

## New York Federal Court Remands Interpleader Action in *Tyco* Case

June 2006

A New York federal district court, applying New York and federal law, has remanded to state court an interpleader action that was originally removed by a third-party defendant excess insurer, holding that the insurer did not have a right to remove the action and the court did not have original jurisdiction over it. *Fed. Ins. Co. v. Tyco Int'l Ltd.*, 422 F. Supp. 2d 357 (S.D.N.Y. Mar. 21, 2006).

A primary insurer, domiciled in Indiana and New Jersey, issued a series of D&O and fiduciary liability policies to Tyco. Tyco also had a series of excess professional liability policies with a number of insurers. Various officers and directors of Tyco were named as defendants in lawsuits alleging liability for misstatements about the company's finances, misrepresentations in SEC filings and misappropriation of hundreds of millions of dollars. There was also a criminal investigation that resulted in the indictments of four officers, two of whom were eventually convicted, including former CEO Dennis Kozlowski.

Kozlowski sought coverage for both the criminal trial and the various civil litigations from the primary insurer. In response, the insurer rescinded the policy and filed a declaratory judgment action against Kozlowski, Tyco and 14 other defendants. Kozlowski counterclaimed, seeking a declaration that the insurer had a duty to defend and advance defense costs. A state trial judge held that the insurer had to advance defense costs to Kozlowski until the insurer's rescission claims were litigated in its favor. (See the March 2004 issue of *The Executive Summary*.) This ruling was largely upheld on appeal. (See the March 2005 issue of *The Executive Summary*.)

After the trial court's decision, the primary insurer brought a "defensive interpleader" action in state court in which it contended that, although the defendants in the rescission action were not entitled to payments of defense costs or other loss, the insurer was concerned about being subjected to multiple adverse claims exceeding the \$25 million limit of its policy. The primary insurer therefore sought permission to pay defense costs attributable to Tyco and the interpleader defendants into court and require those parties to interplead their adverse claims to any amounts deposited. Kozlowski, in turn, sought to implead the first-layer excess insurer into the interpleader action as a third-party defendant. The trial court granted leave to implead the insurer and, in late 2004, two different third-party complaints from three of the four indicted officers were filed against the excess insurer. The excess insurer, domiciled in Indiana and Connecticut, removed the interpleader action to federal court and the third-party plaintiffs sought remand.

The court held that the excess insurer, as a third-party defendant, could not remove an action under 28 U.S.C. § 1441(a)'s provision that an action "may be removed by the defendant or the defendants." Noting that there was extensive judicial debate over the issue—but no decision on the issue by the Second Circuit—the district court found that the history of §1441(a), along with the U.S. Supreme Court's instruction to narrowly construe the removal statute in *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100 (1941), "strongly supports the notion that Congress intended to limit removal only to defendants and not to any other party, including third-party defendants." The court also found this conclusion served "the practical purpose of limiting a third-party from undermining the forum choices of both the plaintiff and defendant" and "optimally harmonize[d] federalism interests," given the relationship between the interpleader action and the rescission action, which remained in state court.

The district court also rejected the excess insurer's contention that it was entitled to remove under the "fraudulent joinder doctrine," in which a court overlooks the presence of a non-diverse defendant in its removal analysis if there is "outright fraud" in the plaintiff's pleadings or no possibility, based on the pleadings, that a cause of action could be asserted against that defendant in state court.

The court, however, concluded that the insurer's argument was better classified as "fraudulent misjoinder," where a plaintiff attempts to defeat removal jurisdiction by joining claims against multiple defendants where there is "no sufficient factual nexus among the claims to satisfy the permissive joinder standard." Without clear precedent on the issue, the court concluded that the excess insurer faced a similar standard in showing fraudulent misjoinder—either that it was fraudulently joined as a party or that there was no possibility that the claims against it could be permissively joined.

While the court noted that there was a "strong argument" that the excess insurer was not a proper third-party under Fed. R. Civ. P. 14(a), the court concluded that New York state joinder law governed because the issue was whether or not the insurer had been properly joined as a party before the removal—when the case was still in state court.

The court then suggested that the joinder of the insurer was debatable since the main issue in the interpleader action was the primary insurer's responsibilities, but refused to find misjoinder, relying somewhat on New York courts' broad interpretation of joinder rules, and primarily on the fact that the trial court already had "explicitly permitted Third-Party Plaintiffs to bring the third-party action against" the insurer.

The court next rejected the insurer's contention that it had original jurisdiction over the interpleader action once "the real parties in interest are properly realigned" because the primary insurer's citizenship did not count for diversity purposes in that it was, as a mere interpleader plaintiff, a "nominal party."

The court reasoned that the primary insurer was not the typical "disinterested stakeholder/[interpleader] plaintiff," but instead it continued to dispute its obligations to the interpleader defendants and had not yet deposited any money into the court.

Finally, the court rejected the assertion that it had original jurisdiction under the statutory interpleader provision, 28 U.S.C. § 1335, which only requires "minimal diversity." After considering law from other jurisdictions, the court found the clear majority rule to be that removal was not permitted under § 1441, which requires complete diversity, where the only basis for jurisdiction is minimal diversity under § 1335. The court then found that it actually lacked jurisdiction under § 1335 because the primary insurer had not yet deposited the entire amount in controversy into court (its full policy limits), a requirement for jurisdiction under the statute, and, in representations to the court, indicated that it was not planning to do so.