

THE NUTS AND BOLTS OF DECLARATORY JUDGMENT ACTIONS

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Actions for declaratory judgment are a common feature of a litigator's insurance coverage practice. Sometimes they can be simple and straightforward and other times they can be complex, protracted and expensive. This article is intended to address many of the substantive and procedural issues that arise in declaratory judgment actions.

Statute and Rule

The declaratory judgment remedy is a means to adjudicate the rights and duties of parties (a) in cases involving an actual controversy that has not reached the point at which either party may sue for a coercive remedy such as money damages and (b) in cases where a party who could sue has not yet done so. Wright & Miller, *Federal Practice and Procedure* §2751. The uniqueness of the remedy is that an actual wrong or loss need not have occurred for the courts to be able to grant declaratory relief.

The remedy became a part of our American jurisprudence in the 1920s and 1930s. The North Carolina legislature enacted the Uniform Declaratory Judgment Act in 1931. N.C. Gen. Stat. §1-253 to §1-267. Congress passed the Federal Declaratory Judgment Act in 1934. 28 U.S.C. §2201. The federal and state statutes are not jurisdictional and do not create or grant jurisdiction where it does not otherwise exist nor do they extend the

jurisdiction of the courts over the subject matter or the parties. *See e.g. State ex rel. Edmisten v. Tucker*, 312 N.C. 326, 323 S.E.2d 294 (1984).

1. **North Carolina.** Article 26 of the North Carolina’s declaratory judgment statute reads as follows:

Courts of record within their respective jurisdictions shall have power to declare rights, status, and other legal relations, whether or not further relief is or could be claimed. No action or proceeding shall be open to objection on the ground that a declaratory judgment or decree is prayed for. The declaration may be either affirmative or negative in form and effect; and such declarations shall have the force and effect of a final judgment or decree.

N.C. Gen. Stat. §1-253. Moreover, “[a]ny person ... whose rights, status, or other legal relations are affected by a statute ... may have determined any question of construction or validity arising under the ... statute ... and obtain a declaration of rights, status, or other legal relations thereunder.” *Id.* at §1-254. These statutes are complimented by Rule 57 of the North Carolina Rules of Civil Procedure, which states:

The procedure for obtaining a declaratory judgment pursuant to Article 26, Chapter 1, General Statutes of North Carolina, shall be in accordance with these rules, and the right to trial by jury may be demanded under the circumstances and in the manner provided in Rules 38 and 39. The existence of another adequate remedy does not preclude a judgment for declaratory relief in cases where it is appropriate. The court may order a prompt hearing of an action for a declaratory judgment and may advance it on the calendar.

N.C. Gen. Stat. §1A-1, Rule 57, N.C. Civ. Pro. As can be seen, there is some overlap of the provisions in Rule 57 and the statute §1-253, but the courts have been able to construe them together without much trouble.

2. **Federal.** The federal declaratory judgment statute is similar to North Carolina’s statute and states as follows:

In a case of actual controversy within its jurisdiction ... any court of the United States ... 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. Rule 57 of the Federal Rules of Civil Procedure is also similar to North Carolina's Rule 57 and states as follows:

These rules govern the procedure for obtaining a declaratory judgment under 28 U.S.C. §2201. Rules 38 and 39 govern a demand for a jury trial. The existence of another adequate remedy does not preclude a declaratory judgment that is otherwise appropriate. The court may order a speedy hearing of a declaratory judgment action.

Fed. Rule Civ. Pro. 57.

Purpose and Scope

North Carolina's Declaratory Judgment Act is designed to provide "an expeditious method of procuring a judicial decree construing wills, contracts, and other written instruments and declaring the rights and liabilities of parties thereunder." *Ripley v. Day*, 141 N.C.App. 546, 539 S.E.2d 384, 386 (2000). The purpose is to "preserve inviolate the ancient and sound juridic concept that the inherent function of judicial tribunals is to adjudicate genuine controversies between antagonistic litigants with respect to their rights, status or other legal relations." *Gaston Bd. of Realtors v. Harrison*, 311 N.C. 230, 234, 316 S.E.2d 59 (1984) (citation omitted). The Act is remedial and is to be liberally construed and administered. N.C.Gen. Stat. §1-264; *Little v. Wachovia Bank & Trust Co.*, 252 N.C.229, 243, 113 S.E.2d 689 (1960).

