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SOUTHERN DISTRICT OF CALIFORNIA

BY:  DEPUTY

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

ADVANCED MARKETING SERVICES,
INC.,

Plaintiff,

vs.

COLUMBIA CASUALTY COMPANY,
CONTINENTAL CASUALTY COMPANY,
CNA FINANCIAL CORPORATION, and
DOES 1 through 10, inclusive,

Defendants.

CASE NO. 04-CV-1660-BEN (AJB)

**Order Granting Plaintiff's Motion
for Remand and Denying
Defendants' Motion to Dismiss as
Moot (Docket Nos. 11 and 18)**

On July 9, 2004, Plaintiff Advanced Marketing Services, Inc. ("AMS") filed a complaint in San Diego Superior Court alleging breach of contract and breach of the covenant of good faith and fair dealing, and requesting declaratory relief against Defendants Columbia Casualty Company ("Columbia"), Continental Casualty Company ("Continental"), and CNA Financial Corporation ("CNA"). Plaintiff's allegations stem from Defendants' refusal to pay on a directors and officers ("D&O") liability insurance contract between Plaintiff and Columbia. On August 16, 2004, Defendants removed the case to this Court, asserting diversity of the parties as a basis for federal jurisdiction under 28 U.S.C. § 1441(b). On August 24, 2004, Defendants brought a motion to dismiss Continental and CNA, with prejudice, from the lawsuit. On August 31, 2004, Plaintiff moved to

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04cv1660-BEN (AJB)

1 remand the case to state court. The Court took both motions under submission on October 21, 2004.
2 The Court now grants Plaintiff's motion to remand the case to state court and denies Defendants'
3 motion to dismiss as moot.

4 Background

5 AMS is a wholesale retailer of books. It is incorporated in Delaware and has its principal place
6 of business in San Diego County, California. AMS purchased D&O liability insurance from Columbia
7 for the term April 28, 2003 to April 28, 2004. (Compl. ¶ 6.) On July 22, 2003, a search warrant was
8 executed against AMS's business premises in connection with a federal criminal investigation. (Id.
9 ¶ 10.) A grand jury subpoena was also issued against AMS to compel the production of documents
10 relating to correspondence and meetings among the various AMS directors and officers. (Id. ¶ 11.)
11 In August of 2003, AMS requested reimbursement from Columbia for expenses associated with the
12 warrant and the subpoena pursuant to its D&O insurance policy. (Id. ¶ 13.) Columbia denied AMS's
13 claim. (Id. ¶ 14.)

14 On July 9, 2004, AMS filed a claim in state court against Columbia, Continental, and CNA.
15 In its complaint, AMS identified Columbia as a "wholly owned subsidiary" of Continental, an Illinois
16 corporation. (Id. ¶ 2.) Continental, in turn, was alleged to be a "wholly owned subsidiary" of CNA,
17 a Delaware corporation. (Id. ¶¶ 3, 4.) Plaintiff asserted that Defendant CNA "controls the day to day
18 operations of Continental and Columbia, determines whether such entities will have employees,
19 determines who will be an Officer and/or Director for those companies, incorporates the financial
20 results of those companies within its own books and records and otherwise exercises complete
21 dominion and control over such companies." (Id. ¶ 4.) Plaintiff also alleged that neither Columbia
22 nor Continental had employees who were responsible for handling this matter. (Id. ¶¶ 2, 3.) Plaintiff
23 set forth three causes of action: (1) breach of contract (Id. ¶¶ 30-33.); (2) declaratory judgment (Id. ¶¶
24 34-36.); and (3) breach of covenant of good faith and fair dealing. (Id. ¶¶ 37-44.).

25 On August 16, 2004, Defendants removed the case to federal court pursuant to 28 U.S.C. §
26 1441(b). In their notice of removal, Defendants claimed that both Columbia and Continental were
27 incorporated in Illinois, had their principal place of business in that state, and were diverse from AMS.
28 Defendants also argued that CNA and Continental were fraudulently joined in the case by Plaintiff,

1 meaning that their citizenship would be ignored by the Court when determining its jurisdiction.

2 Following their removal of the case to federal court, Defendants moved to dismiss Plaintiff's
3 case against CNA and Continental on similar grounds. Plaintiff opposed Defendants' motion and filed
4 its own motion to remand with the Court on August 31, 2004.

