THE WHEN, WHERE AND WHY'S OF LITIGATING COVERAGE:
STRATEGIES FOR DECLARATORY JUDGMENT ACTIONS

I. CAN YOU FILE? BASIS FOR DECLARATORY RELIEF

A. State: Uniform Declaratory Judgment Act, TEX. CIV. PRAC. & REM. CODE §37

Section 37.004 provides:

> *(A) A person interested under a deed, will, written contract, or other writings constituting a contract or whose rights, status, or other legal relations are affected by statute, municipal ordinance, contract, or franchise may have determined any question of construction or validity arising under the instrument, statute, ordinance, contract or franchise and obtain a declaration of rights, status, or other legal relations there under.*
>
> *(B) A contract may be construed either before or after there has been a breach.*

Section 37.002 provides that the chapter is remedial: "Its purpose is to settle and to afford relief from uncertainty and in security with respect to rights, status, and other legal relations; and it is to be legally construed and administered." The Act does not create or enlarge jurisdiction. *E.g., Chenault v. Phillips*, 914 S.W.2d 140, 141 (Tex. 1996). Pursuant to Section 37.003, a declaration may be either affirmative or negative in form and effect. Thus, an insured can seek an affirmative finding of coverage, or an insurer can seek a negative determination that coverage does not exist. However, each party must still plead for relief and carry its own burden of proof. *See, e.g., City of Galveston v. Giles*, 902 S.W.2d 167 (Tex. App. -- Houston [1st Dist.] 1995, no writ); *Employers Cas. Co. v. Tilley*, 484 S.W.2d 802, 806 (Tex. Civ. App. -- Beaumont 1972), *aff'd other grounds*, 496 S.W.2d 552 (Tex. 1973)(court had no authority to order declaration against insurer in response to insured's motion for summary judgment on insurer's claims.

Section 37.008 provides that the court may refuse to render a declaratory judgment if the judgment would not terminate the uncertainty or controversy giving rise to the proceeding.

B. Federal: Declaratory Judgment Act, 28 U.S.C. §§2201-2202

§2201. Creation of remedy

> *(a) In a case of actual controversy within its jurisdiction, except with respect to Federal taxes . . . 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.*

* * *

§2202. Further relief

> *Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment.*

The Federal Declaratory Judgment Act creates a remedy, not a basis for jurisdiction; either diversity or federal question jurisdiction must still exist. *See, e.g., Commercial Metals Co. v. Balfour, Guthrie & Co., Ltd.*, 577 F.2d 264 (5th Cir. 1978). In determining the amount in controversy, the court may consider policy limits and defense costs, and is not necessarily limited by the damages pleaded in the underlying suit. *See Hartford Ins. Group v. Lou-Con, Inc.*, 293 F.3d 908 (5th Cir. 2002); *Monticello Ins. Co. v. Patriot Sec., Inc.*, 926 F.Supp. 97, 99 (E.D. Tex. 1996).

Rule 57 of the Federal Rules of Civil Procedure also addresses declaratory judgments, by reference to 28 U.S.C. §2201, and further provides for a jury trial. Rule 57 notes that "the existence of another adequate remedy does not preclude a judgment for declaratory relief in cases where it is appropriate." In addition, Rule 57 provides that "the court may order a speedy hearing as an action for a declaratory judgment and may advance it on the calendar."

Federal courts have typically held that declaratory relief is discretionary, and a federal court has broad authority to stay or dismiss an action seeking a declaratory judgment. *See, e.g., Wilton v. Seven Falls Co.*, 515 U.S. 277, 286 (1995). A court may not, however, refuse to exercise jurisdiction "on the basis of a whim or personal disinclination." *See, e.g., St. Paul Ins. Co. v. Trejo*, 39 F.3d 585, 590 (5th Cir. 1994).

C. Actual Case or Controversy

Under state or federal law, declaratory relief is only appropriate when there is an actual case or controversy. *See, e.g., Texas Ass'n of Bus. v. Texas Air Control Bd.*, 852 S.W.2d 440, 446 (Tex. 1993); *Trinity Univ. Ins. Co. v. Sweatt*, 978 S.W.2d 267 (Tex. App. -- Fort Worth 1998, no pet.)(whether policy was void or loss was covered presented justiciable controversy); *American States Ins. Co. v. Bailey*, 133 F.3d 363, 368 (5th Cir. 1998). Advisory opinions are prohibited by both the state and federal constitutions. *Texas Air Control Bd.*, 852 S.W.2d at 444. A justiciable controversy requires a real and substantial controversy over tangibles interests, and not merely a theoretical dispute. *Bonham State Bank v. Beadle*, 907 S.W.2d 465, 467 (Tex. 1995). A trial court has discretion to enter declaratory judgment if it "will serve a useful purpose or will terminate the controversy between the parties." *Id.* at 468.

D. Burden Of Proof

The burden is initially upon the insured, to establish a claim within the scope of coverage. *Employee Cas. Co. v. Block*, 744 S.W.2d 940, 945 (Tex. 1988); *Harken Exploration Co. v. Sphere Drake Ins., PLC*, 261 F.3d 466, 471 (5th Cir. 2001). The burden is on the insurer, however, to establish that an exclusion applies. *See* TEX. INS. CODE §554.002 (previously art.

21.58); *Harken Exploration*, 261 F.3d at 471. The burden then shifts back to the insured to establish an exception to the exclusion. *Id*.

II. WHY TO FILE: REASONS TO REQUEST DECLARATORY RELIEF

Coverage disputes under liability policies are well-suited for declaratory actions. There is a contract and a dispute over the parties' rights and obligations under the contract. The controversy is ripe, because the insurer is called upon to defend, and because the existence of coverage may impact the outcome of the suit. Declaratory relief is an especially appropriate method for resolving liability coverage disputes, because of the limited options available for resolution of such disputes. While somewhat less common, a declaratory action may be appropriate to resolve a coverage dispute under a property policy. *Cf. Bayoil Supply & Trading, Ltd. Gulf Ins. Co.*, 2004 U.S. App. LEXIS 12211 (5th Cir. 2004), *cert. denied*, 2005 U.S. LEXIS 790 (Jan. 24, 2005).