Federal authority focuses on similar concepts. "A declaratory judgment is appropriate when it will 'terminate the controversy' giving rise on undisputed or

relatively undisputed facts, it operates frequently as a summary proceeding, justifying docketing the case for early hearing as on a motion,..." Advisory Committee Notes, Federal Rule 57. If the issuance of declaratory relief would effectively settle the dispute and clarify the legal relations at issue, then it may be granted. Wright & Miller, *Federal Practice and Procedure* §2759. A district court is obliged to rule on the merits of a declaratory judgment action when declaratory relief "will serve a useful purpose in clarifying and settling the legal relations in issue," and "will terminate and afford relief from the uncertainty, insecurity, and controversy giving rise to the proceeding." *Volvo Construction Equipment North America v. CLM Equipment Company, Inc.*, 386 F.3d 581, 594 (4th Cir. 2004) (citation omitted).

On the other hand, the courts have no jurisdiction to determine matters purely speculative, enter anticipatory judgments, declare social status, deal with theoretical problems, give advisory opinions, answer moot questions, adjudicate academic matters, provide for contingencies which may hereafter arise, or give abstract opinions. *Little v. Wachovia Bank & Trust Co.*, 252 N.C.229, 243, 113 S.E.2d 689 (1960). The statute "does not undertake to convert judicial tribunals into counselors and impose upon them the duty of giving advisory opinions to any parties who may come into court and ask for either academic enlightenment or practical guidance concerning their legal affairs." *Lide v. Mears*, 231 N.C. 111, 117-18, 56 S.E.2d 404, 409 (1949). The declaratory remedy is not appropriate for unresolved issues of fact not tied to questions of law, such as a negligence action. *Strickland v. Town of Aberdeen*, 124 N.C.App. 430, 477 S.E.2d 218 (1996).

A declaratory judgment action may be brought to determine whether coverage exists under an insurance policy. *Western World Ins. Co., Inc. v. Carrington*, 90 N.C.App. 520, 522, 369 S.E.2d 128, 129 (1988), or whether the insurer has a duty to defend the insured under the policy. *W&J Rives, Inc. v. Kemper Ins. Group*, 92 N.C.App. 313, 374 S.E.2d 430 (1988). Such an action is appropriate even prior to a breach of the insurance policy. *Harleysville Mut. Ins. Co. v. Narron*, 155 N.C.App. 362, 368, 574 S.E.2d 490 (2002). The U.S. Supreme Court has also concluded that a dispute between a liability insurer, its insured, and a third party with a tort claim against the insured over the extent of the insurer's responsibility for that claim is an “actual controversy” within the meaning of the federal Declaratory Judgment Act, even though the tort claimant has not yet reduced his claim against the insured to judgment. *Maryland Cas. Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270 (1941); *Stout v. Grain Dealers Mut. Ins. Co.*, 307 F.2d 521 (4th Cir. 1962). The Fourth Circuit has noted that the nature of the duties a liability insurer owes its insured makes such disputes particularly appropriate for early resolution in a declaratory action. *Nautilus Ins. Co. v. Winchester Homes, Inc.*, 15 F.3d 371, 376 (4th Cir. 2000).

However, issues as to excess liability insurance coverage have been held inappropriate for declaratory relief where the primary liability insurance either has not been exhausted or is sufficient to satisfy the underlying claim. *N.C. Farm Bureau v. Warren*, 89 N.C.App. 148, 365 S.E.2d 216 (1988).

Pleading and Proof Requirements

The complaint and the record must show that an actual controversy exists.

Western World Ins. Co., Inc. v. Carrington, 90 N.C.App. 520, 522, 369 S.E.2d 128, 129 (1988). As the North Carolina Supreme Court has stated:

It is required only that the plaintiff shall allege in his complaint and show at the trial that a real controversy, arising out of their opposing contentions as to their respective legal rights and liabilities under a deed, will, or contract in writing, or under a statute, municipal ordinance, contract, or franchise, exists between or among the parties, and that the relief prayed for will make certain that which is uncertain and secure that which is insecure.

