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Insurance Declaratory Judgment Actions and the Federal Abstention Doctrine: Strategies and Limitations

Perspectives From Policyholder and Insurer Counsel on
Litigating Declaratory Judgments and Abstention Motions

TUESDAY, APRIL 12, 2016

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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INSURANCE DECLARATORY JUDGMENT ACTIONS AND THE FEDERAL ABSTENTION DOCTRINE: STRATEGIES AND LIMITATIONS

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 - Policyholder-side insurance coverage lawyer

Overview of Today's Presentation

- Nature of a declaratory judgment action
- Common features of insurance coverage litigation
- Filing in federal court – the abstention doctrine
- Insurer and policyholder strategies
- Questions

Why this Matters

- Declaratory judgments are a key tool in insurance coverage litigation
- Forum battles are common in insurance coverage litigation, in part because the law can vary dramatically between states
- Traps for the unwary—especially in federal court
- Planning strategy and dealing with risks is critical
- Open dialogue with clients is key

Declaratory Judgment Actions – Overview

- What is a declaratory judgment action?
- When is it used?
- Actual controversy requirement
- Strategy considerations

Declaratory Judgment Act

- 28 U.S.C. § 2201:
 - “(a) In a case of **actual controversy** within its jurisdiction, . . . , any court of the United States, upon the filing of an appropriate pleading, **may declare** the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.” [. . . .]
- 28 U.S.C. § 2202:
 - “**Further necessary or proper relief** based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment.”
- States have their own declaratory judgment statutes

Declaratory Judgment Act

- The Declaratory Judgment Act is an enabling act
 - Confers discretionary jurisdiction on courts, not rights to litigants. *Wilton v. Seven Falls Co.*, 515 U.S. 277 (1995)
 - Independent federal jurisdiction required (diversity or federal question). *Am. Cas. Co. of Reading, Pa. v. Krieger*, 181 F.3d 1113, 1118 (9th Cir. 1999)

Jurisdiction Over Declaratory Judgment Actions is Discretionary

- Courts have discretion to exert jurisdiction over declaratory judgment actions
- Several factors to be considered when deciding whether to exercise jurisdiction:
 - Likelihood that a declaration will resolve the uncertainty that gave rise to the suit
 - Convenience of the parties
 - Public interest in settlement of the uncertainty of obligation
 - Availability and relative convenience of other remedies
 - General policy of restraint when the same issues are pending in state court
 - Avoidance of duplicative litigation
 - Prevention of use of declaratory judgment actions as a means to forum shop
 - Inherent conflict between insurer's duty to defend in state court and its attempt to characterize that suit in federal court as falling within a policy exclusion

Reifer v. Westport Ins. Corp., 751 F.3d 129 (3d Cir. 2014).

Why File a Declaratory Judgment Action?

- Allows parties to have rights under an insurance policy declared even if there is no present breach of contract
- Often useful for determining the duty to defend
 - In some states an insurer with a duty to defend is required to seek a declaratory judgment if it does not undertake the defense, or may be estopped from raising coverage defenses
- Can also determine the duty to indemnify

Actual Controversy Requirement

- A declaratory judgment action still must satisfy the constitutional “case” or “controversy” requirement
 - The Declaratory Judgment Act applies to “case[s] of actual controversy” (28 U.S.C. § 2201)
- To be justiciable a controversy “must be definite and concrete, touching the legal relations of parties having adverse legal interests”
 - *Aetna Life Ins. Co. of Hartford, Conn. v. Haworth*, 300 U.S. 227, 240-41 (1937)
- “It must be a real and substantial controversy admitting of specific relief through a decree of conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts”
 - *Haworth*, 300 U.S. at 241.
- Insurance-specific concepts that can impact the actual controversy analysis:
 - Status of underlying claim
 - Excess insurers

