In, Out, and Judicial Declarations: Procedural Considerations in Declaratory Judgment Actions

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I. Introduction

This paper offers a procedural review of the nuts and bolts of bringing a declaratory judgment action in an insurance matter, with consideration given to when actions may lie under the federal Declaratory Judgment Act, and parallel state declaratory judgment acts, along with implications for fee-shifting. We will examine the prerequisites to suit, some differences between state and federal proceedings, the basis of federal jurisdiction, and various federal abstention doctrines – which came to the fore, particularly, in the Third Circuit when federal courts were called upon to declare the availability of insurance coverage for COVID-19 business interruption losses in New Jersey and Pennsylvania.

This paper is not intended to be an exhaustive study of these topics – indeed, volumes and treatises have been written on them. Rather, we have selected specific issues and discuss them primarily in the context of more recent cases and developments.

II. Federal Declaratory Judgment Actions

Regardless of whether a declaratory judgment action is originally filed in federal court or is removed to federal court from state court, the action proceeds under the federal Declaratory Judgment Act, which is codified at 28 U.S.C. §§ 2201-02. In relevant part, it states:

> 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. § 2201. As a result, there first must be a "case of actual controversy." The district court must also have jurisdiction under a statute other than 28 U.S.C. § 2201. As a practical matter, in the insurance-coverage context, this tends to mean that the parties have complete diversity of citizenship, and the amount in controversy exceeds $75,000. *See* 28 U.S.C. § 1332.

Further, since the declaratory judgment statute provides that a court "may" declare the rights of parties, a court can, in its discretion, decline to do so. A court's discretion, however, may be curtailed if an action seeks coercive relief in addition to declaratory relief. Finally, although a declaration has the effect of a final judgment and can be reviewable as such, interesting appeal issues can arise when a district court rules on less than all of the requested relief in a declaratory judgment action.

A. Case of Actual Controversy

The Declaratory Judgment Act alone does not furnish federal jurisdiction. *California v. Texas*, 141 S. Ct. 2104, 2115 (2021). "Instead, just like suits for every other type of remedy, declaratory-judgment actions must satisfy Article III's case-or-controversy requirement." *Id.* The Supreme

Court has observed that a dispute must be "'real and substantial' and 'admit of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.'" *Id*. at 2115-16 (quoting *MedImmune, Inc. v. Genentech, Inc*., 549 U.S. 118, 127 (2007)). Yet, it also noted that its precedent does "not draw the brightest of lines between those declaratory-judgment actions that satisfy the case-or-controversy requirement and those that do not." *MedImmune* at 127.

Citing *MedImmune*, the Tenth Circuit observed: "It is not the role of federal courts to resolve abstract issues of law. Rather, they are to review disputes arising out of specific facts when the resolution of the dispute will have practical consequences to the conduct of the parties. Unfortunately, there is no formula to determine in every dispute whether the Article III 'Case or Controversy' requirement has been satisfied." *Columbian Fin. Corp. v. BancInsure, Inc*., 650 F.3d 1372, 1376 (10th Cir. 2011). The determination is made as of the time the court is to act. *Id*. at 1382-82 (quoting 10B Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, FEDERAL PRACTICE AND PROCEDURE § 2757, at 495-96 (3d ed. 1998) ("The presence of a controversy must be measured at the time the court acts. It is not enough that there may have been a controversy when the action was commenced if subsequent events have put an end to the controversy, or if the opposing party disclaims the assertion of countervailing rights.")).

1. Duty to Defend

Generally, courts have found that the issue of an insurer's duty to defend is an actual case or controversy, even when an insured's duty to indemnify might not be. "The duty to defend[,] . . . broader than the duty to pay, arises well before any duty to pay is conclusively established, and may well exist in a case in which the insurer is ultimately deemed not to be liable on the policy." 16 Lee R. Russ & Thomas F. Segalla, COUCH ON INSURANCE 3D, § 227:27 (1997) (footnotes omitted). "Accordingly, whether an insurer has a duty to defend a suit against its insured is generally considered a controversy ripe for declaratory relief, even when the issue of the insurer's actual liability in the underlying suit may not be considered until after a resolution of that suit." *Id.* at § 227:29.

An actual case or controversy has been found to exist, even in the absence of underlying litigation against an insured, when a claim is made against an insurer. *Std. Fire Ins. Co. v. Armstrong*, 2012 U.S. Dist. LEXIS 122402, *9-10 (E.D. Va. 2012) ("Regardless of whether any additional litigation ensues, Defendant has already invoked his rights under an insurance contract by submitting a claim to Plaintiff as his insurer. Thus, the dispute involves a 'real and substantial' set of facts, as opposed to a hypothetical situation.").

However, the duty to defend has not been considered a controversy ripe for declaratory relief in several situations, such as when an insurer stipulates to coverage during the litigation (*Columbian Fin. Corp.*) or when insureds withdraw their request for defense and indemnification after an insurer files its declaratory judgment action. *Selective Ins. Co. v. Phusion Projects, Inc*., 836 F. Supp. 2d 731 (N.D. Ill. 2011). Also, the receipt of a notice of claim and an insurer's anticipation of a coverage disagreement are sometimes insufficient to establish a case or controversy. *See, e.g.*, *Progressive N. Ins., Co. v. RA Transp., LLC*, No. 3:17CV623-HEH, 2017 WL 5474054, at *3 (E.D.

Va. Nov. 14, 2017).