Carolina Power & Light Co. v. Iseley, 203 N.C. 811, 167 S.E. 56 (1933). “Although the North Carolina Declaratory Judgment Act does not state specifically that an actual controversy between the parties is a jurisdictional prerequisite to an action thereunder, our case law does impose such a requirement.” *Bueltel v. Lumber Mut. Ins. Co.*, 134 N.C.App. 626, 628, 518 S.E.2d 205 (1999) (citation omitted). For there to be an “actual controversy,” there must be more than a mere disagreement between the parties and litigation must “appear unavoidable.” *Id.* “A mere difference of opinion between the parties” does not constitute a controversy within the meaning of the Declaratory Judgment Act. *Gaston Bd. of Realtors v. Harrison*, 311 N.C. 230, 234, 316 S.E.2d 59 (1984) (citation omitted). But the court does “not require the plaintiff to show with absolute certainty that litigation will arise; the plaintiff must merely demonstrate to a ‘practical certainty’ that litigation will ensue.” *Ferrell v. Department of Transportation*, 334 N.C. 650, 656, 435 S.E.2d 309, 315 (1993) (citation omitted).

The parties may not confer jurisdiction on a court by consenting or stipulating to jurisdiction for a DJ action. *City of Raleigh v. Norfolk S. Ry.*, 275 N.C. 454, 168 S.E.2d

389 (1969). Referring to the Declaratory Judgment Act is not necessary in the pleading so long as the facts alleged are sufficient to state a claim for declaratory judgment.

Langdon v. Hurdle, 15 N.C.App. 158, 189 S.E.2d 517 (1972). But the better practice is to allege that the action is being filed pursuant to the statute and Rule 57.

The actual controversy must exist “both at the time of the filing of the pleading and at the time of hearing.” *Harleysville Mut. Ins. Co. v. Narron*, 155 N.C.App. 362, 368, 574 S.E.2d 490 (2002) (citations omitted). In an earlier panel of the Court of Appeals took a different view, in *Sharpe v. Park Newspapers of Lumberton, Inc.*, where it was stated:

There is no absolute requirement that the controversy exist at the time the pleadings are filed. Indeed, the Supreme Court in *Gaston Realtors* expressly considered both the pleadings and the evidence in resolving the genuine controversy issue. *Gaston Bd. of Realtors v. Harrison*, 311 N.C. 230, 235, 316 S.E.2d 59, 62 (1984). The requirement of an existing controversy imposed by our courts is comparable to that under Federal Declaratory Judgment Act, 28 U.S.C. 2201. See *Town of Tryon v. Duke Power Co.*, 222 N.C. 200, 22 S.E.2d 450 (1942). The U.S. Supreme Court has held that under that Act the controversy must exist at the time of hearing, not at the time of the complaint. *Golden v. Zwickler*, 394 U.S. 103 (1969).

78 N.C.App. 275, 337 S.E.2d 174, 177 (1985).

It is not necessary under the Declaratory Judgment Act that there exist a controversy between each and every party to the action, assuming there are multiple plaintiffs and/or defendants. *Singleton v. Sunset Beach & Twin Lakes, Inc.*, 147 N.C.App. 736, 556 S.E.2d 657 (2001)

The plaintiff need not plead that it has already sustained an injury to file suit under the Act. As stated by the Court of Appeals, a declaratory judgment action may be maintained “without actual wrong or loss as its basis.” *American Civil Liberties Union of North Carolina, Inc. v. State*, 181 N.C.App. 430, 433, 639 S.E.2d 136 (2007). But the

demand for relief shall state with precision the declaratory judgment relief sought, cumulatively or in the alternative. Advisory Committee Notes, Rule 57, Fed.R.Civ.Pro.

Burden of proof may become an issue when an insurer seeks declaratory relief that there is no coverage under an insurance policy. Several courts have held that the burden should not be shifted from the insured to the insurer merely because the insurer institutes the action as one for declaratory judgment. *See e.g. American Eagle Ins. Co. v. Thompson*, 85 F.3d 327 (8th Cir. 1996) (insured seeking coverage has burden of proving coverage). Other courts have not accepted this rule and have required that the party filing the action has the burden of proof. *See e.g. Liberty Mutual Ins. Co. v. Sweeney*, 216 F.2d 209, 210 (3d Cir. 1954); *NRT Metals, Inc. v. Manhattan Metals (Non-Ferrous) Ltd.*, 576 F.Supp. 1046 (D.C.N.Y. 1983).

A party to a declaratory action has a right to trial by jury. N.C.Gen.Stat. §1-261. The court may award costs “as may seem equitable and just.” *Id.* at §1-263.