5 Discussion

6 **1. Legal Standard**

7 A suit filed in state court can be removed to federal court if the federal court would have had
8 original subject matter jurisdiction over the matter. 28 U.S.C. § 1441(a). The removal statute, 28
9 U.S.C. § 1441, must be strictly construed against removal jurisdiction, however, and any doubt must
10 be resolved in favor of remand. Gaus v. Miles, Inc., 980 F.2d 564, 566 (9th Cir. 1992) ("Federal
11 jurisdiction must be rejected if there is any doubt as to the right of removal in the first instance.").
12 Because there is a strong presumption against removal, the party opposing a motion to remand always
13 has the burden to demonstrate that federal jurisdiction is proper. Enrich v. Touche Ross & Co., 846
14 F.2d 1190, 1195 (9th Cir. 1988).

15 In this case, Defendants cited diversity of the parties, see 28 U.S.C. § 1332, as the basis for
16 removal. For federal jurisdiction to be proper, complete diversity of citizenship is required; in other
17 words, each of the plaintiffs must be a citizen of a different state than each of the defendants. Id. See
18 Morris v. Princess Cruises, Inc., 236 F.3d 1061, 1067 (9th Cir. 2001). Section 1332 also requires that
19 the amount in controversy exceed \$75,000.¹

20 When determining whether complete diversity exists between a plaintiff and defendants, a
21 district court may disregard a non-diverse party named in the state court complaint if that non-diverse
22 party is joined as a sham or if the joinder is fraudulent. Morris, 236 F.3d at 1067. Defendants are
23 entitled to present facts beyond the pleadings to illustrate that joinder is fraudulent, but bear a heavy
24 burden of persuasion. McCabe v. General Foods Corp., 811 F.2d 1336, 1339 (9th Cir. 1987). To
25 determine if a defendant has been fraudulently joined, a court should consider whether "plaintiff fails
26 to state a cause of action against a resident defendant, and the failure is obvious according to the settled
27 rules of the state. . . ." Id. Put another way, Defendants can demonstrate fraudulent joinder by

28 ¹ The parties do not dispute that the amount in controversy exceeds \$75,000.

1 “show[ing] that the individuals joined in the action cannot be liable on any theory” or by “submit[ing]
2 facts showing that a resident defendant had ‘no real connection with the controversy.’” Ritchey v.
3 Upjohn Drug Co., 139 F.3d 1313, 1318 (9th Cir. 1998) (quoting Wilson v. Republic Iron & Steel Co.,
4 257 U.S. 92, 97-99 (1921)). The Court should consider only “whether the plaintiff truly had a cause
5 of action against the alleged sham defendants,” not whether “those defendants could propound
6 defenses to an otherwise valid cause of action.” Id. at 1318.

7 **2. Are CNA and Continental fraudulently joined as Defendants to this lawsuit?**

8 *a. Arguments of the Parties*

9 In both their motion to dismiss and their opposition to Plaintiff’s motion to remand,²
10 Defendants argue that Plaintiff failed to state a claim on which relief can be granted against
11 Continental and CNA. According to Defendants, Plaintiff was only in privity of contract with
12 Columbia, and therefore cannot maintain a claim for breach of contract or breach of implied covenants
13 against Continental or CNA, with whom it had not contractual relationship. Defendants also contend
14 that Plaintiff cannot establish liability against Columbia or CNA under the equitable doctrine of “alter
15 ego.” Because Defendants see no basis for holding Continental and CNA liable on Columbia’s
16 contract with Plaintiff, Defendants assert that these two parties are fraudulently joined and should not
17 be considered by the Court for purposes of determining whether complete diversity exists.

18 Plaintiff responds, in its motion to remand and its opposition to the motion to dismiss, that it
19 has alleged the facts necessary at this early stage in the proceeding to survive a Rule 12(b)(6) motion.

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22 ² The Ninth Circuit has said that the test for fraudulent joinder is equivalent to that for
23 a motion to dismiss under Rule 12(b)(6). See, e.g., Sessions v. Chrysler Corp., 517 F.2d 759, 761 (9th
24 Cir. 1975) (“Inasmuch as appellant’s case against the individual defendants was sufficient to withstand
25 a dismissal motion under [FRCP] 12(b)(6), the joinder of claims against them was not fraudulent so
26 as to warrant dismissal on that score.”). In this case, then, the question of whether jurisdiction is
27 proper over CNA and Continental is the same as whether Plaintiff’s claim satisfies Rule 12(b)(6). On
28 one hand, if Plaintiff has failed to state a claim upon which relief can be granted against either
Continental or CNA, those Defendants will have been improperly joined, and Plaintiff’s causes of
action against them will have to be dismissed. On the other hand, if Plaintiff’s complaint allegations
do satisfy the Rule 12(b)(6) standard, the jurisdictional question raised by Defendants will also have
been resolved in Plaintiff’s favor, and Plaintiff will be allowed to proceed.