2. Duty to Indemnify

Typically, when filing a declaratory judgment action, insurers seek an adjudication of both their duty to defend and their duty to indemnify, because the duty to defend is broader than the duty to indemnify and, if insurers do not have the former duty, then they typically do not have the latter duty, either. *See, e.g., Scottsdale Ins. Co. v. Universal Crop Prot. Alliance, LLC*, 620 F.3d 926, 934 (8th Cir. 2010). A claim about the duty to indemnify brought as part of a declaratory judgment action usually sees the one party move to have the trial court dismiss it. *See, e.g., Nationwide Ins. v. Zavalis*, 52 F.3d 689, 693 (7th Cir. 1995) (affirming the lower court's dismissal of the duty to indemnify claim, but remanding the case for a determination of the duty to defend claim). If an insurer has a duty to defend or is defending its insured, courts typically hold that duty-to-indemnify issues are not ripe until liability has been established. *See, e.g., Lear Corp. v. Johnson Elec. Holdings Ltd.*, 353 F.3d 580, 583 (7th Cir. 2003). Various courts have held that declaratory actions on duty to indemnify only become ripe after the underlying liability is settled. *See, e.g., Charter Oak Fire Ins. Co. v. Lazenby*, 2012 U.S. Dist. LEXIS 99765, *24-25 (W.D. Pa. 2012).

Yet, this rule is not universally applied in all situations or jurisdictions, such as where potential settlement may be a factor. *See, e.g., Carolina Cas. Ins. Co. v. Tutle & Tutle Trucking, Inc*., 2010 U.S. Dist. LEXIS 35974, 3-4 (N.D. Tex. 2010); *Federal Ins. Co. v. Sammons Fin. Group, Inc*., 595 F. Supp. 2d 962 (S.D. Iowa 2009). In some instances, even in the absence of the prospect of settlement, when an insured has made a demand on an insurer, and the insurer has contended that there are no circumstances under which it can owe the insured any money, "[t]he lines are drawn, the parties are at odds, the dispute is real." *Scottsdale Ins. Co. v. Universal Crop Prot. Alliance, LLC*, 620 F.3d 926, 934 (8th Cir. 2010). Yet, in *Scottsdale*, the court concluded that the insurer had no duty to defend, noting that the duty to defend is broader than the duty to indemnify.

Thus, even though there has been no final adjudication of an underlying claim against an insured, in some jurisdictions, there may be an actual case in controversy regarding indemnification if there has been a settlement demand or there is a prospect of a settlement demand.

B. Jurisdiction

The declaratory judgment statute confers a remedy; it does not confer jurisdiction. *See, e.g., Government Emples. Ins. Co. v. Dizol*, 133 F.3d 1220, 1222-1223 (9th Cir. 1998) (citing *Skelly Oil Co. v. Phillips Petroleum Co*., 339 U.S. 667, 672 (1950)). As a result, a federal court must have jurisdiction through other statues, such as 28 U.S.C. § 1331 (federal question) or 28 U.S.C. § 1332 (diversity). Most insurance coverage cases will be based on a federal court's diversity jurisdiction, which requires that the amount "in controversy exceeds the sum or value of $75,000, exclusive of interest and costs, and is between--(1) Citizens of different States." 28 U.S.C. § 1332(a)(1).

"If the defendant challenges the plaintiff's allegations of the amount in controversy, then the plaintiff must establish jurisdiction by a preponderance of the evidence." *McNutt v. Gen. Motors Acceptance Corp*., 298 U.S. 178, 188-89 (1936). The requirements for diversity jurisdiction must

be satisfied only as of the time of filing. *See Grupo Dataflux v. Atlas Global Group, L.P.*, 541 U.S. 567, 570-71 (2004). As to the standard of proof that a proponent of federal jurisdiction must show regarding the amount in controversy, it typically must demonstrate by a preponderance of the evidence that there is not "a legal certainty that the amount in controversy cannot be recovered." 14A Charles Alan Wright, Arthur R. Miller, and Edward H. Cooper, FEDERAL PRACTICE AND PROCEDURE § 3702 (4th Ed. 2011).

1. Amount in Controversy

The Seventh Circuit has found that the potential outlay for indemnity should be counted toward the amount in controversy, whether or not adjudication about indemnity should be deferred until the state case is over. *See, e.g., Meridian Sec. Ins. Co. v. Sadowski*, 441 F.3d 536, 539 (7th Cir. 2006) (collecting cases). The Seventh Circuit explained that, because the duty to defend extends to many suits in which there will be no duty to indemnify – since defense depends on what the plaintiff alleges, while indemnity is limited to what the plaintiff proves – a declaratory judgment that the insurer need not defend means that it need not indemnify either, whether or not the plaintiff makes good on his contentions. *Meridian*, 441 F.3d at 539. *See also Scottsdale Ins. Co. v. Universal Crop Prot. Alliance, LLC*, 620 F.3d 926, 932 (8th Cir. 2010). When a claim exceeds the policy limits, the policy limits, rather than the larger value of the claim, typically determine the amount in controversy. *Hartford Ins. Group v. Lou-Con Inc.*, 293 F.3d 908, 911 (5th Cir. 2002).

However, there is some authority to the contrary. *See City of New York v. Travelers Property Casualty Co. of America*, 2020 WL 263658, *3 (S.D.N.Y. 2020) ("[The value of the potential indemnities cannot be applied to the amount in controversy when only duty to defend claims are pleaded. Doing so would violate the rule against considering the collateral effect of a judgment when determining the amount in controversy."); Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, 14AA FEDERAL PRACTICE & PROCEDURE § 3710 (4th ed. 2011) (noting the argument that the measure of the defense costs is the amount in controversy when only the duty to defend is at issue).

2. Citizens of Different States

"Section 1332 has been interpreted to require 'complete diversity.'" *Ruhrgas Ag v. Marathon Oil Co.*, 526 U.S. 574, 580 n 2 (1999). Thus, each of the plaintiffs must be a citizen of a different state than each of the defendants. *See also Allstate Ins. Co. v. Hughes*, 358 F.3d 1089, 1095 (9th Cir. 2004). There are various factors and considerations that can arise in determining the citizenship of parties to an insurance coverage case. This paper looks at a few of them.