Proper and Necessary Parties

“When declaratory relief is sought, all persons shall be made parties who have or claim any interest which would be affected by the declaration, and no declaration shall prejudice the rights of persons not parties to the proceedings.” N.C. Gen. Stat. §1-260. The statute does “not require that the participating parties be strictly designated as having adverse interests in relation to each other.” *Hoke County Bd. of Educ. v. State*, 358 N.C. 605, 617, 599 S.E.2d 365, 378 (2004). The plaintiff “must have a practical interest in the declaration sought and all parties having an interest therein or adversely affected must be made parties or be cited.” Advisory Committee Notes, Federal Rule 57.

When a “necessary party” to a declaratory suit has not been joined in the action, the trial court should not proceed until the absent person is brought into the action as a party. *N.C. Monroe Construction Co. v. Guilford County Board of Education*, 278 N.C. 633, 640, 180 S.E.2d 818, 822 (1971). A person is a necessary party in a declaratory judgment action when “he is so vitally interested in the controversy involved ... that a valid judgment cannot be rendered in the action completely and finally determining the controversy without his presence as a party.” *Inland Greens HOA, Inc. v. Dallas Harris Real Estate-Construction, Inc.*, 127 N.C.App. 610, 492 S.E.2d 359, 361-62 (1997). Whether a proper but not necessary party may be joined in a DJ action is within the discretion of the court. *N.C. Monroe*, 278 N.C. 633, 180 S.E.2d 818; *but see Singleton v. Sunset Beach & Twin Lakes, Inc.*, 147 N.C.App. 736, 556 S.E.2d 657 (2001) (appellate court reversed the dismissal of a proper party whose interest would be affected by declaratory judgment).

The issue of proper and necessary party surfaces in declaratory judgment actions to construe insurance policies. Clearly, the insurance company is a proper and necessary party. *See e.g. Welling v. Walker*, 117 N.C.App. 445, 451 S.E.2d 329 (1994) (trial court properly denied motions for partial summary judgment and declaratory judgment to determine whether automobile policy provided for payment of prejudgment interest in action between motorists involved in automobile accident where insurer was not a party to the action and had interest in the proceeding). The insured is also a proper and necessary party.

But case law is mixed as to whether a claimant/injured person is a proper and necessary party defendant to a declaratory judgment action. One panel of the Court of

Appeals has held that a claimant is “a proper party to the declaratory judgment.” *Nationwide Mut. Ins.Co. v. Anderson*, 118 N.C.App. 92, 95, 453 S.E.2d 542 (1995). The court noted the common practice of making the claimant a party defendant and stated that the claimant “has more than an incidental or indirect interest in this matter, particularly since it will be conclusive on the issue of coverage.” *Id.* The claimant being a party to the action, the appeal presented the claimant’s “sole opportunity to contest the court's decision.” *Id.* at 96. One commentator has stated that such alleged injured party must be joined as a party defendant. *See Moore’s Federal Practice*, §57.11[1][a]. However, other panels of the Court of Appeals appear to take a different view. For instance, in *U.S.F.&G v. Scott*, 124 N.C.App. 224, 226-27, 476 S.E.2d 404, 406 (1996), the court held that “a party does not automatically qualify as a proper party merely because they have been included as a defendant in a declaratory judgment action,” and until the insured’s liability is established, a claimant has “no interest in the subject matter of the litigation.”

The law seems clearer that a claimant/injured person may not be a plaintiff in a declaratory action prior to obtaining a judgment against the insured tort-feasor. In *Dement v. Nationwide Mut. Ins. Co.*, 142 N.C.App. 598, 554 S.E.2d 797, 801 (2001), the appellate court ruled that an automobile accident victim could not bring an action directly against the tort-feasor's liability insurer for a declaratory judgment because the accident victim's claim was merely incidental to the insurance policy, and plaintiff's claim against the insured tort-feasor had not been established as an enforceable contractual right. *See also McLaughlin v. Martin*, 92 N.C.App. 368, 369, 374 S.E.2d 455, 456 (1988)

(“Without a judgment, plaintiff cannot establish a ‘right’ to recover and liability of the insured does not attach.”).

Existence of Another Adequate Remedy

“Existence of another adequate remedy does not preclude judgment for declaratory relief, which preserves the discretionary right of the court to decline to declare rights.” Comment to Rule 57, N.C. R.Civ. Pro. As stated by the North Carolina Supreme Court, the “mere existence of an alternate adequate remedy will not be held to bar an appropriate action for declaratory judgment.” *State v. Fayetteville St. Christian School*, 299 N.C. 351, 356 n. 3, 261 S.E.2d 908 (1980). “The fact that a declaratory judgment may be granted ‘whether or not further relief is or could be prayed’ indicates that declaratory relief is alternative or cumulative and not exclusive or extraordinary,” and “the fact that another remedy would be equally effective affords no ground for declining declaratory relief.” Advisory Committee Notes, Rule 57, Fed.R.Civ.Pro. For example, the availability of injunctive relief does not preclude declaratory relief. *N.C. Monroe*, 278 N.C. 633, 180 S.E.2d 818. However, the availability of another remedy may give the court the discretion to deny declaratory relief. Rule 57, Fed.R.Civ.Pro., Comment.