Although efforts are occasionally made, it is inappropriate for the insurer to be joined as a defendant in a liability suit. Texas Rule of Civil Procedure 38(c) specifically provides, with regard to joinder of third parties, that "This rule shall not be applied, in tort cases, so as to permit the joinder of a liability or indemnity insurance company, unless such company is by statute or contract liable to the person injured or damaged." Most policies include a "no action" provision that provides that a third party's right of action against the insured does not arise until there is a settlement, to which the insurer has agreed, or a judgment against the insured. *See Great Am. Ins. Co. v. Murray*, 437 S.W.2d 264, 265-66 (Tex. 1969); *Getty Oil v. Ins. Co. of N. Am.*, 845 S.W.2d 794, 801 (Tex. 1992), *cert. denied, sub nom. Youell & Cos v. Getty Oil Co.*, 510 U.S. 820 (1993); *Superior Ins. Co. v. Kelliher*, 343 S.W.2d 278 (Tex. Civ. App. -- Fort Worth 1961, writ ref'd n.r.e.)(auto liability insurer seeking declaratory relief was not subject to cross-action by injured party, or consolidation of liability and coverage suit).

Courts have traditionally held that an insurance company has no right to intervene in the liability action against the insured to seek a coverage determination. *See, e.g., State Farm Fire & Cas. Co. v. Taylor*, 706 S.W.2d 352 (Tex. App. -- Fort Worth 1986, writ ref'd n.r.e.). Nor can an insurer join the claimants and address the issues through interpleader. *See Owens v. Allstate Ins. Co.*, 996 S.W.2d 207 (Tex. App. -- Dallas 1998, pet. denied)*; but see Amica Mut. Ins. Co. v. Moak*, 55 F.3d 1093 (5th Cir. 1995); a*lso cf. Aetna Cas. & Sur. Co. v. Ahrens*, 414 F.Supp. 1235 (S.D. Tex. 1976)(in pre-*Soriano* case, court allowed insurer to interplead, after settlement of some claims, when all claims could not be settled within limits). So, declaratory relief is usually the only viable option to resolve coverage issues.

In recent cases, however, the Fifth Circuit and the Texas Supreme Court both recognized at least a limited exception to this rule. In *Ross v. Marshall*, 426 F.3d 745 (5th Cir. 2005), the court allowed the insurer, Allstate Texas Lloyds, to intervene in the appeal of the liability suit. The circumstances were unusual, and it is unclear to what extent the holding is limited by the circumstances. The underlying suit involved the issue of a father's liability for his adult son's conduct in a cross-burning incident. Allstate defended the father under reservation of rights. The plaintiffs asserted the parents should have known their property was being used in a negligent and reckless manner, after the father instructed his son and friends to "wrap things up" and went to bed. The court initially dismissed the parents, but then reinstated them on a theory of vicarious liability as principals for their son's intentional acts. The jury found the father had

negligently delegated authority to his son, but the delegation was not a proximate case of the cross-burning. Initially, the court entered a take-nothing judgment against the father. On motion to amend, however, the court held the father was vicariously liable. The court also gratuitously found that the negligent delegation was an "accident," as defined in a policy of insurance. The father initially appealed. In addition, Allstate moved to intervene, both to ensure appeal, and based on the gratuitous coverage finding. The court struck Allstate's intervention and denied Allstate' motion for bond; Allstate appealed. The insured father then fired his counsel (retained by Allstate), dismissed his appeal, and assigned his rights against Allstate to the plaintiffs. In addition to a number of procedural and timing issues, the Court of Appeals concluded that Allstate was entitled to intervene, and that the rights of the other parties were not prejudiced. The court found Allstate had an interest in making sure an appeal was pursued, and was not obligated to intervene earlier, because its interests were aligned with the insured, until that point, and adequately protected by defense counsel. The court also noted the potential harm to Allstate if it was not allowed to intervene, and then faced extracontractual exposure. In addition, the court noted, that, while a "close call," Allstate had a financial interest up to the policy limits, as it had defended and would be bound by the judgment. Finally, the court found the interest was sufficiently direct, as there was an existing judgment that Allstate sought to appeal, and it could not interfere with the defense of its insured, or steer the case away from coverage. While the impact of the case remains to be seen, it does provide another possible avenue for insurers, and may lead to increased focus on intervention.

In *In re Lumbermen's Mutual Ins. Co.*, 184 S.W.3d 718 (Tex. 2006), the court held that under the equitable "virtual representation doctrine" a liability insurer was entitled to intervene on appeal to raise a legal issue the insured abandoned in order to settle other uninsured claims. Citing *Ross v. Marshall*, the Texas Supreme Court recognize a limited right of an insurer to appeal a judgment against its insured when the insurer defended its insured under reservation of rights, and posted a supersedeas bond. In this case, after perfecting its appeal of the $20 million verdict, the insured entered into a settlement of separate uncovered claims with the plaintiff in exchange for agreeing to forego its appeal on the arguably covered $20 million claims. The insurer waited ten weeks after the insured dropped its appeal on the choice of law issue to intervene in order to preserve the appeal. Much of the court's opinion discussed the timeliness of Lumbermen's appeal, but the court was clear that the facts that the insured and insurer's interests in pursuing the appeal had diverged, the carrier could later assert a non-cooperation defense against its insured or try to recoup the amount pledged in the supersedeas bond from its insured did not prevent Lumbermen's from invoking the virtual representation doctrine due to the immediate harm it would suffer in having to pay the underlying judgment if the appeal was unsuccessful. *Id*. at 725.