(a) Principal Place of Business

Under 28 U.S.C. § 1332(c), "a corporation shall be deemed to be a citizen of every State and foreign state by which it has been incorporated and of the State or foreign state where it has its principal place of business . . . ." *Id*. In *Hertz Corp. v. Friend*, 130 S. Ct. 1181 (2010), the Supreme Court held that "the phrase 'principal place of business' refers to the place where the corporation's high level officers direct, control, and coordinate the corporation's activities. Lower federal courts

have often metaphorically called that place the corporation's 'nerve center.'" *Id*. at 1186. The Court explained that "in practice it should normally be the place where the corporation maintains its headquarters – provided that the headquarters is the actual center of direction, control, and coordination, *i.e.*, the 'nerve center' . . . ." *Id*. at 1192.

(b) Citizenship of Reciprocal Exchanges, LLPs and LLCs

Citizenship can be a more complicated analysis when an entity is not a corporation. Recently, the Third Circuit decided a suit involving questions about the citizenship of reciprocal insurance exchanges. *See Peace Church Risk Retention Group v. Johnson Controls Fire Protection LP*, No. 21-2923, 2022 WL 4352489 (3rd Cir. Sept. 20, 2022). It noted that "[f]or 'artificial entities other than corporations,' the general rule is that the citizenship of the entity is determined by the citizenship of 'all [its] members.'" *Id*. at *2 (quoting *Americold Realty Tr. v. Conagra Foods, Inc.*, 577 U.S. 378, 381 (2016)). This rule has been applied to unincorporated entities, such as unions, joint stock companies, and partnerships, including limited partnerships. *Id*. The court noted that since partners may be artificial entities themselves, and the citizenship rules need to be applied to them in turn, "'the inquiry into jurisdictional citizenship 'can become quite complicated' because '[t]he citizenship of unincorporated associations must be traced through however many layers of partners or members there may be.'" *Id*. at 2 (*quoting GBForefront, L.P. v. Forefront Mgmt. Grp., LLC*, 888 F.3d 29, 36 (3d Cir. 2018)). The Third Circuit applied the general rule to reciprocal insurance exchanges, concluding that "[b]ecause the members of a reciprocal insurance exchange are its subscribers, we look to the citizenships of those subscribers to determine the citizenship of the exchange itself." *Id*. at *4.

Federal courts have held that, at least for diversity purposes, the citizenship of a limited liability company, despite the resemblance of such a company to a corporation, is the citizenship of each of its members. *Zambelli Fireworks Mfg. Co. v. Wood*, 592 F.3d 412, 420 (3rd Cir. 2010); *Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 267 (7th Cir. 2006); *Rolling Greens MHP, L.P. v. Comcast SCH Holdings L.L.C.*, 374 F.3d 1020, 1021-22 (11th Cir. 2004); *Handelsman v. Bedford Village Associates Limited Partnership*, 213 F.3d 48, 51-52 (2d Cir. 2000).

(c) Fed. R. Civ. P. 7.1

Effective December 1, 2022, Fed. R. Civ. P. 7.1 was amended to require that both plaintiffs and defendants make initial disclosures regarding citizenship in diversity actions. The rule provides, in part:

> Rule 7.1. Disclosure Statement
>
> (a) Who Must File; Contents
>
> ***
>
> (2) Parties or Intervenors in a Diversity Case.
>
> In an action in which jurisdiction is based on diversity under 28 U.S.C. §

> 1332(a), a party or intervenor must, unless the court orders otherwise, file a disclosure statement. The statement must name – and identify the citizenship of – every individual or entity whose citizenship is attributed to that party or intervenor:
>
> (A) when the action is filed in or removed to federal court, and
>
> (B) when any later event occurs that could affect the court's jurisdiction under§ 1332(a).
>
> (b) Time to File; Supplemental Filing.
>
> A party, intervenor, or proposed intervenor must: (1) file the disclosure statement with its first appearance, pleading, petition, motion, response, or other request addressed to the court; and ….

The Advisory Committee on Civil Rules noted that the new "disclosure does not relieve a party that asserts diversity jurisdiction from the Rule 8(a)(l) obligation to plead the grounds for jurisdiction, but is designed to facilitate an early and accurate determination of jurisdiction." https://www.federalrulesofcivilprocedure.org/frcp/title-iii-pleadings-and-motions/rule-7-1-disclosure-statement/ The committee observed that an LLC takes on the citizenship of each of its owners, that a "party suing an LLC may not have all the information it needs to plead the LLC's citizenship" and that "[t]he same difficulty may arise with respect to other forms of noncorporate entities, some of them familiar – such as partnerships and limited partnerships – and some of them more exotic, such as 'joint ventures.'" *Id*. "Pleading on information and belief is acceptable at the pleading stage, but disclosure is necessary both to ensure that diversity jurisdiction exists and to protect against the waste that may occur upon belated discovery of a diversity-destroying citizenship. Disclosure is required by a plaintiff as well as all other parties and intervenors." *Id*. "Disclosure is limited to individuals and entities whose citizenship is attributed to a party or intervenor. The rules that govern attribution, and the time that controls the determination of complete diversity, are matters of subject-matter jurisdiction that this rule does not address." *Id*.

In sum, the newly-amended Rule 7.1 may make the process of suing a noncorporate entity more streamlined, as a plaintiff may plead the grounds for jurisdiction on information and belief, and then the defendant must disclose the individuals and entities whose citizenship is attributed to the noncorporate entity upon its first appearance in court. The rules that govern attribution are found in cases such as *Peace Church*.

C. Whether Underlying Claimants Are Necessary Parties

"There is no doubt that a third-party claimant is a *proper* party to a declaratory relief action between the insurer and its insured to determine the scope of insurance coverage." *Navigators Ins. Co. v. K & O Contracting, LLC*, No. 3:12-CV-01324-ST, 2013 WL 1194722, at *2 (D. Or. Jan. 10, 2013), *report and recommendation adopted*, No. 3:12-CV-01324-ST, 2013 WL 1194715 (D. Or. Mar. 21, 2013) (original emphasis). The question is whether the claimant is a

necessary and indispensable party. In federal court, that issue usually turns on the application of Fed. R. Civ. P. 19.