Discretionary Authority to Grant Declaratory Relief – Parallel Proceedings Pending in State Court

Federal district courts often face the issue of whether it should decline to grant declaratory relief when there is a parallel proceeding pending in state court.¹ There is no *per se* rule forbidding a federal court from entertaining a declaratory action brought to resolve issues of insurance coverage during the pendency of related litigation against the insured in the state courts. *Nautilus Ins. Co. v. Winchester Homes, Inc.*, 15 F.3d 371, 376 (4th Cir. 2000).

“It is commonly said that the granting of declaratory relief is a matter resting in the judicial discretion of the district court.” *Stout v. Grain Dealers Mut. Ins. Co.*, 307 F.2d 521, 523 (4th Cir. 1962). The decision to entertain a claim for declaratory relief is reviewed under an abuse of discretion standard, as opposed to a *de novo* standard. *Aetna Cas. & Sur. Co. v. Ind-Com Electric Company*, 139 F3d 419, 421 (4th Cir. 1998).

However, another panel of the Fourth Circuit appears to have taken a contrary view. In *Nautilus Ins. Co. v. Winchester Homes, Inc.*, 15 F.3d 371 (4th Cir. 2000), overruled on other grounds, *Wilton v. Seven Falls Co.*, 515 U.S. 277, 289-90 (1995), the Fourth Circuit stated that it does not approach the case in a wholly deferential posture, but instead exercises its own judgment in reviewing the various interests at stake – “We have characterized this review, which requires us effectively to ‘substitute our discretion for that of the district court,’ as essentially ‘de novo.’” *Id.* at 375. Though a federal court has some measure of discretion to decline to entertain a declaratory judgment action, the discretion is not unbounded. *Id.* A district court may not refuse to entertain a declaratory

¹ There is no requirement that a parallel proceeding be pending in state court before a federal court should decline to exercise jurisdiction over a declaratory judgment action. *Aetna Cas. & Sur. Co. v. Ind-Com Electric Company*, 139 F3d 419, 423 (4th Cir. 1998). The existence or nonexistence of a state court action is simply one consideration relevant to whether to grant declaratory relief.” *Id.* “Clearly, the existence of such a proceeding should be a significant factor in the district court’s determination. But it is not dispositive.” *Id.*

judgment action out of “whim or personal disinclination,” but may do so only for “good reason.” *Id.* (citations omitted).

The breadth of a district court's discretion in determining whether to exercise its jurisdiction in declaratory judgment actions was resolved by the U.S. Supreme Court in *Wilton*. The Court rejected the rule that a district court may decline jurisdiction under only “exceptional circumstances” and concluded that the district court had more discretion in determining whether to exercise jurisdiction. *Id.* at 281-82. The Court stated that distinct features of the Declaratory Judgments Act “justify a standard vesting district courts with greater discretion in declaratory judgment actions than that permitted under the ‘exceptional circumstances’ test.” *Id.*

The *Wilton* Court stated that the rules articulated in *Brillhart v. Excess Ins. Co.*, 316 U.S. 491, 495 (1942) govern a district court's decision to stay or dismiss a declaratory judgment action while parallel state court proceedings are pending. In *Brillhart*, an insurer, anticipating a coercive suit, sought a declaration in federal court of non-liability on an insurance policy. The *Brillhart* Court upheld the district court's refusal to exercise jurisdiction over the declaratory judgment action. In upholding the refusal to exercise jurisdiction, the *Brillhart* Court explained that “[o]rdinarily 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 v. Excess Ins. Co.*, 316 U.S. 491, 495 (1942). The *Brillhart* Court further cautioned that when a related state proceeding is underway, a court considering a declaratory judgment action should specifically consider whether the controversy “can better be settled in the proceeding

pending in the state court.” *Id.* The *Brillhart* Court noted that this consideration should be guided by a number of factors, including the nature and scope of the state proceeding and “whether the claims of all parties in interest can satisfactorily be adjudicated in that proceeding” *Id.* In discussing *Brillhart*, the *Wilton* Court observed: “*Brillhart* indicated that, at least where another suit involving the same parties and presenting opportunity for ventilation of the same state law issues is pending in state court, a district court might be indulging in ‘[g]ratuitous interference,’ if it permitted the federal declaratory action to proceed.” *Wilton*, 515 U.S. at 283 (citation omitted).²

