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SOUTHERN DISTRICT JURIST REVISITS POST-DEPOSITION REMOVAL BASED ON IMPROPER JOINDER OF ADJUSTER

Last week, Federal District Court Judge Gray H. Miller from the Southern District of Texas revisited issues associated with a timely removal and improper joinder. In *Frisby v. Lumbermens Mutual Casualty Company*, H-07-015 (Feb. 20, 2007), Frisby was injured on the job while working for Administaff. Administaff provided worker's compensation insurance to its employees through Lumbermens. Specialty Risk Services was the TPA for Lumbermens, and Karen LaFleur was a claims adjuster with Specialty Risk and was charged with the handling and adjusting Frisby's worker's compensation claim. Frisby sued Lumbermens, Specialty and LaFleur in Galveston County in June, 2006. The defendants took Frisby's deposition in December, 2006. Specialty claimed that upon receipt of the deposition transcript on December 20, 2006, it realized that LaFleur was named as a defendant for the sole purpose of defeating federal diversity jurisdiction. Accordingly, Specialty and LaFleur removed the case to federal district court on January 3, 2007. Lumbermens gave notice of its consent to the removal that same date. Thereafter, on January 25, 2007, Frisby moved the court to remand the case to state court.

Frisby argued in favor of remand because Specialty's removal was allegedly untimely. Moreover, Frisby argued that even if the removal was timely, LaFleur was a valid defendant with causes of action against her that are recognized by Texas courts. Specialty countered that LaFleur was improperly joined, and therefore her citizenship should be ignored for diversity purposes. Specialty also relied upon 28 U.S.C. §1446(b) and Fifth Circuit precedent holding that the 30-day time period for removal begins to run from the time the improper joinder is discovered.

The Court began its analysis with a discussion of the timing of Specialty's removal and 28 U.S.C. §1446(b). Noting that the Fifth Circuit "has been quite clear that in cases of improper joinder, the 30 day time period begins to run from the time the improper joinder is discovered." Courts may look beyond the plaintiff's original state court pleadings when evaluating a motion to remand a case involving issues of improper joinder. In its notice of removal, Specialty noted that it did not discover that LaFleur was a sham defendant until it deposed Frisby on December 14, 2006. Therefore, removal less than 30 days later on January 3, 2007 was timely.

Next, the Court addressed the issue of improper joinder. The Court noted that Texas law provides when a removing party alleges improper joinder, it falls to that party to prove the "fraud" constituting improper joinder. In order to determine if joinder is improper, the court must decide based on the facts and the law whether a state court could reasonably impose liability on the improperly joined defendant. In the course of its analysis, the court should pierce the pleadings and perform a summary judgment type inquiry. Essentially, a court must make this threshold determination based on the evidence adduced by the parties and the record as a whole.

Noting that both Fifth Circuit and Texas Supreme Court precedent have held that Texas law does allow an insurance adjuster to be held liable under the Texas Insurance Code, the Court noted that before such liability may be imposed, the plaintiff must demonstrate through summary judgment evidence that the employee committed the alleged violation that caused the harm. "Therefore, the inquiry becomes whether the record contains any evidence to support any of the claims against LaFleur individually."

In applying this summary judgment-like standard to the motion to remand, the Court observed that Frisby alleged that LaFleur engaged in unfair settlement practices and misrepresented the insurance policy. Additionally, Frisby alleged that LaFleur violated seven subsections of the Texas Insurance Code, §541.060-61. However, Frisby did not offer any admissible evidence to support his claims. Instead, he argued that his petition satisfied the notice requirements under the Texas Rules of Civil Procedure, and should therefore survive scrutiny regarding improper joinder. The Court summarily dismissed such argument and, instead, relied upon *Smallwood v. Illinois Central R.R. Company*, 385 F.3d 568, 573 (5th Cir. 2004) (*en banc*) for the proposition that a Rule 12(b)(6)-like inquiry is the preferred methodology to determine whether joinder is proper. Where the facts presented in the plaintiff's petition do not sufficiently separate those actions attributable to the diverse versus non-diverse defendants, the court will conduct an inquiry as a summary judgment-like procedure as provided by *Smallwood*. Thus, the inquiry no longer centered on the plaintiff's state court petition, but on the record as a whole.

If the plaintiff chooses not to adduce any summary judgment evidence in its motion to remand, then the court may not presume that plaintiff could offer such evidence. Therefore, the court must perform its inquiry based on the pleadings of the plaintiff and the summary judgment evidence introduced by the defendant. In conducting its review, Judge Miller noted that the insured made various allegations against the adjuster. However, the insured offered "no single shred of evidence that LaFleur personally committed any of the acts which he accuses her of committing." The insured never once testified that the adjuster interacted with him. In fact, the insured testified that to his knowledge he had never spoken with the adjuster. Further, when asked what evidence he had that the adjuster intentionally delayed his medical care, Frisby replied "[j]ust 13 months in between the first surgery and the second surgery." The insured offered no evidence that the adjuster had any individual involvement in this case beyond being employed as the adjuster by Specialty. "Theoretically, a possibility exists that Frisby could have a viable claim under some portions of the Texas Insurance Code, but theory is simply not enough." On the other hand, the defendant had offered excerpts from the insured's deposition testimony which contradicted claims made in his own petition, including admissions that the adjuster never made any untrue statements to him, never failed to tell him an important fact, and never made a statement in a way that led him to a false conclusion. Accordingly, Specialty met its burden to show that the adjuster's joinder was improper.