Under Rule 19, a court "must determine: (1) whether an absent party is necessary to the action; and then, (2) if the party is necessary, but cannot be joined, whether the party is indispensable such that in equity and good conscience the suit should be dismissed." *Roberts v. City of Fairbanks*, 947 F.3d 1191, 1204 (9th Cir. 2020).

Under Rule 19(a), a party is necessary if: (a) "the court cannot afford complete relief among existing parties" without that person, or (b) "that person claims an interest" in the litigation, and proceeding without that person would "impair or impede the person's ability to protect the interest," or cause an existing party to incur "double, multiple, or otherwise inconsistent obligations because of the interest." *Id*.

Cases on whether an injured third-party claimant is a necessary party to a declaratory judgment action between an insurer and its insured are "both numerous and conflicting." *Cincinnati Ins. Co. v. Nw. Painting, Inc.*, No. CV 20-176-M-DLC, 2021 WL 3142163, at *5 (D. Mont. July 26, 2021). As one federal court has summarized:

> Some courts have held that an injured third-party is a necessary party in a declaratory judgment action by an insurer against its insured.
>
> However, other courts have reached the opposite conclusion, finding that the insured adequately protects the interest of the absent party because they both share the ultimate objective of obtaining a declaration of insurance coverage.
>
> Some courts have rejected the notion of any protectable interest before the third-party obtains a judgment against the insured.
>
> Some courts also have concluded that the possibility of a suit against the insurer at a later date does not create a substantial risk of multiple or inconsistent obligations.

Navigators Ins. Co. at *3 (citations omitted). Another court has observed that "underlying tort claimants are not necessary parties to a declaratory judgment action regarding an insurer's duty to defend when the action is filed by the *insured.* However, if the declaratory judgment action is filed instead by the *insurer* or involves a determination of insurance coverage or both, then the underlying claimant is considered a necessary party." *Georgia-Pac. Corp. v. Sentry Select Ins. Co.*, No. 05-CV-826-DRH, 2006 WL 1525678, at *6 (S.D. Ill. May 26, 2006) (original emphasis).

If an underlying claimant is "necessary" but joinder is not feasible, then under Rule 19(b), the court must determine whether the party is "indispensable." Indispensability, in turn, is determined based on the following factors set forth in Rule 19(b): (1) to what extent a judgment rendered in the party's absence may be prejudicial to the party or the existing parties to the action; (2) the extent to which the judgment can be shaped to lessen or avoid prejudice; (3) whether the judgment rendered in the party's absence will be adequate; and (4) whether the plaintiff will have an adequate

remedy if the court dismisses the action. *Id*.

When a declaratory judgment action in federal court is based on diversity jurisdiction, the preclusive effect of a judgment from such action in second action should be decided under the *res judicata* law of the state where the federal district court sat in the first action. *Q Int'l Courier Inc. v. Smoak*, 441 F.3d 214, 218 (4th Cir. 2006). Some state courts have held that a "declaratory action obtained by an insurer against its insured is not binding on a third-party claimant who was not a party to the declaratory judgment action." *Indep. Fire Ins. Co. v. Paulekas*, 633 So. 2d 1111, 1113 (Fla. Dist. Ct. App. 1994).

D. Abstention

The doctrine of abstention is necessarily implicated by insurance-coverage actions that seek declaratory relief in federal court, because insurance contracts are creatures of state law. For purposes of the discussion that follows, it is worth going back to the basics of first-year civil procedure: diversity jurisdiction exists "in order to prevent apprehended discrimination in state courts against those not citizens of the State." *Erie R.R. v. Tompkins*, 304 U.S. 64, 74 (1938).

1. Court's Discretion to Hear a Declaratory Judgment Action

The federal Declaratory Judgment Act does not mandate that a federal court grant declaratory relief. In *Brillhart v. Excess Insurance Co. of America*, 316 U.S. 491, 495 (1942), the Supreme Court held that a district court has discretion to dismiss a federal declaratory judgment action when "the questions in controversy . . . can better be settled in" a pending state court proceeding. The Court later reaffirmed this principle, holding that a district court may decline to entertain a federal declaratory judgment action when state court proceedings "present[] opportunity for ventilation of the same state law issues." *Wilton v. Seven Falls Co.*, 515 U.S. 277, 290 (1995).

One pivotal issue can be whether there are parallel state court proceedings already pending. Suits are parallel if "substantially the same parties litigate substantially the same issues in different forums." *New Beckley Mining Corp. v. Int'l Union, United Mine Workers of Am*., 946 F.2d 1072, 1073 (4th Cir. 1991). Some circuits have allowed federal district courts some, but not complete, discretion in determining whether to dismiss or stay declaratory actions when there are no parallel state court proceedings. *See, e.g.*, *Scottsdale Ins. Co. v. Detco Indus*., 426 F.3d 994, 998 (8th Cir. 2005) (citing *United States v. City of Las Cruces*, 289 F.3d 1170, 1187 (10th Cir. 2002); *Scottsdale Ins. Co. v. Roumph*, 211 F.3d 964, 968 (6th Cir. 2000); *Aetna Cas. & Sur. Co. v. Ind-Com Elec. Co.*, 139 F.3d 419, 422 (4th Cir. 1998)).

Other courts have put less emphasis on this factor. For example, the Seventh Circuit has noted that the Supreme Court did not indicate that parallel proceedings were either necessary or sufficient. *Medical Assur. Co. v. Hellman*, 610 F.3d 371, 379 (7th Cir. 2010) ("Even if there is no parallel proceeding, the district court still has discretion to decline to hear a declaratory judgment suit.").

There are no set criteria for when a court should exercise its discretion to abstain. *Envision Healthcare, Inc. v. PreferredOne Ins. Co*., 604 F.3d 983, 986 (7th Cir. 2010). Although the

Supreme Court has not yet delineated "the outer boundaries" of the *Brillhart/Wilton* doctrine, some lower courts have provided some guideposts. *See, e.g., Nat'l Tr. Ins. Co. v. S. Heating & Cooling Inc.*, 12 F.4th 1278, 1282–83 (11th Cir. 2021) (nine non-exclusive factors); *R.R. Street & Co. v. Transp. Ins. Co*., 656 F.3d 966, 975 (9th Cir. 2011); *Hellman*, 610 F.3d at 379 (four factors); *Scottsdale Ins. Co. v. Flowers*, 513 F.3d 546, 554 (6th Cir. 2008) (five factors); *AXA Re Property & Casualty Ins. Co. v. Day*, 162 Fed. Appx. 316, 320 (5th Cir. 2006) (seven nonexclusive factors).