In 2005, the Texas Supreme Court recognized at least a limited right of reimbursement of indemnity payments for non-covered claims, in *Excess Undw'rs at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, 48 Tex.Sup.J. 735 (Tex. 2005). By the same reasoning, a right to reimbursement for defense of non-covered claims may also now exist. Thus, determination and allocation of covered and non-covered claims may provide an additional reason to seek declaratory relief.

III. WHEN TO FILE

When to file is often determined by what is at issue. Although *Gandy* promotes filing declaratory judgment actions, an insurer should not be held to have waived its right to litigate coverage by defending under reservation of rights, or by delay in filing a declaratory judgment action. *See, e.g., State Farm Lloyds v. Borum*, 53 S.W.3d 877 (Tex. App. -- Dallas 2001, pet. denied); *see also State Farm Fire & Cas. Co. v. Taylor*, 832 S.W.2d 645 (Tex. App. - Fort Worth 1992, writ denied)(insurer not estopped by failing to have declaratory judgment determined before judgment in underlying case). Still, there are often strategic benefits to filing early. Previously, the defense issue could be rendered moot by delay. *See State Farm Mut. Auto. Ins. Co. v. Carmichael*, 1998 Tex. App. LEXIS 1736 (Tex. App. -- Dallas 1998, no pet.)(issue moot after judgment entered in underlying case). A declaratory action may also bring the coverage issues into focus for the plaintiff, and assist the insured in negotiating settlement. Although it appears Texas now recognizes at least a limited right of reimbursement, and it may be beneficial to proceed while the insured still has financial resources for reimbursement, it is not yet clear when the right to reimbursement accrues.

On the other hand, in cases in which only indemnity is at issue, or where stay or abstention is likely, there may be no benefit to early filing.

IV. WHO TO JOIN

A. State Law

Section 37.006 of the Texas Civil Practice & Remedies Code provides, in subpart (a), that:

> *When declaratory relief is sought, all persons who have or claim any interest that would be affected by the declaration must be made parties. A declaration does not prejudice the rights of a person not a party to the proceeding.*

B. Federal Law

The federal act allows the court to declare the rights of "any interested party."

C. Joinder of the Claimants

Texas is not a direct action state, and a claimant typically has no claim against an insurer until a judgment is obtained. Under most liability policies, the claimants are not third-party beneficiaries and have no direct rights, and no cause of action, against the insurer until there has been a settlement, to which the insurer agrees, or a judgment against the insured. *See Murray*, 437 S.W.2d 264 (Tex. 1969); *see also Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 149 (Tex. 1994). Therefore, the claimants should not be necessary or indispensable parties, prior to the settlement or judgment. *See Firemen's Ins. Co. v. Burch*, 442 S.W.2d 331 (Tex. 1968); *National Sav. Ins. Co. v. Gaskins*, 572 S.W.2d 573, 575 (Tex. Civ. App. -- Fort Worth 1978, no writ); *Providence Lloyds Ins. Co. v. Blevins*, 741 S.W.2d 604, 606 (Tex. App. -- Austin 1987, no writ); *Safway Mng. Gen'l Agency v. Cooper*, 952 S.W.2d 861 (Tex. App. -- Amarillo 1997, no pet.). A

future interest in a potential judgment has been held insufficient to allow intervention. *See Feria v. CU Lloyds of Tex.*, 2001 Tex. App. LEXIS 7088 (Tex. App. -- Dallas 2001, no pet.) (because claimant could not bring suit, she had no right to intervene); *see, e.g., Graciela v. Tagle*, 946 S.W.2d 504 (Tex. App. -- Corpus Christi 1997, no pet.)(on petition for mandamus, found claimant was not third party beneficiary and had no right to intervene in declaratory action). There are exceptions, of course. The courts have recognized an exception when the liability insurance is statutorily required, and arguably for the benefit of the claimant, such as compulsory auto insurance or workers' compensation. *See, e.g., Dairyland County Mut. Ins. Co. v. Childress*, 650 S.W.2d 770, 775-76 (Tex. 1983). Recent cases discussing the enforceability of policy buy-backs suggest there may be other exceptions in which a statutory insurance requirement renders a claimant an intended beneficiary. *See, e.g., Stroop v. N. County Mut. Ins. Co.*, 2000 Tex. App. LEXIS 8082 (Tex. App. -- Dallas 2000, pet. denied); *Ranger Ins. Co. v. Ward*, 107 S.W.3d 820 (Tex. App. -- Texarkana 2003, pet. denied).

While the law is less clear, federal courts, applying Texas law, have reached a similar conclusion. *See, e.g., Standard Fire Ins. Co. v. Sassin*, 894 F.Supp. 1023, 1026 (N.D. Tex. 1995); *but cf. Ohio Cas. Ins. Co. v. Cooper Mach. Corp.*, 817 F.Supp. 45 (N.D. Tex. 1993). At least one court, however, has recognized that the claimants are entitled to intervene, without establishing independent standing or a justiciable controversy. *See Bituminous Cas. Co. v. Garcia*, 223 F.R.D. 308 (N.D. Tex. 2004). It is unclear whether the *Ross* opinion, allowing the insurer to intervene, will also expand the intervention rights of claimants.

V. WHERE TO FILE

Filing a declaratory action usually involves a consideration of whether suit should be filed in state or federal court. It may also involve a decision of which state to file in, and which state's law will apply.

A. State v. Federal Court

Conventional wisdom has typically been that declaratory judgment actions are best pursued in federal courts – at least where an insurer is the petitioner. Historically, the federal rules generally allowed for broader and faster relief, and summary judgments were more readily granted. On the other hand, proceeding in federal court can be far more expensive because of the mandatory meetings and reports required by Rule 26 and local rules. In addition, recent Fifth Circuit opinions regarding use of extrinsic evidence may call into question whether relief is broader. And, many federal dockets are crowded and may not move as quickly as some state courts.

Where the policy is issued in one state, but the accident or offense occurs in another, there may also be a question of which state to file in. In part, this determination may be driven by which state has jurisdiction over the claimants, if they are likely to be parties. In addition, choice of law may be a consideration.

