclusion regarding the insurer's second argument, that the plaintiffs lacked evidence in support of their claim against the claims professional. The court found that the claims professional was not fraudulently joined, but not on the basis that there was sufficient evidence to establish the claim. Rather, the court held that the alleged deficiencies in the evidence provided by the plaintiffs applied equally to all defendants and not just the claims professional. In other words, the court held that there is no fraudulent joinder when the claims against the insurance carrier and claims professional are equally meritless: when this occurs, the proper recourse is to seek to dismiss the claims entirely rather than removing them to federal court. This decision potentially places an insurance defendant in the unusual position of arguing that there is less evidence of misconduct against one of its employees than against the carrier—which correspondingly suggests an admission of at least some degree of evidence of misconduct on the part of the carrier. The most prudent approach in these cases may be to argue fraudulent joinder as a secondary argument to a motion to dismiss.

Even with a broad bad-faith statute allowing claims directly against claims

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professionals, Texas courts have placed limitations upon the circumstances under which a claims professional may be sued individually for bad faith. For example, in *Davis v. Metro. Lloyds Ins. Co.*, Civ. Action No. 4:14-CV-957-A, 2015 U.S. Dist. Lexis 12879 (N.D. Tex. Feb. 3, 2015), the court admonished the plaintiff's counsel for using boilerplate allegations of bad faith in support of the claims against the individual claims professional. The *Davis* court analyzed the holding in *Gasch* and found that unlike in *Gasch*, the allegations against the insurance carrier were broader than those against the individual claims professional. As a result, the court held that the allegations against the non-diverse individual claims professional were to be disregarded for the purposes of diversity jurisdiction and the claims against the claims professional dismissed.

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Pennsylvania

A recent case out of Pennsylvania that continues to garner significant attention is *Kennedy v. Allstate Prop. & Cas. Ins. Co.*, Civ. Action No. 15-2221, 2015 U.S. Dist. Lexis 88327 (E.D. Pa. July 8, 2015). Unlike Texas and West Virginia, Pennsylvania's bad-faith statute only provides for a claim against an "insurer." In *Kennedy*, the complaint alleged that the individual claims professional defendants misrepresented and concealed material facts to delay the resolution of the claim. In opposing a motion to remand by the plaintiffs, Allstate argued that Pennsylvania law does not allow insurance company employees to be personally sued for their claims decisions because claims professionals owe no duty of care to an insured. The court noted that Pennsylvania state courts had not addressed the question of whether a claims professional owes a duty of care to an insured but that Alaska and New Hampshire have recognized such a duty.

Based upon this approach taken by two other states, the *Kennedy* court found "a possibility" that the Pennsylvania Supreme Court could decide that a claims professional owes a duty of care to an insured. *Kennedy* placed significance on the fact that the plaintiffs had already conducted pre-complaint discovery. Specifically, the plaintiffs supported their allegations with reference to claim logs and correspondence that purported to support their claims for negligent misrepresentation. The court found that Allstate failed to establish bad-faith intent in proceeding against the claims professional. Ultimately, the court rested its decision on the need for further guidance from Pennsylvania state courts about whether they will permit direct claims against claims professionals.

The *Kennedy* decision acknowledged that previous federal cases from Pennsylvania's district courts have touched on similar issues with different results. For example, the court in *Tippett v. Ameriprise Ins. Co.*, Civ. Action No. 14-4710, 2015 U.S. Dist. Lexis 37513 (E.D. Pa. Mar. 25, 2015), granted a motion to dismiss counts against an independent adjuster on the basis that "imposing a duty of care on the adjuster to the insured 'would allow for potential double recovery' from both insurer and adjuster for the same conduct." Moreover, the *Tippett* court noted that imposing a duty of care on the adjuster individually could create a conflict of interest when the duty of care owed to the insured conflicts with the contractual duty to follow any procedures or instructions from the insurance carrier. The *Kennedy* court declined to follow the lead of *Tippett* on the basis that the motion to dismiss in *Tippett* involved different standards than a motion to remand, and as a federal court opinion, it was not a binding interpretation of Pennsylvania substantive law.

New York

The New York Appellate Division did not consider the issue of fraudulent joinder in *Bardi v. Farmers Fire Ins. Co.*, 260 A.D.2d 783 (N.Y. App. Div. 3d Dep't 1999), but did find that claims professionals cannot be held personally responsible to plaintiffs because they are agents of the insurance carrier and perform actions at the direction of the carrier. Subsequent court decisions have cited this case when dismissing claims against claims professionals on the basis that there is no independent duty owed to insureds by claims professionals when acting in the scope of their employment for an insurance carrier.