In practice, the non-exhaustive factors articulated by different appeals courts have yielded results that are all over the map. Some cases suggest that a federal court would be more likely to entertain a declaratory judgment when there is no parallel state court action, the insurer is not a party to the underlying action against its insured, the insurer's grounds for denying coverage are either based on a matter of law or on a factual issue that would not be decided in the underlying case, and/or the action would resolve all controversies between the parties. It may also help if the state law issues are fairly straightforward. *See, e.g., Hellman*; *Flowers*; *AXA Re Property; Evanston Ins. Co. v. Johns*, 530 F.3d 710, 712 (8th Cir. 2008).

Conversely, federal courts are more apt to decline to hear "reactive declaratory actions," such as when an insurer files a declaratory judgment action in federal court during the pendency of a non-removable state court action presenting the same issues of state law, or when all the same parties are participating in the underlying action where relevant finding of facts will necessarily be made. *See, e.g. R.R. St. & Co. v. Transp. Ins. Co*., 656 F.3d 966, 976 (9th Cir. 2011); *Envision Healthcare, Inc. v. PreferredOne Ins. Co*., 604 F.3d 983, 984 (7th Cir. 2010); *RLI Ins. Co. v. Wainoco Oil & Gas Co*., 131 Fed. Appx. 970, 972-973 (5th Cir. 2005); *Bituminous Cas. Corp. v. J & L Lumber Co*., 373 F.3d 807, 811-14 (6th Cir. 2004) (seeking to avoid a "friction" between state and federal courts, where it "was an actuality, not a mere possibility").

2. When Coercive Relief is Sought in Addition to a Declaratory Judgment: *Colorado River* Abstention

Where both declaratory *and* non-declaratory relief (*i.e.*, coercive relief) is sought, does the *Wilton/Brillhart* standard even apply, and, if so, under what circumstances? This issue has received different treatment in the courts of appeals that have addressed it. *See, generally, R.R. St. & Co. v. Vulcan Materials Co.*, 569 F.3d 711, 715 (7th Cir. 2009).

Unlike declaratory relief under 28 U.S.C. § 2201, federal courts typically do not have discretion to decline to exercise jurisdiction over a claim for coercive relief. The Supreme Court has recognized the federal courts' "virtually unflagging obligation to exercise the jurisdiction given them." *Colorado River Water Consv. Dist. v. United States*, 424 U.S. 800, 813 (1976).

The federal courts' abdication of their obligation to decide cases can be justified under abstention only in the exceptional circumstances where the order to the parties to repair to the State court would clearly serve an important countervailing interest. *Id*. at 813. The *Colorado River* doctrine typically is described as requiring parallel suits and the application of different factors than *Brillhart*. *See, e.g., Great Am. Ins. Co. v. Gross*, 468 F.3d 199, 205-06 (4th Cir. 2006); *R.R. St. & Co. v. Transp. Ins. Co*., 656 F.3d 966, 978-979 (9th Cir. 2011). Therefore, for an insurer seeking

declaratory relief in federal court, it would be advantageous if the court would analyze a defendant's motion to stay or dismiss under *Colorado River* rather than *Brillhart*, if the litigation also involves a request for coercive relief.

Courts have recognized at least three different approaches by the circuits to litigation involving requests for both declaratory and coercive relief. The Fifth Circuit has adopted a strict bright-line approach: When an action includes a claim for declaratory relief along with any non-frivolous claim for coercive relief, *Wilton/Brillhart* abstention is completely inapplicable to all claims, and the *Colorado River* doctrine governs instead. *See New Eng. Ins. Co. v. Barnett*, 561 F.3d 392, 395 (5th Cir. 2009). The Second, Fourth, and Tenth Circuits have agreed with the Fifth Circuit's approach, albeit some in dicta. *See VonRosenberg v. Lawrence*, 781 F.3d 731, 735 (4th Cir. 2015); *Vulcan Materials*, *supra*, at 715 (citing *United States v. City of Las Cruces*, 289 F.3d 1170, 1181-82 (10th Cir. 2002); *Vill. of Westfield v. Welch's*, 170 F.3d 116, 125 n.5 (2d Cir. 1999)).

The Third, Seventh and Ninth Circuits have adopted a test that inquires into the nature of the asserted claims. Under that test, where state and federal proceedings are parallel and the federal suit contains claims for both declaratory and non-declaratory relief, the district court should determine whether the claims seeking non-declaratory relief are independent of the declaratory claim. If they are not, the court can exercise its discretion under *Wilton/Brillhart* and abstain from hearing the entire action. But if they are, the *Wilton/Brillhart* doctrine does not apply and, subject to the presence of exceptional circumstances under the *Colorado River* doctrine, the court must hear the independent non-declaratory claims. The district court, then, should retain the declaratory claim under *Wilton/ Brillhart* (along with any dependent non-declaratory claims) in order to avoid piecemeal litigation. *Rarick v. Federated Serv. Ins. Co.*, 852 F.3d 223, 229 (3d Cir. 2017); *R.R. St. & Co. v. Transp. Ins. Co*., 656 F.3d 966, 970 (9th Cir. 2011); *R.R. St. & Co. v. Vulcan Materials Co.*, 569 F.3d 711, 716-717 (7th Cir. 2009);