Choice of law comes into play only when there is a conflict between the laws of the relevant states. Every state applies its own conflict of law analysis. In Texas (absent a valid choice of law provision), courts follow the Restatement analysis, applying the law of the state with the most significant contacts in regard to a particular issue. *See* RESTATEMENT (2d) OF

CONFLICTS OF LAWS §6; *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 420-21 (Tex. 1984); *Maxus Exploration Co. v. Moran Bros., Inc.*, 817 S.W.2d 50, 53 (Tex. 1991). So, different laws can apply to different issues. In addition, a controlling statute or compelling interest can tip the scales. *See, e.g., Mayo v. Hartford Life Ins. Co.*, 220 F.Supp.2d 714 (S.D. Tex. 2002). Under RESTATEMENT §188, the relevant contacts are:

> *(a) The place of contracting;*
>
> *(b) The place of negotiation of the contract;*
>
> *(c) The place of performance;*
>
> *(d) The location of the subject matter of the contract; and*
>
> *(e) The domicile, residence, nationality, place of incorporation and place of business parties.*

RESTATEMENT §188(2). However, the contacts are evaluated according to their importance to each particular issue. Therefore, at least theoretically, different states' laws could apply to different issues even within the coverage suit. RESTATEMENT (2d) OF CONFLICT OF LAWS § 6(2); *Houston Cas. Co. v. Certain Undw'rs at Lloyds London*, 51 F.Supp.2d 789 (S.D. Tex. 1999), *aff'd*, 252 F.3d 1357 (5th Cir. 2001).

While the RESTATEMENT analysis is common, it is not universal. Other states still follow a *lex loci contractus* rule, or some other test. Thus, the state in which suit is filed may determine which state's law applies.

A lot of confusion has been generated by art. 21.42 of the Texas Insurance Code. The article, which is entitled "Texas Laws Govern Policies" provides:

> *Any contract of insurance payable to any citizen or inhabitant of this State by any insurance company or corporation doing business within the State, shall be held to be a contract made and entered into under and by virtue of the laws of this State relating to insurance, and governed thereby, notwithstanding such policy or contract of insurance may provide that the contract was executed and the premiums and policy (in case it becomes a demand) should be payable without this State or at the home office of the company or corporation issuing same.*

By its terms, the provision governs only contracts both "payable" to a citizen or inhabitant of Texas, and arising out of the company's Texas business. *See Austin Bldg. Co. v. National Union Fire Ins. Co.*, 432 S.W.2d 697 (Tex. 1968). This language has been construed, however, to apply to claimants who are citizens or inhabitants of Texas, when a liability policy is involved. *See American Home Assur. Co. v. Safway Steel Prod. Co.* 743 S.W.2d 693 (Tex. App. -- Austin 1987). In the context of Texas insureds, the statute has been readily applied in lieu of a conflicts analysis. *See, e.g., Hanson Prod. Co. v. Americas Ins. Co.*, 108 F.3d 627, 629 (5th Cir. 1997); *Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co.*, 99 F.3d 695, 700 (5th Cir. 1996). The *Safway Steel* case represents a questionable reading of the statute, and has not been

widely followed. Federal courts, and more recently state courts, have rejected art. 21.42, and have refused to give it extraterritorial effect, when the policies are not actually issued in Texas or to a Texas insured. *See, e.g., TV-3, Inc. v. Royal Ins. Co. of Am.*, 28 F.Supp.2d 407 (E.D. Tex. 1998); *W.R. Grace Co. v. Continental Cas. Co.*, 896 F.2d 865 (5th Cir. 1990)(not payable to Texas insured); *New York Life Ins. Co. v. Baum*, 700 F.2d 928, 933 (5th Cir. 1983) (not issued as part of insurer's business in Texas); *Kimberly-Clark Corp. v. Continental Cas. Co.*, 2005 U.S. Dist. LEXIS 24266 (N.D. Tex., Oct. 19, 2005); *see also Reddy Ice Corp. v. Travelers Lloyds Ins. Co.*, 145 S.W.3d 337 (Tex. App. -- Houston [14th Dist.] 2004, pet. denied)(corporation was "inhabitant" of its state of incorporation – not Texas); *Lennar Corp., supra*. On the other hand, at least one court has refused to construe art. 21.42 as a limitation on the cases to which Texas law can apply. *See Mayo v. Hartford Life Ins. Co.*, 220 F.Supp.2d 714 (S.D. Tex. 2002).

B. Venue

In addition to the county of the defendant's residence or principal office, venue is generally deemed proper in the county where the liability suit is pending, or judgment is entered. *Cigna Lloyds Ins. Co. v. Bradleys' Elec., Inc.*, 993 S.W.2d 673 (Tex. App. -- Corpus Christi 1998), *rev'd on other grounds*, 995 S.W.2d 675 (Tex. 1999)(insured's motion to transfer erroneously granted); *Southern Cty. Mut. Ins. Co. v. Ochoa*, 19 S.W.3d 452 (Tex. App. -- Corpus Christi 2000, no writ). The county where the contract was formed may also be a proper venue. In *Bradleys' Electric*, the court rejected an argument from the insured that the county where the insurance contract was negotiated and executed was the only proper venue, but recognized it was also proper. In *Chiriboga v. State Farm Mut. Auto Ins. Co.*, 96 S.W.3d 673 (Tex. App. -- Austin 2003, no pet.), the court held the county where the agent was located, the policy was sold, and the claim was reported, was not a proper venue. The dispute was over an unscheduled vehicle. State Farm argued the policy changes were made in Milam County, where the agent was located, and the policy was sold. The court, however, concluded this was not a county in which a substantial part of the facts giving rise to the coverage dispute arose. The insured was located in Hidalgo County, the car was purchased in Hidalgo County, and the salesman contacted the agent by phone, from Hidalgo County, to add the car to the policy. The collision was also in Hidalgo County, as was the liability suit.