[Note: Martin, Disiere, Jefferson & Wisdom L.L.P. has the privilege of representing Specialty Risk Services in this case.]

KNOWN LOSS DOCTRINE APPLIED TO ADVERTISING INJURY COVERAGE

Recently, a Federal District Court Judge from the Northern District of Texas addressed the application of the "Known Loss Doctrine" to Advertising Injury coverage. In *Sentry Insurance v. DFW Alliance Corp.*, 2007 WL 507047 (Feb. 16, 2007), National Diversified Sales (NDS) sued DFW and others for unfair competition, patent and trademark infringement, and breach of contract regarding the patents and trademarks. NDS alleged that prior to June 2000, the underlying defendants committed a subterfuge to unfairly compete with NDS. NDS also alleged the underlying defendants manufactured, distributed and sold plastic goods under an allegedly infringing trademark, trademark and/or patent since at least as early as January 2001.

After its formation, DFW obtained two CGL policies from Sentry. The first policy was in force from May 2002 through May 2003. Thereafter, the CGL policy was renewed for a consecutive one-year term. Both CGL policies contained coverage for "advertising injury," but only if the offense was committed in the coverage territory during the policy period. Also, the policies contained a "First Publication" exclusion which excluded advertising injuring arising out of oral or written publication of material whose first publication took place before the beginning of the policy period.

Sentry initiated this declaratory judgment action based upon the First Publication exclusion and the "Known Loss Doctrine." Sentry sought summary judgment declaring that it had no duty to defend DFW in the underlying litigation because the offenses that gave rise to the claims arose at least as early as January 2001 and long before the policies went into force and effect on May 2002.

The Court began its analysis by examining the rules associated with insurance policy construction and interpretation and the duty to defend. Next, the Court noted that the insurer bears the burden of establishing that one of the policy's limitations or exclusions constitutes an avoidance or affirmative defense to coverage. Sentry argued the First Publication exclusion excused it from defending DFW because part of the offending conduct began before the policy period commenced. DFW said it was unclear whether NDS alleged that DFW's use of the mark was itself a trademark infringement and Sentry did not allege that DFW made any oral or written publication of material before the commencement of the policy period. Thus, according to DFW, NDS's pleadings potentially stated a claim within coverage. Essentially, DFW contended that the First Publication exclusion did not apply to the type of advertising injury at issue in the underlying lawsuit. It reasoned that the exclusion only applied to contentions involving slander libel or a violation of a person's right of privacy. According to DFW, because the definition of "advertising injury" included four different offenses, only two of which pertain to oral or written publication of material, and because the First Publication exclusion is restricted to oral or written publication of material, the exclusion only applies to the two offenses that involve oral or written publication of material, *i.e.*, material that slanders, libels, or disparages a person or organization or violates a person's right of privacy. DFW maintained that because NDS's claims against DFW were for advertising injury covered by the remaining two offenses that do not involve oral or written publication of material, the First Publication exclusion did not apply.

Relying upon *Matagorda Ventures, Inc. v. Travelers Lloyds Insurance Company*, 208 F.Supp.2d 687 (S.D. Tex. 2001), the Court rejected DFW's argument. The Court found that the First Publication exclusion applied to all four enumerated advertising injury offenses. The Court then examined whether Sentry had established beyond peradventure that the claims that NDS brought against DFW were subject to the First Publication exclusion. Because Sentry relied on the third and fourth offenses listed in the definition of "advertising injury," (misappropriation of advertising ideas or style of doing business and infringement of copyright, title or slogan), for the exclusion to apply NDS must have alleged that the misappropriation or infringement arose from the publication of oral or written material. If Sentry made such showing, it must also establish NDS alleged that its claims arose from material that DFW published before the beginning of the policy period.

In examining NDS' factual allegations and pleadings, the Court noted that Sentry had failed to make the requisite showing. Finding that allegations of "preparation for infringement" do not equate to infringement or publication, the Court held Sentry failed to carry its burden. Additionally, allegations regarding the manufacture, distribution or sale of infringing products does not constitute "publication" as that term is understood in the context of the First Publication exclusion.

Sentry then argued that the "Known Loss" doctrine precluded coverage for NDS' claims. It asserted that the wrongful conduct about which NDS complained occurred long before the inception of the insurance policies and was known to have begun at the time the Sentry policy was issued, thus barring coverage. DFW responded that the Known Loss doctrine did not apply to allegations under the Lanham Act because intent was not a required element of a trademark infringement claim. The Court found the factual allegations in the underlying lawsuit alleged the infringing activity began before June 2000 and the allegations specified the activities that allegedly were undertaken, when they started, and who were the actors. As such, the Court concluded Sentry had established that the infringing activity, which began in June 2000 almost two years before the beginning of the Sentry policy, were precluded by the "Known Loss doctrine." Therefore, the "Known Loss doctrine" precluded Sentry's coverage of DFW for the claims asserted against it by NDS in the underlying lawsuits.

HOUSE BILL 1589 EXPANDS HB 1197

As reported in last week's Newsbrief, the 80th Biennial Session of the Texas Legislature is considering HB 1197 which would set mandatory auto policy limits at $25,000 for bodily injury or death per person/$50,000 per accident and $25,000 for property damage. However, HB 1589 has also been introduced into the Texas Legislature, which seeks to raise the mandatory auto policy limits to 40/80/30. We will continue to monitor these competing bills and report any developments on this significant issue.