An exception was carved out from this doctrinal rule by the court eight years later in *Ryan v. Preferred Mutual Insurance Company*, 38 A.D.3d 1148 (NY. App. 2007). In this case, a claim for negligent misrepresentation was made against a claims professional under a similar property damage claim. Unlike *Bardi*, however, the court in *Ryan* recognized an exception in this case to the rule that claims professionals are not personally liable for claims handling practices. Specifically, it held that individual liability could potentially be found against a claims professional when there was actual contractual privity or a relationship approaching privity. The court held that the test for whether such a relationship existed in the context of a negligent misrepresentation claim was (1) that the claims professional was aware that the representation was going to be used by the insureds for a particular purpose, (2) the insured relied upon the statement in furtherance of that purpose, and (3) conduct by the claims professional demonstrating that he or she understood the statement would be relied upon. The court determined that the plaintiff's complaint satisfied these criteria and the plaintiff could assert a claim against the claims professional individually.

California

California courts have also experienced a shift away from the doctrine that individual claims professionals could not be liable for alleged bad-faith claims handling. In *Icasiano v. Allstate Ins. Co.*, 103 F. Supp. 2d 1187 (N.D. Cal. 2000), the Northern District of California found that an agent of an insurance company is generally immune from personal liability when an insurance company is sued by a claimant, as long as they are acting within the scope of their position. The claims against the claims professional for conspiracy and negligent misrepresentation were deemed untenable because an agent of an insurance company does not independently hold any duties to the insured.

Recently, however, California's 4th District Court of Appeal departed from the principles set forth in *Icasiano*, determining that a claims professional could be found independently liable for claims handling practices, in certain circumstances. The court's decision in *Bock v. Hansen*, 225 Cal. App. 4th 215 (2014), represents what may be considered bad facts making bad law. In this opinion, the court outlines a series of allegations made by the insureds regarding misconduct by the claims professional, which, in the court's words, can "best be described as appalling."

In addition to bad-faith claims against the insurance company, the individual claims professional in *Bock* was sued for negligent misrepresentation and intentional infliction of emotional distress. These claims were based upon allegations that he altered the site of a claimant's property damage before taking pictures, spoke derogatorily toward the insureds, and caused the insureds to begin cleaning the scene themselves based upon a misrepresentation of policy coverage. The court made particular note of this last allegation, which also included a claim that one of the insureds cut her hand while performing the cleanup, in finding that the negligent misrepresentation claim was actionable. Even if the cut was an "incidental injury," the California court reasoned, the negligent misrepresentation claim was viable against the claims professional individually because it alleged damages separate and apart from any contractual damages. This decision may encourage direct claims against claims professionals where non-contractual damages are alleged. However, it remains to be seen how broadly subsequent courts will interpret this decision—or how creatively plaintiffs will plead physical or mental injuries resulting from claims handling practices.

Practice Tips

Claims professionals should always act in a courteous and professional manner when handling an insured's claim, even if they are not shown the same courtesy. It is important not to act in a way that could later serve as evidence in a bad-faith claim and used by a plaintiff to argue that personal liability should be found to punish a claims professional. Nevertheless, even when claims professionals do everything right, it is inevitable that attorneys bringing bad-faith claims will employ any strategy that they believe may help their client's case, including attempting to prevent removal to federal court by joining a non-diverse claims professional as a defendant.

If the trend of permitting plaintiffs to join claims professionals to defeat diversity continues to expand in scope, insurance carriers could face a new era of boilerplate complaints naming non-diverse claims professionals or other employees involved in claims handling as defendants to defeat diversity. Unless courts impose heightened joinder standards for questionable claims against insurance employees, or until they loosen the tight standards for proving fraudulent joinder, defense counsel must be cautious when handling the removal and remand process for a bad-faith claim.

Counsel representing insurance carriers must carefully assess the evidence for bad faith, if any, being cited in a plaintiff's complaint, remove the case to federal court when appropriate, and determine the best course of action for opposing a motion for remand by the plaintiff. The best approach for opposing remand when using the doctrine of fraudulent joinder will depend upon the approach that courts have taken in that jurisdiction.

In states such as Texas and West Virginia, where the language in the bad-faith statute explicitly contemplates bad-faith claims against individuals, arguing for removal under a fraudulent joinder theory is more difficult. Nevertheless, it is still possible to make a case that inclusion of a claims professional was done solely to defeat diversity jurisdiction.

"Badges" of Improper Joinder

In *Plascencia v. State Farm Lloyds*, No. 4:14-CV-524-A, 2014 U.S. Dist. Lexis 135081 (N.D. Tex. Sept. 25, 2014), the court outlined three "badges" of improper joinder. The first badge is when a plaintiff uses a boilerplate petition that appears to be developed for use in similar cases and was purposefully designed to defeat diversity jurisdiction. To address this issue, defense counsel should call attention to allegations that generically allege misconduct by the claims professional, if specific examples are not cited or exhibits are not attached in support of such allegations.