C. Dismissal, Abatement and Abstention

Federal courts have broad discretion as to whether to retain jurisdiction or dismiss declaratory judgment actions. *E.g., Wilton v. Seven Falls Co.*, 515 U.S. 277 (1995); *American States Ins. Co. v. Bailey*, 133 F.3d 363, 368 (5th Cir. 1998). It is not an abuse of discretion, however, to retain a suit, and to decide issues of indemnity, even before the underlying liability suit has reached judgment. *Id.* at 368-69. It may be appropriate for courts to abstain, in certain circumstances. *See Bailey*, 133 F.3d at 369 n. 4; *Travelers Ins. Co. v. Louisiana Farm Bureau Fed'n, Inc.*, 996 F.2d 774, 778 (5th Cir. 1993); *St. Paul Ins. Co. v. Trejo*, 39 F.3d 585, 590 (5th Cir. 1994). Federal courts are especially reluctant to exercise jurisdiction if there is a parallel state court proceeding – even if subsequently filed – that includes all necessary parties and will resolve the issues. *See Brillhart v. Excess Ins. Co.*, 316 U.S. 491 (1942); *Wilton*, 515 U.S. 277; *RLI Ins. Co. v. Wainsco Oil & Gas Co.*, 131 Fed.Appx. 970 (5th Cir. 2005)(court properly stayed action in favor of pending California state court suit); *Fireman's Fund Ins. Co. v. Hlavinka Eqpmt. Co.*, CA No. H-05-2515 (S.D. Tex., Oct. 26, 2005)(declaratory action dismissed in favor of state court action, where state court action included interested party not joined in federal suit).

One of the factors the courts will review is whether the declaratory action is filed in anticipation of a state court suit. *See Granite State Ins. Co. v. Tandy Corp.*, 986 F.2d 94, 96 (5th Cir. 1992), *cert. dism'd*, 507 U.S. 1026 (1993).

While federal abstention doctrine is equally applicable to declaratory judgments action, courts are particularly vigilant in exercising their discretion to protect comity and prevent forum shopping. A court can dismiss a declaratory action even if it fails to meet the stringent standards for abstention. *See Travelers Ins. Co. v. Louisiana Farm Bureau Fed'n*, 996 F.2d 774, 778 (5th Cir. 1993)(*Colorado River* factors inapplicable in declaratory judgment action); *Granite State Ins. Co. v. Tandy Corp.*, 986 F.2d 94, 95 (5th Cir. 1992), *cert. dism'd*, 507 U.S. 1026 (1993); *cf. Frontier Pac. Ins. Co. v. Marathon Ashland Petrol., L.L.C.*, 87 F.Supp.2d 719 (S.D. Tex. 2000) (staying declaratory action because of motion to join insurer in state court liability suit).

While abstention doctrine is more frequently an issue in federal court, state courts can also abstain. Typically, the first-filed suit has dominant jurisdiction. There are exceptions, however, (1) when conduct estops a party from asserting prior active jurisdiction; (2) where parties are lacking; or (3) where there is lack of intent to prosecute. *See Southern Cty. Mut. Ins. Co. v. Ochoa*, 19 S.W.3d 452 (Tex. App. -- Corpus Christi 2000, no writ).

Where suits are filed in two states, one court may abstain in favor of the first-filed suit. A Texas court may also enjoin the litigants from moving forward on the same issues in any other jurisdiction. Typically, an anti-suit injunction is appropriate in limited instances: (1) to address a threat to the court's jurisdiction; (2) to prevent the evasion of important public policy; (3) to prevent a multiplicity of suits; or (4) to protect a party from vexatious or harassing litigation. *See London Mut. Ins'rs v. American Home Assur. Co.*, 95 S.W.3d 702 (Tex. App. -- Corpus Christi 2003, no writ); *Texas Mut. Ins. Co. v. Howell*, 2005 Tex. App. LEXIS 6950 (Tex. App. -- Corpus Christi, Aug. 25, 2005, pet. filed).

A federal anti-injunction also exists. 28 U.S.C. §2283. As with the state act, one of the exceptions allows a federal court to enjoin re-litigation in state court "to protect or effectuate its judgments." *See Royal Ins. Co. v. Quinn-L Capital Corp.*, 3 F.3d 877 (5th Cir. 1993), *cert. denied*, 511 U.S. 1032 (1994).

VI. WHAT CAN BE DETERMINED?

A. Duty to Defend

Under Texas law, a duty to defend is determined by the complaint allegation rule. Under this rule, the insurer's defense obligations are determined by the allegations of the pleadings and the language of the insurance policy, without regard to the actual facts. The focus is on the factual allegations that show the origin of damages, rather than the legal theories alleged. If no facts within the scope of coverage are alleged, an insurer is not required to defend. If any facts within the scope of coverage are determined, however, an insurer is required to defend. *See National Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139 (Tex. 1997); *Trinity Univ. Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1991).

It is axiomatic that the duty to defend is broader than the duty to indemnify. Indemnity is based on the actual facts establishing liability in the underlying suit. *See Farmers Tex. Cty. Mut.*

Ins. Co. v. Griffin, 955 S.W.2d 81 (Tex. 1997); *Heyden Newport Chem. Corp. v. Southern Gen'l Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1965).

The complaint allegation rule can pose a problem with declaratory relief. Since the duty to defend is based solely on the live pleadings, a declaratory judgment is arguably based only on the pleading in effect, and is not determinative as to any subsequent amended or supplemental pleading. *See Bernard v. Gulf Ins. Co.*, 542 S.W.2d 429 (Tex. Civ. App. -- El Paso 1976, writ ref'd n.r.e.)(prior judgment not res judicata as to amended pleading that alleged new facts, not involving "completed operations"); *St. Paul Ins. Co. v. Tex. Dept. of Transp.*, 999 S.W.2d 881, 883 (Tex. App. -- Austin 1999, pet. denied); *cf. Admiral Ins. Co. v. Rio Grande Heart Specialists of S. Tex., Inc.*, 64 S.W.3d 497 (Tex. App. -- Corpus Christi 2002, pet. dism'd by agr.)(no right to new trial because of amended petition where suit brought and determined based on prior petition).