Adding to the principles enunciated by the Supreme Court in *Wilton*, the Fourth Circuit Court of Appeals has developed a multi-factor balancing test that is guided by

² This analysis is not to be confused with the abstention doctrine. Abstention comes into play when non-declaratory relief claims are asserted in a civil action. The U.S. Supreme Court has cautioned that federal courts are bound by a “virtually unflagging obligation ... to exercise the jurisdiction given them.” *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976). The high court, however, has indicated that, in certain limited instances, federal courts may abstain, *i.e.* decline, to exercise their jurisdiction, in otherwise ‘exceptional circumstances,’ where denying a federal forum would clearly serve an important countervailing interest.” *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 716 (1996) (quoting *Colorado River*, 424 U.S. at 813). “These ‘exceptional circumstances’ inevitably relate to a policy of avoiding unnecessary constitutional decisions and of accommodating federal-state relations.” *Chase Brexton Health Servs, Inc. v. Maryland*, 411 F.3d 457, 462 (4th Cir. 2005).

When a complaint states claims for both nondeclaratory and declaratory relief, there is a question as to which standard -- abstention under *Colorado River* or relaxed standard under *Brillhart/Wilton* -- governs the decision whether to order a stay in favor of the parallel state proceedings. *Great American Ins. Co. v. Gross*, 468 F.3d 199, 210-11 (4th Cir. 2006). Some courts have held that the *Brillhart/Wilton* discretionary standard is *per se* supplanted by the harsher *Colorado River* standard whenever an action includes both declaratory and non-frivolous nondeclaratory claims. *See e.g. Kelly Inv., Inc. v. Continental Common Corp.*, 31 F.3d 494, 497 n. 4 (5th Cir. 2002). Other courts hold that jurisdiction is mandatory (subject only to *Colorado River* constraints) if the nondeclaratory claims can exist independently of the declaratory claims, such that they could survive even if the declaratory claims vanished. *See e.g. United National Ins. v. R&D Latex Corp.*, 242 F.3d 1102, 1112-13 (9th Cir. 2001). Another view, embraced by some district courts, looks to the “heart of the action” to determine if the *Colorado River* standard or the *Brillhart/Wilton* standard should apply. *See, e.g. ITT Indus., Inc. v. Pacific Employers Ins. Co.*, 427 F.Supp.2d 552, 555-56 (E.D.Pa. 2006). Under this approach, if the outcome of the nondeclaratory claims hinges on the outcome of the declaratory ones, the *Brillhart/Wilton* standard governs; conversely, if the opposite applies, the *Colorado River* standard controls. *See*

considerations of federalism, efficiency, and comity. *Mitcheson v. Harris*, 955 F.2d 235, 237-40 (1992). These additional concerns require a court to consider:

(1) the strength of the state's interest in having the issues raised in the federal declaratory judgment action decided in the state courts;

(2) whether the issues raised in the federal action can be more efficiently resolved in the court in which the state action is pending;

(3) whether permitting the action to go forward would result in unnecessary “entanglement” between the federal and state courts; and

(4) whether the federal action is being used merely as a device for “procedural fencing”- that is, “to provide another forum in a race for *res judicata*” or “to achieve a federal hearing in a case otherwise not removable.”

Nautilus Ins. Co. v. Winchester Homes, Inc., 15 F.3d 371, 377 (4th Cir. 1994).

The Middle District of North Carolina followed these guidelines in declining to exercise discretionary authority to grant declaratory relief on the issue of whether an insured's uninsured motorist claim was barred by the three-year statute of limitations.

Netherlands Ins. Co. v. Cockman, 342 F.Supp. 2d 396 (M.D.N.C. 2004).