The second badge of improper joinder is when a plaintiff makes minimal or no attempt to serve the individual defendant.

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This demonstrates a lack of genuine intention actually to pursue the claim, so this should be highlighted when it is applicable. Counsel should also research how a court treats unserved defendants for the purposes of removal.

The final badge of improper joinder is one that should be common to fraudulent joinder claims in all states—the lack of a plausible reason for suing the in-state defendant other than to defeat diversity. In *Plascencia*, the court noted that there was no financial incentive for recovery against the individual defendant when the insurance carrier would be able to pay any judgment. Other factors, such as the presence of a second defense attorney and potential jury sympathy for an individual defendant, all demonstrated that there was no reasonable basis for the joinder other than to defeat diversity jurisdiction. None of these factors are determinative, however, and some subsequent court decisions have rejected their application.

Counsel representing insurance carriers must carefully assess the evidence for bad faith, if any, being cited in a plaintiff's complaint, remove the case to federal court when appropriate, and determine the best course of action for opposing a motion for remand by the plaintiff.

The considerations set forth above are equally applicable in jurisdictions where bad-faith statutes only contemplate bad faith causes of action against "insurers" but allow separate tort claims to proceed against claims professionals under certain circumstances. Additionally, counsel should seek information that could serve to distinguish their cases from those in which a fraudulent joinder argument was rejected. Specifically, counsel for insurers should recognize when the allegations against the claims professionals do not allege any new damages from those claimed against the insurance carrier.

For example, despite involving a claim for property damages, the allegations in California's *Bock v. Hansen* decision went beyond damages covered by the homeowners' policy and also included claims of physical injury resulting from the claims professional's actions. Particularly in fact-pleading states such as California, counsel should scrutinize the pleadings to determine whether a plaintiff has alleged any damages that are not contractual or punitive in nature. When the damages claimed against a claims professional are the same as those claimed against the insurance carrier, separate claims against the claims professional should not be permitted because they could result in a double recovery by the plaintiff. In notice-pleading states or when a complaint alleges damages caused by a claims professional apart from those attributed to the insurance carrier, a more in-depth analysis may be necessary to determine whether any such damages can be causally linked to the independent tort alleged against the claims professional.

Another argument that claims professionals may face is that a fiduciary or near-fiduciary relationship created a duty owed by the claims professional to the insured; this position was adopted by the New York Appellate Division in *Ryan v. Preferred Mutual*. In jurisdictions that allow such a finding, claims professionals will need to establish the standard for finding a fiduciary relationship. This standard should be strictly applied, and a court should not be swayed by a sympathetic plaintiff or allegations of particularly egregious conduct on the part of a claims professional. If the allegations against a claims professional are true and were performed at the direction of the carrier, the potential for bad-faith damages against the carrier is the proper remedy rather than imposing personal liability on the claims professional acting at his or her employer's direction. If an employee exposed his or her employer to bad-faith damages by taking rogue actions contrary to company policies and procedures, it should be left to the carrier to discipline its employee. Under neither scenario would it be appropriate to impose a duty when no fiduciary relationship existed.

Finally, counsel arguing against the joinder of a claims professional in jurisdictions such as Pennsylvania, where state courts have yet to rule on whether a cause of action is colorable against claims professionals individually, should remember that decisions such as *Kennedy v. Allstate* are not binding and that the issue remains undetermined until a state court rules on the issue. As such, removal to a federal court remains an option based upon the fraudulent joinder doctrine when a non-diverse claims professional is joined. To the extent that a court will consider such a claim potentially colorable, the factors set forth above should be analyzed when they apply to demonstrate that even if Pennsylvania is predicted to rule that claims professionals can be sued individually, the joinder should still be considered fraudulent based upon the intent of the plaintiff and the lack of evidence supporting the claim. Ultimately, however, both the plaintiffs' and defense bars will need guidance from state courts on this issue where it has not yet been decided.

Conclusion

The trend of allowing individual liability in bad-faith lawsuits is concerning because there is potential for the tactic to be applied to almost every bad-faith claim, due to a claims professional's integral role in the claims-handling process. Proponents of the approach may point to outlier cases of particularly egregious conduct by claims professionals, but the far more common scenario is that claims professionals are joined for no other reason than to defeat diversity jurisdiction in a lawsuit in which the plaintiff is unhappy with the proposed settlement amount. Courts must be mindful of the limitations available at the remand to distinguish meritorious allegations from those lodged merely as a procedural tactic. It is critical that attorneys be familiar with the most recent court rulings on this evolving issue and then tailor their arguments for fraudulent joinder accordingly. FD