B. Indemnity

A developing issue has been the extent to which declaratory relief is available to determine an insurer's indemnity obligations, while the underlying suit is pending. A declaratory judgment must be based on an actual controversy, and cannot be merely advisory. For years, Texas courts concluded that a declaration of indemnity was premature, until the underlying suit was resolved. *See Fireman's Ins. Co. v. Burch*, 442 S.W.2d 331 (Tex. 1968). *Burch* involved a declaration that the insurer owed defense, and also owed indemnity for the insured's liability for his wife's torts. *Id.* at 332. There was also a declaration that the insurer owed neither defense nor indemnity to the wife. The Burches were the plaintiffs, and were also the petitioners for declaratory relief. Because there was no judgment in the liability suit, the court concluded that any declaration regarding indemnity would be purely hypothetical.[1] In 1997, the Supreme Court concluded that the law had changed, however, and determined that a declaration of indemnity was available, when the same facts that defeated a duty to defend also defeated a duty to indemnify. *See Farmers Tex. Cty. Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82-84 (Tex. 1997)[2]; *see also State Farm Lloyds v. Borum*, 53 S.W.3d 877 (Tex. App. -- Dallas 2001, pet. denied). The court in *Griffin* relied upon a change in the Texas Constitution, expanding the scope of district court jurisdiction and eliminating the minimum amount in controversy. 955 S.W.2d at 84 (construing Tex. Const. art. V §8).

On the other hand, where the insured seeks a declaration that the insurer owes indemnity, before resolution of the underlying case, the opinion may be considered advisory, and declaratory relief may, indeed, be premature. *See, e.g., Ruth v. Imperial Ins. Co.*, 579 S.W.2d 523 (Tex. Civ. App. -- Houston [14th Dist.] 1979, no writ)(not justiciable controversy); *Boorhem-Fields, Inc. v. Burlington N. R.R. Co.*, 884 S.W.2d 530 (Tex. App. -- Texarkana 1994, no writ)(possibility that liability triggering indemnity would be incurred was a feature hypothetical event, and court had no power to pass upon hypothetical or contingent situation); *Fort Worth Lloyds v. Garza*, 527 S.W.2d 195 (Tex. Civ. App. -- Corpus Christi 1975, writ ref'd n.r.e.)(not justiciable controversy); *Foust v. Ranger Ins. Co.*, 975 S.W.2d 329, 332 (Tex. App. -- San Antonio 1998, pet. denied)(any judgment on indemnity was advisory and beyond power and

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1 Justice Smith was perhaps prescient in his dissent, concluding that a justiciable controversy existed.

2 The court's decision has been described as carving out an exception, rather than overruling prior law. *Foust v. Ranger Ins. Co.*, 975 S.W.2d 329, 332 n. 1 (Tex. App. -- San Antonio 1998, pet. denied).

jurisdiction of the court); *Campbell v. Commercial Standard Ins. Co.*, 502 S.W.2d 232 (Tex. Civ. App. -- Fort Worth 1973, writ ref'd n.r.e.).

Where a judgment has been entered in the underlying case, and the insurer has refused indemnity, it may also be that declaratory relief is inappropriate, because a cause of action for breach of contract has ripened. The declaratory judgment action allows relief, even where another remedy exists. Nevertheless, some courts have concluded that declaratory relief is inappropriate where another cause of action is fully mature and provides an appropriate remedy at law. *See, e.g., Sylvester v. Watkins*, 538 S.W.2d 827 (Tex. Civ. App. -- Amarillo 1976, writ ref'd n.r.e.); *but cf. Bonham State Bank v. Beadle*, 907 S.W.2d 465 (Tex. 1995).

The federal act is broader in scope. Even before the Texas Supreme Court's opinion in *Griffin*, federal courts recognized that indemnity presented an actual controversy and was justiciable, prior to judgment in the underlying liability suit. *See, e.g., Western Heritage Ins. Co. v. River Entm't*, 998 F.2d 311, 315 (5th Cir. 1993); *American States Ins. Co. v. Bailey*, 133 F.3d 363, 368 (5th Cir. 1998); *Monticello Ins. Co. v. Patriot Sec., Inc.*, 926 F.Supp. 97 (E.D. Tex. 1996)(nevertheless refraining from determining coverage for indemnity, on the basis of judicial economy); *but see Westport Ins. Corp. v. Atchley, Russell, Waldrop, Hlavinka, L.L.P.*, 267 F.Supp.2d 601 (E.D. Tex. 2003)(applying Texas law to justiciability of indemnity).

C. Breach of Conditions

Whether the insured has complied with policy conditions, or has forfeited coverage by material breach, can also be the subject of a declaratory action. *See, e.g., Investors Ins. Co. of Am. v. Breck Operating Corp.*, 2003 U.S. Dist. LEXIS 8103 (N.D. Tex. 2003); *American Auto. Ins. Co. v. Grimes*, 2004 U.S. Dist. LEXIS 1696 (N.D. Tex. 2004); *Travelers Indem. Co. v. Presbyterian Healthcare Resources*, 2004 U.S. Dist. LEXIS 6373 (N.D. Tex. 2004). Where the issue is whether the insurer is prejudiced, declaratory relief may be premature, pending the outcome of the underlying suit or the specific issue that may give rise to prejudice.