1. As to the first factor – North Carolina’s interest in having the issues raised in the federal action decided in the state courts – the Middle District acknowledged that a state court will have a particularly strong interest in resolving an issue of state law that is particularly “close,” “difficult,” or “problematic.” *Id.* at 401, citing *Nautilus*, 15 F.3d at 378; *Continental Cas. Co. v. Fuscardo*, 35 F.3d 963, 967 (4th Cir. 1994). “Thus, finding that the state law at issue is not entirely settled is a factor weighing against the federal

e.g. Lexington Ins. Co. v. Rolison, 434 F.Supp.2d 1228, 1236 (S.D.Ala. 2006).

court's exercise of jurisdiction.” *Netherlands*, 342 F.Supp.2d at 401; *see also Miles Lumber Co. v. CNA Financial Corp.*, 233 F.3d 821, 824 (4th Cir. 2000) (coverage issue was the interpretation of certain exclusions in a CGL policy -- “although this case will involve the application of state law, there is nothing that would give West Virginia courts a particularly strong interest in deciding it”); *but see Argonaut Great Central Ins. Co. v. McDowell County*, 626 F.Supp.2d 554, 562 (W.D.N.C. 2009) (weighing heavily in favor of dismissal: North Carolina has a fundamental interest in contracts providing liability insurance to counties where a statute requires a claimant to forfeit the right to jury trial and have certain issues relating to insurance determined by the trial judge).

2. As to the second factor – whether the issues raised can be more efficiently resolved in a state court action – the court listed the following factors weighing against its exercise of jurisdiction: the court has no jurisdiction to resolve the tort issues raised in the state court lawsuit, the UM coverage issue and underlying state tort issues were already pending in the state court, and thus the North Carolina state court is the only court with the jurisdictional power to resolve all facets of the controversy. *Id.* at 409; *see Nautilus*, 15 F.3d at 378-79 (this factor requires careful inquiry into “the scope of the pending state court proceeding[s],” including such matters as “whether the claims of all parties in interest [to the federal proceeding] can satisfactorily be adjudicated in that proceeding, whether necessary parties have been joined, [and] whether such parties are amenable to process in that proceeding.”)

3. As to the third factor -- whether permitting the action to go forward would result in unnecessary “entanglement” between the federal and state courts -- the court again found a factor weighing against its exercising jurisdiction, namely, there is a clear

threat of unnecessary entanglement between the state and federal courts in the case because any decision by the court on UM coverage will preclude the parties from relitigating the issue in the state court action. *Netherlands*, 342 F.Supp.2d at 409-10; *see Nautilus*, 15 F.3d at 380 (Fourth Circuit considered whether there is a significant overlap in the issues of fact that must be decided to resolve the two separate and independent legal controversies).

4. As to the fourth factor -- whether the federal action is being used merely as a device for “procedural fencing” – the Middle District found that the insurer appeared to be engaging in procedural fencing. The insurer had waited until two years after the state court lawsuit was commenced to bring a declaratory judgment action in federal court. Plus, the insurer had filed the federal action after discovery had already been conducted in the non-removable state court lawsuit and after the UM coverage issue was pending in the form of the insurer’s motion for summary judgment. *Netherlands*, 342 F.Supp.2d at 410; *see Nautilus*, 15 F.3d at 380 (this factor comes into play when a party has raced to federal court in an effort to get certain issues that are already pending before the state courts resolved first in a more favorable forum); *Fuscardo*, 35 F.3d at 967-69 (affirming district court's dismissal, holding that although none of insurance issues raised in DJ action were being litigated in state court personal injury action when the DJ action was filed, and although the issues of state law were relatively settled, dismissal was appropriate because (1) the state courts had an interest in resolving issues of substantive state law in state court; (2) there was a likelihood that the UM carrier filed the DJ action in federal court to acquire the most hospitable forum; and (3) efficiency warranted resolving issues in context of pending state proceeding).

Practical Tips and Observations

Insurer's Perspective.

1. Filing a declaratory judgment action early in a coverage dispute is often better than waiting for months or years to file it. Filing the action before the insured files a bad faith action could have the positive effect of persuading the court early in the litigation that the insurer's coverage position is reasonable and not subject to extra-contractual liability

2. Joining as many parties in interest as possible increases the odds of the controversy being fully adjudicated. *Res judicata* applies to all parties to the action.

3. When an insured brings an action for both declaratory relief and bad faith, the insurer would be well served to counterclaim for declaratory relief. The counterclaim is the insurer's opportunity to tell its story in the pleadings phase and makes it more difficult for the insured to take a voluntary dismissal of its complaint without prejudice.

4. Adding the insurance policy as an exhibit to its pleading – the complaint or counterclaim – could increase the odds of a quick ruling of judgment on the pleadings.

