

BAD FAITH BLOG

Contracting with Commercial Property Loss Adjusters from Other States Can Defeat Federal Diversity Jurisdiction

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The insured Grecian Delight Foods had an explosion at its factory which caused it to submit a claim. When Grecian Delight and its insurer could not agree how to resolve the \$26.76M claim, Grecian Delight filed suit against its insurer in state court for breach of contract, declaratory judgment, tortious interference, and bad faith. Grecian Delight additionally brought claims against the company hired to adjust the claim and its CEO for tortious interference with the insurance policy and the insured's contract with a third-party. The insurer removed the case arguing that the adjusting company and its CEO were fraudulently joined, but the court disagreed and held that the insurer had not met its burden of establishing that the claims against the adjuster and its CEO “[had] no chance of success.” For that reason, the case was remanded back to state court.

The underlying dispute began when the insured had an explosion at its factory. The insurer, a New York corporation with its principal place of business in Ohio, used GM Consultant USA LLC (“GMC”), a Delaware LLC with Illinois members, to assist with adjusting the claims. In order to continue operations following the explosion, the insured contracted with a third-party to supply temporary power generation and to provide necessary temporary commercial refrigeration equipment. The insurer did not directly participate in the contract negotiations between the insured and the third-party, but the contract was sent to the adjuster who made no objection. After the contract was entered, the insurer informed the insured that it believed the insured was being overcharged by \$200,000 and that the insured lacked industry knowledge to make a fair contract. This was the very beginning of an ongoing and continually escalating dispute regarding the amounts that the insurer would pay the insured under the policy.

The insured brought Illinois state law claims against the insurer for breach of contract, declaratory judgment, tortious interference, and bad faith, and additionally brought claims against the company hired to adjust the claim, its CEO, and the individual adjuster it employed for tortious interference with the insurance policy and the insured's contract with the third-party to provide temporary services. The insurer, in removing the case, argued that each of the claims against the other defendants had no chance of success and that the defendants were fraudulently joined to defeat diversity jurisdiction. The court first stated it would find the defendants fraudulently joined "only if there is no chance that [the insured] can succeed on its claims against [those defendants]." Then, the court went on to evaluate whether those claims might succeed.

Regarding the claim for tortious interference, the court rejected the insurer's argument that the claim was merely an attempt to recast allegations of the insurer's alleged bad faith to avoid the fact that Illinois does not recognize an independent bad faith tort claim in first-party insurance disputes. The insurer argued that no court would recognize a tort claim for bad faith conduct against an agent contracted by an insurer, where Illinois does not recognize that claim against an insurer. However, the Northern District found that Illinois case law suggests "that [an insured] may pursue a separate tortious interference with contract claim that does not depend solely on allegations of bad faith or unreasonable and vexatious conduct." Analyzing the allegations, the court, even while acknowledging that the claims were "somewhat thin," held they were sufficient to prevent removal based on fraudulent joinder; the insured alleged that the adjuster induced its insurer to fail to make timely payments.

Moreover, the court evaluated the claim for the adjuster's tortious interference with the insurance policy. The insurer cited Illinois law holding that an entity cannot be liable for interfering with its own contract. This rule extends to agents of one of the contracting parties. However, the insured argued that this conditional privilege for agents does not extend to actions that are unjustified or malicious. Moreover, even if the adjuster was not an agent and was merely an independent contractor as argued by the insured, the adjuster would be protected by a consultant's privilege, which is limited to honest advice in the scope of the engagement. The court noted that while the insured's allegations to overcome both privileges may not be successful, the court also could not find it had no chance of overcoming the privileges. Therefore, the court found that the insurer had failed to meet its high burden of showing that the parties were fraudulently joined.

Arguing for removal on the basis of fraudulent joinder is a high burden for defendants to meet. As such, the thinnest of allegations to create liability against another party in the litigation are often sufficient to defeat diversity jurisdiction and prevent removal. Insurers preferring to litigate high dollar exposure cases in federal court should remain aware of this when choosing to involve other entities in the claims process. If that adjusting company or its principals live in jurisdictions which will defeat federal jurisdiction, that retention could very well prevent removal to federal court should litigation arise.

Case Citation: Grecian Delight Foods, Inc. v. Great American Ins. Co. of New York, 365 F.Supp.3d 948 (N.D. Ill. 2019).