D. Limits/Number of Occurrences

In *Foust v. Ranger Ins. Co.*, 975 S.W.2d 329 (Tex. App. -- San Antonio 1998, pet. denied), the court held it was permissible, and not purely advisory, to determine the number of occurrences involved in the underlying litigation. The claims involved crop-dusting, which allegedly damaged abutting fields because of herbicide drift. The crop-dusting involved only one flight, but several passes during which herbicide was released, and during which wind direction and velocity varied. The policy provided limits of $100,000 per occurrence and $200,000 in the aggregate. The court noted that the *Griffin* exception did not apply, but that a justiciable controversy existed, as the judgment clarified the rights of the parties under the contract; especially because the policy includes a provision under which Ranger could be relieved of its duty to defend by tendering its limits. *See also Employers Ins. Co. of Wausau v. Burlington N. & S. F. Rwy.*, 336 F.Supp.2d 637 (E.D. Tex. 2003); *American Auto. Ins. Co. v. Grimes*, 2004 U.S. Dist. LEXIS 1696 (N.D. Tex. 2004)(whether claims were "related" under professional liability policy).

VII. HOW MANY CORNERS ARE THERE?

Despite the complaint allegation rule, Texas courts have always recognized that there are circumstances in which the court must look to extrinsic evidence to determine whether a duty to defend exists. Indemnity, on the other hand, is based on actual facts and should always be subject to extrinsic evidence. In older cases, courts allowed broad introduction of extrinsic evidence in a declaratory judgment context. In *National Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139 (Tex. 1997), the Supreme Court reaffirmed the complaint allegation rule, with dicta suggesting that the exception for extrinsic evidence would be narrowed.

A. The Fifth Circuit Guesses, and Guesses Again

In *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), the Fifth Circuit made an "*Erie* guess" that extrinsic evidence was impermissible under Texas law. The court noted that Texas follows a complaint allegation rule, and a duty to defend is typically determined by a comparison of the pleadings and the policy. The court also noted, however, that a number of cases – in both the state and federal systems – had recognized an exception. Relying heavily on an opinion from the Eastern District, *Westport Ins. Group v. Atchley, Russell, Waldrop & Hlavinka, L.L.P.*, 267 F.Supp.2d 601 (E.D. Tex. 2003), the court rejected or distinguished this line of cases and predicted that the Texas Supreme Court would adopt an absolute complaint allegation rule, and would not recognize any exception.

At issue was an underlying negligence suit, arising from a fatal injury to an infant, for whom the insured, Loving Home Care, provided in-home childcare. The Harris County coroner ruled the death a homicide, noting injuries to the skull and brain, and listed the cause of death as cranial-cerebral injuries due to blunt force trauma of the head. The childcare provider was found guilty of first degree felony injury to a child and sentenced to seven years in prison.

The liability suit, however, was framed in terms of "negligence." Plaintiffs alleged that the childcare provider negligently dropped the infant, or negligently shook her, causing severe head injuries that resulted in her death. In the alternative, plaintiffs alleged defendant was reckless or criminally negligent.

Loving Home Care was insured under a policy that provided both commercial general liability and professional liability coverage. The insurer, Northfield, provided a defense under reservation of rights, but filed a declaratory judgment action, seeking a determination that it had no duty of defense or indemnity under the general liability part of the policy, because the injuries arose out of professional services, and that it had no duty under the professional liability part because of exclusions relating to criminal acts and physical/sexual abuse.

The district court ultimately agreed that the professional liability exclusion applied, under the general liability portion, but found that the exclusions for criminal acts and physical abuse did not preclude a duty to defend under the professional liability portion.

On appeal, the Fifth Circuit performed an extensive review of Texas state and federal opinions, analyzing the duty to defend and the use of extrinsic evidence. Ultimately, the court concluded that the Texas Supreme Court would not recognize any exception to the strict eight

corners rule. "That is, if the four corners of the petition allege facts stating a cause of action which potentially falls within the four corners of the policy's scope of coverage, resolving all doubts in favor of the insured, the insurer has a duty to defend. If all the facts alleged in the underlying petition fall outside the scope of coverage, then there is no duty to defend."

In what is almost an alternative holding, however, the court continued "However, in the unlikely situation that the Texas Supreme Court were to recognize an exception to the strict eight corners rule, we conclude any exception would only apply in very limited circumstances: when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." The court observed that the alternative position was not at odds with the Fifth Circuit's own previous decisions, including *Western Heritage*.

Several courts have followed this reasoning, and refused to allow extrinsic evidence, in any circumstance, whether to establish or defeat coverage. *See Landmark Chev. Corp. v. Universal Undw'rs Ins. Co.*, 121 S.W.3d 886 (Tex. App. -- Houston [1st Dist.] 2003, pet. filed) (refusing to allow extrinsic evidence that vehicles were purchased on credit, to trigger truth-in-lending coverage); *Founders Comm., Ltd. v. Trinity Univ. Ins. Co.*, 2004 Tex. App. LEXIS 10545 (Tex. App. -- Houston [1st Dist.] Nov. 24, 2004, no pet. h.)(no coverage where no allegation related to scheduled premises); *King, Chapman & Broussard Consulting Group, Inc. v. National Union Fire Ins. Co.*, 171 S.W.3d 222 (Tex. App. -- Houston [1st Dist.] Jan. 6, 2005, no pet. h.)(refusing to allow insured to introduce extrinsic evidence to defeat exclusion).

Less than six months later, the Fifth Circuit issued an opinion in *Primrose Operating Co. v. Nat'l American Ins. Co.*, 382 F.3d 546 (5th Cir. 2004). Although the case was presented to a different panel, the opinions are actually authored by the same judge. In the *Primrose* opinion, the court recognized that Texas employs a complaint allegation rule and then noted: "The duty to defend analysis is not influenced by facts ascertained before the suit, developed in the process of litigation, or by the ultimate outcome of the suit . . . . Fact finders, however, may look to extrinsic evidence if the petition 'does not contain sufficient facts to enable the court to determine if coverage exists.'"

The court then cited the *Western Heritage* opinion in support of this principle. On the facts, the court found that there was not sufficient information in the pleadings, or based upon extrinsic evidence, to determine that a pollution exclusion applied to preclude coverage. Therefore, it found a duty to defend.