5. It is generally a good idea to follow a discovery plan that is as efficient and streamlined as possible. Serving interrogatories and document requests that are focused and not overly broad is usually the preferred approach. Requests for admissions are a good discovery tool to further narrow the issues and eliminate the need for many depositions. Take only the depositions that are absolutely necessary and stick to what is needed to satisfy the burden of proof.

6. Summary judgment of no coverage should be the ultimate goal. Affidavits are often essential. Stipulated facts may be the best way to help the court focus on the legal issues that favor the insurer. Well written, concise briefs can go a long way toward winning summary judgment.

Insured's Perspective.

1. State court is generally perceived as a more favorable forum for insureds in declaratory judgment actions than federal court. To avoid removal to federal court, insureds should consider naming defendants whose citizenship would defeat the diversity of citizenship required for federal jurisdiction, but the claim against such defendants must be valid.

2. If the insured decides to file a bad faith action against its insurer, the insured should include a claim for declaratory relief to prove coverage. Otherwise, the insured could face the insurer argument that there is no bad faith in the absence of a breach of the insurance contract.

3. The common practice for insureds is to sue an insurer for declaratory relief and breach of contract, along with counts for bad faith and unfair and deceptive trade practices. The addition of the extra-contractual liability claims may tend to create protracted expensive litigation. If the insured wants a fairly quick resolution of the coverage question, it may be better not to add the extra-contractual claims.

4. The insured is at an advantage as a plaintiff in a declaratory judgment action because it can tell its story first, be the aggressor, and put the insurer on the defensive from the very beginning of the case.

5. If the insurer is providing a defense under a reservation of rights but does not also file a declaratory judgment action, the insured may be better off not filing a DJ action as well. Having your defense lawyer be paid by the insurer is a good benefit. The odds are favorable that the insurer will be amenable to settling the coverage dispute at the same time as the underlying action.

6. Discovery by the insured can result in the production of documents and information very favorable for proving coverage. Interrogatories and document requests that are expansive, broad and comprehensive can go a long way toward helping the cause. Insurers usually have many relevant documents and it is not uncommon for requests for production to yield the proverbial smoking gun documents. Depositions of claims adjusters, underwriters and other insurance personnel can lead to the kinds of admissions needed for summary judgment and trial. Often, the more the discovery, the tougher it is for the insurer to prevail.

7. An insured can win at summary judgment just as often as the insurer, depending on the kind of case. But if the insured can create an issue of material fact to defeat an insurer's motion for summary judgment, the insured usually has the advantage at trial. Insurers would rather not have a jury trial if it can be avoided.

Claimant/Injured Party's Perspective.

1. If the claimant or injured party is not named as a defendant in a declaratory action but wants to join in the suit, the claimant would be well served to file a motion to intervene. The odds are pretty good that the claimant's motion will be granted.

2. If it appears the insured in a DJ action does not have the financial means to defend itself and prove coverage, a claimant should seek to intervene in the DJ action in order to be the one carrying the torch for coverage.

3. Being included in a DJ action gives the claimant the opportunity to participate in discovery, keep an eye on issues related to the underlying action, and team up with the insured to prove coverage.

4. The claimant should keep the insurer on notice of the progress of the underlying action (*e.g.* sending courtesy copy of the complaint and invite the insurer to mediation), and take whatever steps are necessary to improve the odds of proving coverage in a DJ action after obtaining judgment in the underlying action.

5. The claimant should try to keep informed about the status of the DJ action if not a party to it, unless the claimant knows the insured is fully capable of paying a judgment in the underlying action without insurance.

6. In discovery, the claimant/injured party is often best served by taking a similar approach to discovery as the insured, *i.e.* expansive, broad and comprehensive interrogatories and document requests. Err on the side of more depositions than few depositions.

7. Strategy for summary judgment is usually better when following the approach taken by the insured-- defeat the insurer's summary judgment motion and earn a chance at a jury trial, or win on summary judgment by proving coverage.

Conclusion

No matter what party you are in a declaratory judgment action, the procedures and strategies are fairly straightforward. Tell your story in your pleading. Make the most of your discovery tools. Win on summary judgment by proving or defeating coverage. And if a jury or bench trial is necessary, the key is preparation, preparation and more preparation. The single issue DJ action can be adjudicated quickly and painlessly, whereas the complex DJ/bad faith action can take forever to reach conclusion and can give you plenty of gray hairs. But at the outset, it is essential to have a good working knowledge of the nuts and bolts of declaratory judgment actions.