Because of the similarity in issues involved, in determining its jurisdiction, the Court will
consider arguments made by Defendants in support of their motion to dismiss. It will not, however,
rule on Defendants’ motion unless its jurisdiction over the matter had been firmly established.

1 Plaintiff cites numerous factual allegations contained in its complaint that purportedly satisfy the
2 notice pleading standard of FRCP 8(a).³ For the reasons that follow, the Court agrees with Plaintiff.

3 *b. Analysis*

4 As with a motion to dismiss, in deciding whether Defendants are fraudulently joined, the Court
5 must accept all material allegations of fact as true and construe those allegations in the light most
6 favorable to the non-movant. The Court must also permit Defendants to present facts beyond
7 Plaintiff's pleading to demonstrate that the joinder is fraudulent. Ritchey, 139 F.3d at 1318.

8 Under California law, a claim of breach of contract or of breach of the implied covenant of
9 good faith and fair dealing may only be made against a party with whom the Plaintiff was in
10 contractual privity. Henry v. Assoc. Indemnity Corp., 217 Cal. App. 3d 1405, 1416-17 (1990)
11 (requiring a "direct contractual relationship . . . from which either a breach of the covenant of good
12 faith and fair dealing or a breach of contract action could properly spring"); Gruenberg v. Aetna, 9 Cal.
13 3d 566, 576 (1973). Plaintiff does not dispute this proposition. Instead, Plaintiff appears to rest on
14 the "alter ego" theory of liability by which Continental and CNA could be held responsible for the acts
15 of their corporate subsidiary, Columbia.

16 A parent company is presumed to have an existence separate from its subsidiary, see Neilson
17 v. Union Bank of Cal., N.A., 290 F. Supp. 2d 1101, 1116 (C.D. Cal. 2003), but in narrow
18 circumstances, a court may disregard the corporate form and hold the parent liable for the acts of its
19 subsidiary. To obtain relief under an alter-ego theory of liability, Plaintiff must show "(1) that there
20 is such unity of interest and ownership that the separate personalities [of the two entities] no longer
21 exist and (2) that failure to disregard [their separate identities] would result in fraud or injustice." Doe
22 v. Unocal Corp., 248 F.3d 915, 926 (9th Cir. 2001) (quoting American Telephone & Telegraph Co.
23 v. Compagnie Bruxelles Lambert, 94 F.3d 586, 591 (9th Cir.1996)).

24 To satisfy the first prong, Plaintiff must demonstrate that the parent corporation exercises

25 ³ Plaintiff also points to another suit pending in the Southern District of California
26 against CNA, Continental, and Columbia, in which the judge denied Defendants' motion to dismiss
27 Continental and CNA from the case. See Gebhart v. CNA Financial Corp., a.k.a. CNA Insurance
28 Companies, Columbia Casualty Co., and Continental Casualty Co., No. 02-CV-781 (S.D. Cal. 2002).
As in this case, Defendants argued in Gebhart that because Continental and CNA did not issue the
policy, they could not be held liable. The court rejected this argument, and allowed the case to proceed
against all three Defendants.

1 control over its subsidiary “to such a degree as to render the latter the mere instrumentality of the
2 former.” Institute of Veterinary Pathology, Inc. v. California Health Laboratories, Inc., 116 Cal. App.
3 3d 111, 119 (1981). This determination is highly factual and made on a case-by-case basis. For
4 example, Plaintiff may show that “a parent corporation uses its subsidiary ‘as a marketing conduit’ and
5 attempts to shield itself from liability based on its subsidiaries’ activities” Doe, 248 F.3d at 926
6 (citing United States v. Toyota Motor Corp., 561 F. Supp. 354, 359 (C.D. Cal. 1983)). Alter-ego
7 liability may also be appropriate where “the record indicates that the parent dictates ‘[e]very facet [of
8 the subsidiary’s] business—from broad policy decisions to routine matters of day-to-day operation[.]’”
9 Id. (quoting Rollins Burdick Hunter of So. Cal., Inc. v. Alexander & Alexander Servs., Inc., 206 Cal.
10 App. 3d 1, 11 (1988)). Additionally, if the subsidiary is inadequately capitalized, the parent may be
11 held liable for the subsidiary’s actions under an alter-ego theory. Id. at 927 (citing Slottow v. Am. Cas.
12 Co. of Reading, Penn., 10 F.3d 1355, 1360 (9th Cir. 1993)).