A third approach – the "essence of the lawsuit" – has been adopted by the Eighth Circuit, under which a federal court is not obligated "automatically to apply the exceptional circumstances test articulated in *Colorado River*" when both non-declaratory and declaratory relief are sought. *Royal Indem. Co. v. Apex Oil Co*., 511 F.3d 788, 793 (8th Cir. 2008). Instead, because the declaratory judgment act authorizes a court to grant "[f]urther necessary or proper relief based on a declaratory judgment or decree," 28 U.S.C. § 2202, the district court may abstain from non-declaratory claims under *Wilton/Brillhart* "so long as the further necessary or proper relief would be based on the court's decree so that the essence of the suit remains a declaratory judgment action." *Royal Indem. Co.*, 511 F.3d at 793-94. The independence of non-declaratory claims from declaratory claims hinges on whether the grant of declaratory relief is a necessary predicate to the grant of non-declaratory relief. *See id*. at 794 (holding that the plaintiff's claims for contribution, subrogation, unjust enrichment, equitable estoppel, and attorney fees, costs, and interest were not independent but rather "further necessary or proper relief" because "[i]f the district court were to reject [the plaintiff's] claims under the Declaratory Judgment Act, it could not recover on th[ose] claims").

As a result, depending on the jurisdiction, an insurer should consider whether the presence of requests for coercive relief in its declaratory judgment litigation could help persuade a federal court to hear the matter. Sometimes an insured will insert such requests by way of a counterclaim.

In addition, an insurer should consider whether it might have such a claim itself, such as the recoupment of defense costs paid under a reservation of rights. But such a claim might not lead to the application of the *Colorado River* doctrine under two of the approaches outlined above.

3. Some Recent Abstention Cases

Coverage litigation that has been spawned by the COVID-19 pandemic has, as this audience well knows, been litigated extensively in both state courts and federal courts across the United States.

Following the lead of their respective circuit courts of appeal, federal district courts in the Seventh, Ninth, and Tenth Circuits tended to conclude that it was not appropriate for them to abstain from issuing declarations about coverage for losses occasioned by the novel coronavirus (as it was then known), because settled principles of state insurance law and contract interpretation governed the resolution of the claims. *See, e.g., Tavistock Rest. Group v. Zurich Am. Ins. Co.*, 2021 WL 1614519, *4 (N.D. Ill. Apr. 26, 2021) ("This case presents unusual facts related to the ongoing COVID-19 pandemic, to be sure, but it is not obvious that ordinary principles of contract interpretation would not apply to the Parties' dispute"); *Geragos & Geragos v. Travelers Indem. Co.*, 2020 WL 4793459 (C.D. Cal. Aug. 12, 2020); *Goodwill Indus. of Cent. Oklahoma v. Phila. Indem. Ins. Co.*, 499 F. Supp. 3d 1093 (W.D. Okla. 2020).

In the Third Circuit, some district courts have found that both the novelty of the virus that causes COVID-19 and questions of state public policy justified them in abstaining from the exercise of federal jurisdiction, and instead directing the litigants to state court. *See, e.g.*, *Greg Prosmushkin, P.C. v. Hanover Ins. Group*, 479 F. Supp. 3d 143, 151 (E.D. Pa. 2020) ("The issues of state law presented in Plaintiff's action are novel, complex, and exceedingly important, creating a compelling public policy interest for these claims to be allowed to be decided by Pennsylvania courts."); *Venezie Sporting Goods v. Allied Ins. Co. of Am.*, 2020 WL 5651598 (W.D. Pa. Sept. 23, 2020); *Mattdog, Inc. v. Phila. Indem. Ins. Co.*, 2020 WL 6111038 (D.N.J. Oct. 16, 2020).

However, the trend of Third Circuit courts abstaining from deciding coverage questions relating to the COVID-19 pandemic seems to have been arrested by that circuit's Court of Appeals issuing a precedential opinion in a consolidated appeal of three cases – two from the Western District of Pennsylvania and one from the District of New Jersey. In *Dianoia's Eatery, LLC v. Motorists Mutual Insurance Company*, 10 F.4th 192 (3d Cir. 2021), a split panel flatly declared that there was nothing particularly unique about the legal issues or the public policy considerations raised by the underlying cases that would justify abstention. Indeed, the circuit court reversed the abstention orders in all three underlying cases, finding either that the district courts' consideration of the eight factors used in the Third Circuit was not rigorous enough, or that the district courts had misconstrued certain of the factors.

The Third Circuit was not persuaded that the existence of insurance-coverage disputes in state courts was a sufficient reason for the federal court to shirk its responsibility to adjudicate the cases before it, questioning how that fact could ever "militate against exercising jurisdiction." *See id*., at 207. "At any given time, there are countless insurance cases pending in state courts which implicate some common application of state law." *See id*. To the issue of public policy, the court

was blunt: "It is, generally, of no moment that a federal court is being asked to apply state public policy. Indeed, '[t]he essence of diversity jurisdiction is that a federal court enforces State law and State policy.'" *See id*., at 209, *citing Beneficial Indus. Loan Corp. v. Smith*, 170 F.3d 44, 53 (3d Cir. 1948), *quoting Angel v. Bullington*, 330 U.S. 183, 191 (1947).

The Third Circuit recognized that the policy and purpose of diversity jurisdiction is to give neutral application to the controlling state's law, and to prevent the perceived discrimination by a state court against an out-of-state defendant. Abstention works counter to that purpose by depriving defendants of the federal forum that the law clearly makes available to them.

But the fact that *Dianoia's* was issued over a dissent suggests that abstention is still an argument that parties may have to address time and again, and not just in the context of COVID-19 claims. In the recent case of *Owners Insurance Company v. Scates Builders, LLC*, 2022 U.S. Dist. LEXIS 79001 (E.D. Ky. May 2, 2022), for example, a federal district court abstained from hearing a coverage suit where the insurer brought an affirmative complaint for declaratory relief, finding that efficiency, fairness, and federalism were best served by the federal court declining to exercise jurisdiction on the facts.