Actual Controversy Requirement – Examples

- *Aetna v. Haworth*, 300 U.S. 227 (1937)
 - After insured sought benefits under life/disability policies, insurer filed declaratory judgment action seeking a ruling that it did not owe coverage
 - Court held that the action involved a justiciable actual controversy – parties had taken “adverse positions with respect to their existing obligations”
- *Atlanta Gas Light v. Aetna Cas. & Sur. Co.*, 68 F.3d 409 (11th Cir. 1995)
 - Policyholder sent notice to 23 liability insurers regarding potential environmental liability at policyholder’s sites
 - At the time, the policyholder had incurred no costs and had not been ordered to cleanup the sites
 - Insured filed declaratory judgment action the day after mailing notice, before insurers received it (and, of course, before denying coverage)
 - Court held that no case or controversy existed – no position yet taken by insurers, and underlying liability was hypothetical

Timing of a Declaratory Judgment Action

- The timing of a coverage action is a hotly contested issue when the underlying liability action is ongoing
- Courts have gone in different directions:
 - Some courts permit the underlying and coverage actions to proceed simultaneously
 - Some courts stay the coverage action until resolution of the underlying action
 - Some courts stay the underlying action until resolution of the coverage action

Attorneys Fees

- In insurance coverage actions some jurisdictions have departed from the “American rule” that each side pays its own attorneys fees :
 - Insured entitled to fees when it establishes in a declaratory judgment action that insurer breached duty to defend (e.g., Massachusetts, Maryland)
 - Insured that prevails in declaratory judgment action brought by insurer entitled to fees incurred in defending the action (e.g., New York, Minnesota)
 - Insured entitled to fees incurred in establishing coverage (e.g., Washington)

State Versus Federal Court Considerations

- More conservative in federal court?
- Quicker resolution, particularly when duty to defend is at issue?
- Better staffed / better funded?
- Which substantive law is the court likely to apply?
- Where are procedures and other rules more favorable? (e.g., scope of discovery)

Abstention – Overview

- What is it and when it applies
- There are two abstention doctrines – which one applies depends on the nature of the action
- Relief available through abstention

When Abstention Comes Into Play

- When there are parallel state and federal suits
- The defendant in the federal court suit may file a motion requesting that the federal court abstain (i.e., dismiss or stay) in favor of the state court suit

Abstention in Cases Seeking Declaratory Relief – *Brillhart/Wilton Standard*

- Stems mainly from two Supreme Court cases: *Brillhart v. Excess Ins. Co. of Am.*, 316 U.S. 491 (1942) and *Wilton v. Seven Falls Co.*, 515 U.S. 277 (1995)
- Applies when party brings suit in federal court seeking a declaratory judgment – recall that jurisdiction is discretionary
- “Ordinarily it would be uneconomical as well as vexatious for a federal court to proceed in a declaratory judgment suit where another suit is pending in a state court presenting the same issues, not governed by federal law, between the same parties.” *Brillhart*, 316 U.S. at 495
- Federal courts have “unique and substantial discretion in deciding whether to declare the rights of litigants.” *Wilton*, 515 U.S. at 286

Brillhart/Wilton Factors

- Scope of state court proceedings
- Whether issues implicate state or federal law
- Whether all claims can be satisfactorily adjudicated in the state court proceedings
- Whether necessary parties have been joined
- Whether necessary parties are amenable to process in that forum
- Avoiding duplicative proceedings
- Avoiding forum shopping/ “procedural fencing”
- Order of filing
- Choice of law

Abstention in Cases Seeking Non-Declaratory Relief – *Colorado River Standard*

- *Colorado River Water Conserv. Dist. v. United States*, 424 U.S. 800 (1976)
 - Applies when the federal suit seeks non-declaratory (“coercive”) relief, such as monetary damages or bad faith
 - “Abstention from the exercise of federal jurisdiction is the exception, not the rule.”
 - Abstention “is an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly before it.”
 - Abstention is justified only in “exceptional circumstances”

Colorado River Factors

- Inconvenience of federal forum
- Desirability of avoiding piecemeal litigation
- Order in which fora obtained jurisdiction and progress achieved in each action
- Whether federal or state law will be applied
- Adequacy of the state forum to protect the parties' rights
- Whether a court has assumed jurisdiction over property

