

Can a Third Party Seek a Declaration of an Insurer's Duties Under Its Policy?

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“Be careful what you ask for in your declaratory judgment action” could have been an appropriate subtitle.

Either title would fit the United States District Court’s look at whether a party that is not an insured may seek a declaration regarding an insurer’s duties under its policy. *American Southern Insurance Company v. Affordable Home Improvements, et al.* 2018 WL 2087229 (May 4, 2018).

This matter arises from an underlying construction defect case wherein Ocean Keyes Property Owners Association sued various parties, including Ocean Keyes Development, Keye Construction (Ocean Keyes defendants) and Affordable Home Improvements (AHI), a subcontractor on the project. American Southern Insurance (ASIC) issued a commercial general liability insurance policy to AHI, and is providing a defense to it in the underlying action. ASIC filed this action for declaratory judgment against AHI and the other parties to the underlying action. While AHI failed to answer or otherwise appear, the Ocean Keyes defendants filed a counterclaim also seeking the court’s determination of ASIC’s duties under the policy it issued to AHI. ASIC filed a 12(b)(6) motion to dismiss the counterclaims, arguing the counterclaimants failed to state a claim as they are not parties to the insurance contract. ASIC also argued the issue of its duty to indemnify was not ripe for adjudication. The matter was before the court on ASIC’s motion and the court determined the matter based upon the parties’ briefs.

Even though the Ocean Keyes defendants are not parties to the insurance policy in question, the court found they met the “case or controversy” test for constitutional standing. The Ocean Keyes defendants established facts that, if proven, supported potential financial loss, particularly if the losses in the underlying case are not covered. Further, the Ocean Keyes defendants met the substantial controversy test under the Declaratory Judgment Act; they adequately demonstrated the parties’ adverse legal interests that could potentially be addressed by a declaratory judgment action.

As the defendants were not the named insured and the named insured did not appear in the suit, ASIC argued that the real question in the action was if Ocean Keyes could even seek declaratory relief. The Ocean Keyes defendants argued they indeed had standing, as third party beneficiaries to the policy in question, and have stated a valid claim for relief in their counterclaim.

The court, in response to the parties' arguments, initially pointed out that ASIC sought a determination in this action as to whether coverage exists for AHI for the claims in the underlying action and, if so, its obligations owed to AHI *and the other defendants*. And while the court found the Ocean Keyes defendants could suffer financial exposure, particularly if it is ultimately determined that ASIC owes no duty to indemnify, the court largely relied on the logic that the counterclaims really sought the same relief as requested by ASIC; a determination of ASIC's duties under its policy.

The court determined that because the matter before it was pursuant to a 12(b)(6) motion, the Ocean Keyes defendants stated a claim for relief. Further, in response to ASIC's argument that the issue of its obligation to indemnify was premature, the court once again looked to ASIC's pleading, wherein *it sought a determination as to its obligations relative to indemnity*.

The court cautiously emphasized that this matter was before it upon a motion to dismiss rather than a motion for summary judgment where the court's evaluation may differ. Moreover, despite the fact that the Ocean Keyes defendants were not parties to the policy at issue, the court was drawn to the reality of the potential harm those defendants could suffer in the underlying action based upon the alleged acts or omissions of AHI, particularly if it is ultimately determined that AHI is not covered. Even more significantly, this opinion raises questions for practitioners: how far should an insured extend its request for relief? While standard fare, should the insurer seek the court's determination of any obligations to parties other than its insured or is this opinion a lesson in pleading?

Cheryl D. Shoun is a trial attorney and certified mediator whose experience includes construction law, insurance defense, personal injury defense, employment litigation and medical malpractice. As a frequent writer, she serves as editor for Nexsen Pruet's TIPS: Torts, Insurance and Products Blog.