In *Scates Builders*, two couples filed separate state-court suits against the builder, alleging that faulty construction resulted in water damage to their homes. One of the underlying suits went to arbitration, where the homeowners recovered an award that was later confirmed by the Kentucky state court. The insurer brought a declaratory-judgment action in federal court, asserting that its commercial general liability insurance policies did not owe coverage on grounds that the underlying claims did not constitute "occurrences" and, in any event, asserted claims that were excluded from coverage, such as for breach of contract and for intentional and fraudulent acts. The insurers named the underlying homeowners as defendants in the suit.

The district court held that findings of fact in the state court proceedings, including with respect to the intent of certain representations and the acts of non-parties, were likely relevant to questions of coverage and should be developed in the state-court proceedings. "Were this court to exercise jurisdiction, it would deprive a state court of the opportunity to interpret and apply its own law." *Id.*, at *35.

F. Appeal Issues When Only the Duty to Defend Issue Has Been Decided

Under the declaratory judgment statute, "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. § 2201. The courts of appeals have jurisdiction over appeals from all "final decisions" of the district courts. 28 U.S.C. § 1291. When an insurer files a declaratory action on both the duty to defend and the duty to indemnify, but the district court does not definitively rule on both issues, the ability to appeal on adverse ruling may well depend on whether the trial court has made certain determinations under Fed. R. Civ. P. 54(b).

A Rule 54(b) order requires the district court to make two determinations: (1) that the order in question was truly a "final judgment," and (2) that there is no just reason to delay the appeal of the

claim that was "finally" decided. *See, e.g., Sears, Roebuck & Co. v. Mackey*, 351 U.S. 427, 435-37 (1956). Insurance coverage disputes are often distinct enough to satisfy the final-judgment rule and permit immediate appellate review under Rule 54(b) and § 1291 – as, for example, when coverage and liability issues in the same suit are bifurcated. *See Eberts v. Goderstad*, 569 F.3d 757, 760 (7th Cir. 2009). However, several decisions have highlighted some hazards for insurers seeking to appeal adverse rulings on their duty to defend when other issues have been left undecided in the district courts.

When a district court rules against an insurer on the duty to defend but leaves unresolved the issue of the insurer's duty to indemnify, the insurer should seek a Rule 54(b) determination from the trial court to preserve its opportunity to appeal. *See Penn-America Ins. Co. v. Mapp*, 521 F.3d 290 (4th Cir. 2008) (dismissing the insurer's attempt to appeal an adverse ruling on its duty to defend in a declaratory judgment action when a district court had declined to rule on the duty to indemnify but did not dismiss the case in its entirety). But, in some instances, even an express determination under Fed. R. Civ. P. 54(b) is no guarantee that an appellate court will consider a partial ruling in a declaratory action. *See General Ins. Co. of America v. Clark Mall Corp*., 644 F.3d 375 (7th Cir. 2011) (because the dispositive inquiry for jurisdictional purposes was whether a duty-to-defend order was truly "final," the court found that counterclaims that remained before the district court were substantively intertwined with the duty-to-defend issue and concluded that the final judgment pursuant to Rule 54(b) was entered in error).

III. Some Differences Between State Court and Federal Court Declaratory Actions

A. Ripeness[1]

As noted above, it is not uncommon for the federal district courts to hold that a declaratory judgment action regarding an insurer's duty to indemnify only becomes ripe after the underlying liability is settled. *See, e.g., Charter Oak Fire Ins. Co. v. Lazenby*, 2012 U.S. Dist. LEXIS 99765, *24-25 (W.D. Pa. 2012). This may not be the case under state law.

In California, for example, "[e]xhaustion of underlying limits, while necessary to entitle the insured to recover on the excess policy, is not necessary to create actual controversy." *Ludgate Ins. Co. v. Lockheed Martin Corp.*, 82 Cal. App. 4th 592, 606, 98 Cal. Rptr. 2d 277, 286 (2000) ("Exhaustion is merely an issue of proof and entitlement to recovery, not of pleading."); *see also Health Net, Inc. v. Am. Int'l Specialty Lines Ins. Co.*, 2016 WL 5845753, at *16 fn. 4 (Cal. Ct. App. Oct. 6, 2016) ("[T]he Ludgate court confirmed that '[e]xhaustion of underlying limits' . . . was 'not necessary to create actual controversy' for a declaratory relief action.").

The *Ludgate* court relied on Section 1060 of the California Code of Civil Procedure, which allows that "[a]ny person interested under a written instrument, . . . or under a contract, or who desires a declaration of his or her rights or duties with respect to another, or in respect to, in, over or upon property, . . . may, in cases of actual controversy relating to the legal rights and duties of the respective parties, bring an original action or cross-complaint in the superior court . . . for a

[1] The authors thank David Stanton of Covington & Burling for his contributions to this section.

declaration of his or her rights and duties in the premises, including a determination of any question of construction or validity arising under the instrument or contract." *Ludgate*, 82 Cal. App. 4th at 605 (alterations in original). As Section 1060 adds no other specific requirements for the existence of a controversy, the court held that "[e]xhaustion of underlying limits, while necessary to entitle the insured to recover on the excess policy, is not necessary to create actual controversy." *Id.* at 606. The threshold for asserting a controversy as the basis for a declaratory judgment action in California state court is therefore lower than the federal standard discussed above.

This difference between the California and federal standards for ripeness, however, has led to some apparent confusion among the California federal courts, which has only been exacerbated by the existence of the 1994 Ninth Circuit decision in *Iolab Corp. v. Seaboard Sur. Co.*, 15 F.3d 1500 (9th Cir. 1994). In that case, the district court had dismissed the policyholder's breach of contract claims against its excess insurers because the legal obligations of the primary insurer had not yet been determined, and the Ninth Circuit affirmed. *Id.* at 1504. The Ninth Circuit then went on to find that had the claim been framed as one for declaratory relief, it would fare no better, but the court did so based on its interpretation of California law, *not* the Article III case-or-controversy requirements discussed above:

> Second, the district court did not abuse its discretion in refusing to treat Iolab's action as a request for declaratory relief. The court in *Hartford*, applying California law, "rejected the proposition that 'once the excess insurer has been given notice that the . . . claim against its insured might invade the excess coverage, and the amount of potential exposure is reasonably ascertainable, the excess insurer should be obligated to participate immediately in the defense.'" *Hartford*, 861 F.2d at 1186 (citing *Signal*, 27 Cal.3d at 366, 165 Cal.Rptr. 799, 612 P.2d 889). The *Hartford* court explained that "requiring the excess insurer to join the defense 'would require the [excess insurer] to contribute to the defense costs incurred by the primary carrier even though excess liability might never attach and despite explicit provisions of [the excess insurer's] policy.'" *Id.* (citing *Signal*, 27 Cal.3d at 367-68, 165 Cal.Rptr. 799, 612 P.2d 889). The policy behind the *Hartford* holding, to avoid the imposition of unnecessary litigation costs on excess insurers, applies to a breach of contract claim and to an action for declaratory relief alike. That policy applies here. Iolab has not established that the Jensen loss will ever trigger excess coverage. Regardless of how Iolab's claim against the excess insurers is labeled, requiring the excess insurers to defend against Iolab's claim would impose on the excess insurers the unnecessary cost of litigating a claim that may never trigger excess coverage and thereby would frustrate the policy adopted by California courts. Consequently, the district court did not abuse its discretion in failing to relabel Iolab's complaint as a request for declaratory relief and properly dismissed the claims against the excess insurers.

Id. at 1504-05.

Perhaps unsurprisingly, subsequent federal court decisions in California have struggled to reconcile *Ludgate* and *Iolab*. In *Fremont Reorganizing Corp. v. Fed. Ins. Co.*, an excess insurer

moved to dismiss the insured's claims as "premature" because "its duty to indemnify [] is not triggered until the primary policy is exhausted by payment." 2010 WL 444718, at *2 (C.D. Cal. Feb. 1, 2010). The insurer relied on *Iolab*, and the court acknowledged that "[u]nder *Iolab*, an insured simply cannot state a claim against an excess insurer until the liability of the primary insurer has been established." *Id.* at *3. But the court, citing *Erie*, then held that "to the extent that *Ludgate* is inconsistent with *Iolab*, the Court follows the rule in *Ludgate*. A federal court sitting in diversity applies state law." *Id.*[2]

The same court addressed this issue again the following year in *Hensel Phelps Constr. Co. v. TIG Ins. Co.*, which acknowledged that "*Fremont* held *Iolab* was not controlling because the more recent California case of *Ludgate* . . . supposedly rejected the *Iolab* rule requiring that an excess carrier cannot be sued until the primary insurance has been exhausted." 2011 WL 13130486, at *8 (C.D. Cal. Oct. 5, 2011). But the Court was "not persuaded" that *Ludgate* was relevant, because it was "primarily a pleading case that addresses the adequacy of a complaint under the California declaratory relief statute." *Id.*

At least one takeaway from these conflicting cases appears to be that the differences between federal and state ripeness standards may present a trap for the unwary, and those unwary may at times include federal courts themselves.

Moving from California to Delaware, the courts of that state have adopted a somewhat flexible approach somewhere between the stricter federal standard and the permissive standard of the California Code of Civil Procedure. In particular, the Delaware courts have developed a series of five factors—known as the "Schick Factors"—to guide "[t]he Court's discretion in making th[e] common sense determination" as to "whether a case [is] ripe for judicial review." *Energy Transfer Equity, L.P. v. Twin City Fire Ins. Co.*, 2020 WL 5758027, at *5 (Del. Super. Sept. 28, 2020) (citing, *inter alia*, *Schick Inc. v. Amalgamated Clothing & Textile Workers Union*, 533 A.2d 1235, 1239 (Del. Ch. 1987)). Those factors are as follows:

> [1] a practical evaluation of the plaintiff's legitimate interest in prompt resolution of the question presented . . . [2] the hardship that further delay may threaten . . . . [3] the prospect of future factual development that might affect the determination to be made; [4] the need to conserve scarce resources; and [5] a due respect for identifiable policies of the law touching upon the subject matter of the dispute.

XL Spec'y Ins. Co. v. WMI Liquidating Tr., 93 A.3d 1208, 1217 n.43 (Del. 2014) (quoting *Schick*, 533 A.2d at 1239). The advantage to this approach over the federal standard is that it gives courts a framework for determining when the benefits of a declaratory judgment action outweigh its costs—for example, in the situation in which a policyholder needs certainty around its entitlement to coverage in order to be able to engage in settlement negotiations with an underlying claimant.

[2] The court arrived at this conclusion without acknowledging the precise holding of Erie: *"[e]xcept in matters governed by the Federal Constitution or by acts of Congress*, the law to be applied in any case is the law of the state." 304 U.S. 64, 78 (1938) (emphasis added).

In sum, there are meaningful differences among jurisdictions with respect to when a declaratory judgment action may be maintained, and it is important to be cognizant of these differences and their consequences for both policyholders and insurers.

B. Fee Shifting in Some States

Practitioners and parties to an insurance policy may also want to be familiar with significant differences between state and federal practice when it comes to fee-shifting. The federal declaratory judgment statute is a product of the so-called "American rule," and requires that each party bear its own costs. The rules in some states differ.

New Hampshire, for instance, has a statute that awards attorneys' fees to a prevailing policyholder in a declaratory judgment action, regardless of whether it is the plaintiff or the defendant. *See* N.H. Rev. Stat. Ann. § 491:22-b (1973).

The Texas Declaratory Judgment Act allows courts to award any party "costs and reasonable and necessary attorney's fees as are equitable and just." But the Fifth Circuit has held that this is procedural, rather than substantive, so there is no fee-shifting in federal courts for cases involving Texas law. *Utica Lloyd's of Texas v. Mitchell*, 138 F.3d 208, 210 (5th Cir. 1998).

IV. Conclusion

This paper has reviewed the requirements for pursuing that relief in both federal court and state courts. Practitioners, insureds, carriers, and decision-makers at all levels should be familiar with the law and with the requirements that prevail in their respective jurisdictions.