“Mixed Actions” Involving Declaratory and Non-Declaratory Relief

- When a federal action seeks both declaratory and non-declaratory relief, courts have applied various approaches:
 - Either *Colorado River* or *Brillhart/Wilton* standard applies across the board
 - *Colorado River* standard applies if the non-declaratory claims can exist independently of the declaratory claims
 - Apply the standard by-claim, resulting in both standards being applied and potential that federal court abstains as to some claims but not others
 - *Colorado River* standard applies so long as the non-declaratory claims are not frivolous or included just to secure federal jurisdiction
 - Look to the “essence of the lawsuit” or “heart of the action” – if the declaratory claims predominate and the non-declaratory claims hinge on the outcome of the declaratory claims, the *Brillhart/Wilton* standard applies (and vice versa)

Relief Available Through Abstention

- If party seeking abstention is successful, court will do one of two things:
 - Stay the federal court action
 - Dismiss the federal court action
- Some courts have noted that a stay, rather than a dismissal, is the preferred remedy
 - *E.g., Royal Indem. Co. v. Apex Oil Co.*, 511 F.3d 788 (8th Cir. 2008)

Example Cases in Favor of Abstention

- *Diamond State Ins. Co. v. Fame Oper. Co., Inc.*, 917 F. Supp. 736 (D. Nev. 1996) (declining to exercise jurisdiction over insurer's declaratory judgment actions as fact issues bearing on applicability of policy exclusion will be developed in ongoing underlying actions)
- *Keown v. Tudor Ins. Co.*, 621 F. Supp. 2d 1025 (D. Haw. 2008) (determining remand proper where state law issue involved was unresolved)
- *United States Liab. Ins. Co. v. Wise*, 887 F. Supp. 348 (D. Mass. 1995) (dismissal can be *sua sponte*)
- *Canal Ins. Co. v. Morgan*, 961 F. Supp. 145 (S.D. Miss. 1996) (abstention proper where all parties and claims (which were based on state law) were in state court action).

Example Cases Against Abstention

- *Smithers Constr., Inc. v. Bituminous Cas. Corp.*, 563 F. Supp. 2d 1345 (S.D. Fla. 2008) (no parallel state court proceeding pending)
- *NGM Ins. Co. v. Evans*, 642 F. Supp. 2d 511 (W.D.N.C. 2009) (declining to abstain when state law issues involved were not difficult, complex, or unresolved, and insurer was not a party to the underlying suit)
- *Allstate Ins. Co. v. Veniegas*, 2 F. Supp. 2d 1303 (D. Haw. 1998) (declining to abstain when defendants filed state action months after insurer's federal declaratory action, and state court action did not include the insurer)
- *Am. Nat. Prop. & Cas. Co. v. Weese*, 863 F. Supp. 297 (S.D. W. Va. 1994) (exercising jurisdiction when insurer not a party to the state court tort action, and no issue pending in state court action would be affected by federal court action)

Strategies (Insurers)

- Plead non-declaratory judgment claims if possible
 - Breach of contract; rescission; etc.
 - “Coercive relief”
- Define issues differently than those pending in (any) state court action
- Be ready to hire counsel in a foreign jurisdiction to defend against competing state court action

Strategies (Policyholders)

- File a parallel action in state court involving at least the *same issues and same parties*
 - File a broader action if possible
- If litigation is imminent, file an action in the preferred jurisdiction **first**
- Advance the litigation as much and as quickly as possible (e.g., serve process on all parties; serve discovery as soon as permitted)
- Watch out for removal to federal court
 - Can avoid this risk by filing in a defendant's resident forum – must decide if that's worth it

Discuss the Pros and Cons with Your Client

- An insurer filing a pure declaratory judgment action in federal court is inviting a forum battle and competing state litigation
 - Could be more appropriate in a case with a lot at stake
- Clients needs to be advised of the risks and potential costs ahead of time
- For insurers, does the perceived advantage of the federal forum outweigh the costs and multiplicity of litigation?
- For policyholders, does the perceived advantage of the state court forum outweigh the cost of filing additional proceedings in state court?
- For both insurers and policyholders, is the perceived advantageous forum actually advantageous?

Final Thoughts

- Declaratory judgment actions, the related abstention principles, and forum battles are common in insurance coverage litigation
- Complicated issues that are fact-specific
- The law varies from jurisdiction to jurisdiction
- Anticipating the other side's likely course of action is key
- These issues can make or break a case, and be costly for the client – it is important to understand the concepts and put yourself in the best position to succeed
- Be up front with clients about the likely forum battles and costs

THANK YOU

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