13 Plaintiff’s complaint contains various allegations that, taken as true, demonstrate that CNA
14 exercised control over its subsidiaries, Continental and Columbia. The question is whether the degree
15 of control alleged by Plaintiff is sufficient to make out a claim for alter-ego liability. It is not enough
16 for Plaintiff to set forth, without more, conclusory allegations that the subsidiary was the alter ego of
17 the parent corporation. See, e.g., Hokama v. E.F. Hutton & Co., Inc., 566 F. Supp. 636, 647 (C.D. Cal.
18 1983) (requiring that both elements of the alter-ego claim be alleged in plaintiff’s complaint).
19 Although this case presents a close question, the Court concludes that Plaintiff has pled sufficient facts
20 to proceed with its alter-ego claims against Continental and CNA.

21 Plaintiff specifically alleges that “CNA directs and controls the day to day operations of
22 Continental and Columbia, determines whether such entities will have employees, determines who will
23 be an Officer and/or Director for those companies, incorporates the financial results of those
24 companies within its own books and records and otherwise exercises complete dominion and control
25 over such companies.” (Compl. ¶ 4.) Plaintiff points to at least two instances where the companies
26 disregarded corporate form and displayed a unity of interest. For example, Plaintiff alleges that the
27 insurance policy it received from Columbia bore the trademark of CNA. (Id. ¶ 6.) Plaintiff also
28 describes a letter it received on September 16, 2003 in connection with the insurance claim it had

1 submitted to Columbia, which was on CNA letterhead and sent “on behalf of Continental Casualty
2 Company.” (Id. ¶ 15.)

3 Plaintiff has adequately pled the elements of an alter-ego claim, and has pled specific instances
4 that demonstrate Columbia was a “mere instrumentality” of its parent companies. At this early stage
5 in the case, that showing is sufficient. Because Plaintiff has stated a claim against Continental and
6 CNA upon which relief can be granted, they are not fraudulently joined as Defendants in the case. The
7 Court is thus required to consider the citizenship of all three Defendants to determine if complete
8 diversity exists with Plaintiff.

9 **3. Is there complete diversity between Plaintiff and each Defendant such that federal**
10 **jurisdiction over this case is proper?**

11 Section 1441(b) provides that an action is removable to federal court from state court on
12 diversity grounds only when “none of the parties in interest properly joined and served as defendants
13 is a citizen of the State in which such action is brought.” 28 U.S.C. § 1441(b). The removal statute
14 reflects the requirement of complete diversity found in 28 U.S.C. § 1332(a), which grants district
15 courts original jurisdiction only over suits between “citizens of different States.” See Kuntz v. Lamar
16 Corp., 385 F.3d 1177, 1181 (9th Cir. 2004).

17 For diversity purposes, “a corporation shall be deemed to be a citizen of any State by which
18 it has been incorporated and of the State where it has its principal place of business.” 28 U.S.C. §
19 1332(c)(1). The parties agree that AMS is a Delaware corporation with its principal place of business
20 in California. According to Defendants’ notice of removal, CNA is also incorporated in Delaware,
21 though it has its principal place of business in Illinois. From these uncontested facts, it appears that
22 both CNA and AMS are citizens of Delaware, and are therefore not diverse parties.

23 Because CNA and AMS are not diverse, the Court need not consider the citizenship of either
24 Columbia or Continental. For the purposes of this Court’s jurisdiction, the commonality of citizenship
25 between CNA and AMS is alone sufficient to destroy diversity and requires that the case be remanded
26 to state court.

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Conclusion

The parties to this lawsuit are not completely diverse, so this Court lacks jurisdiction. Plaintiff's motion to remand is therefore GRANTED. Defendants' motion to dismiss is DENIED as moot. Each party shall bear its own costs.

IT IS SO ORDERED/
DATED: 12/13/04



ROGER P. BENITEZ, District Judge
UNITED STATES DISTRICT COURT

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