If the *Primrose* opinion is any indication, it appears that the alternative ruling from the *Loving Home Care* case may in fact be the present law, at least in the Fifth Circuit. *See also Fritz Indus. v. Wausau Undw'rs Ins. Co.*, 2004 U.S. Dist. LEXIS 2638 (N.D. Tex. 2004) (recognizing exception for "fundamental coverage issues").

Texas law remains unclear, although there is still support for an exception. *See, e.g., GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 309 (Tex. 2006) (recognizing exception for "fundamental coverage issues" or where petition does not allege sufficient facts to make coverage determination). In addition, while not squarely addressing the issue, in a recent opinion, the Texas Supreme Court recognized that a profit motive could be

implied from the insured's mining activities, despite any specific allegation of a business pursuit. *Allstate Ins. Co. v. Hallman*, 159 S.W.3d 640 (Tex. 2005).

B. Possible Uses of Extrinsic Evidence

There are a number of instances in which extrinsic evidence may be at issue:

1. Qualification as Insured.

Extrinsic evidence has been allowed to show that the person sued does not qualify as an insured, or that the vehicle or equipment in issue is not insured. *See, e.g., Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712, 715-16 (Tex. App. -- Texarkana 1967, no writ)(auto excluded); *International Serv. Ins. Co. v. Boll*, 392 S.W.2d 158, 161 (Tex. App. -- Houston [1st Dist.] 1965, writ ref'd n.r.e.)(driver excluded); *see also Tri-Coastal Contr's, Inc. v. Hartford Undw'rs Ins. Co.*, 981 S.W.2d 861 (Tex. App. -- Houston [1st Dist.] 1998, pet. denied); *see also Liberty Mut. Ins. Co. v. Graham*, 2005 U.S. Dist. LEXIS 11737 (N.D. Tex. 2005)(allowing extrinsic evidence to determine defendant was not permissive user). There is a good argument that, regardless of the outcome of the debate over extrinsic evidence in other contexts, it should always be admissible to determine insured status, as this determination precedes application of the complaint allegation rule. *See* Allan D. Windt, *Insurance Claims and Disputes* (4th Ed.) §4.5. The issue is more complicated as to additional insured status. A person may only acquire additional insured status by virtue of a contract – extrinsic to the pleadings – but coverage may also be limited or subject to exclusions, and therefore subject to the complaint allegation rule. *See, e.g., Continental Cas. Co. v. Fina*, 126 S.W.3d 163 (Tex. App. -- Houston [1st Dist.] 2003, pet. filed); *also cf. Transport Internat'l Pool v. Continental Ins. Co.*, 166 S.W.3d 781 (Tex. App. -- Fort Worth 2005, no pet.)(additional insured was excluded by "sole negligence" language, where petition did not refer to negligence of any other entity).

2. Pleading Silent as to Determinative Facts.

The most common exception for extrinsic evidence is when the pleadings simply do not assert facts that would determine coverage. In this instance – at least prior to the *Loving Home Care* opinion – both state and federal courts have readily allowed the use of extrinsic evidence to determine the duty to defend. *See, e.g., State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448 (Tex. App. -- Corpus Christi 1992, writ denied)(whether boat was being used for business pursuit); *International Serv. Ins. Co. v. Boll*, 392 S.W.2d 158, 161 (Tex. App. -- Houston 1965, writ ref'd n.r.e.)(whether driver qualified as an insured); *John Deere Ins. Co. v. Truckin' USA*, 122 F.3d 270, 272-73 (5th Cir. 1997)(whether vehicle was owned by insured); *Harken Exploration Co. v. Sphere Drake Ins., P.L.C.*, 261 F.3d 466 (5th Cir. 2001)(when lease obtained); *Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192 (5th Cir. 1998)(whether release was sudden and accidental); *Western Heritage Ins. Co. v. River Entm't*, 998 F.2d 311, 315 (5th Cir. 1993)(whether accident arose from liquor liability); *Acceptance Ins. Co. v. Hood*, 895 F.Supp. 131 (E.D. Tex. 1995)(whether trademark violation occurred during policy period). In *Wade*, the insurer argued that it was not challenging the veracity of the facts alleged, but had a defense independent of the pleadings. *Wade*, 827 S.W.2d at 451. The court recognized that the insurer was defending, but the coverage issue would not be litigated in the underlying case, so declaratory relief was appropriate. Because the pleadings did not address a fact essential to determining coverage, the court allowed extrinsic evidence. *Id.* at 452-53; *but see Tri-Coastal*

Contr's Inc., 981 S.W.2d at 863 (questioning scope of exception); *Landmark Chev. Corp. v. Universal Undw'rs, Inc.*, 121 S.W.3d 886 (Tex. App. -- Houston [1st Dist.] 2003, pet. filed) (refusing to allow exception, even to establish coverage).

The *Western Heritage* case, despite its questionable precedent, epitomizes the argument for use of extrinsic evidence. The underlying liability suit arose from an accident in which one defendant, while intoxicated, hit the plaintiff's vehicle, killing their daughter. River Entertainment was joined because it owned Pepe's where the defendant imbibed. The insurer denied defense based on the liquor liability exclusion and filed a declaratory judgment action. The petition in the underlying suit was amended, however, and all references to alcohol were deleted. Instead, plaintiffs alleged River Entertainment was negligent for allowing the defendant to leave, in his own vehicle, when they should have known his driving ability was impaired. *Id.* at 313. The district court dismissed the indemnification issue, but granted judgment on defense, based on the extrinsic evidence.

3. Pleading Incorrect as to Determinative Facts

The issue becomes more murky when allegations triggering coverage are alleged, but are in conflict with the actual facts. *See, e.g., Ohio Cas. Co. v. Cooper Mach. Corp.*, 817 F.Supp. 45 (N.D. Tex. 1993); *McLaren v. Imperial Cas. & Ind. Co.*, 767 F.Supp. 1364 (N.D. Tex. 1991), *aff'd in part*, 961 F.2d 213 (5th Cir. 1992); *cf. Westport v. Atchley, Russell, Waldrop & Hlavinka*, 267 F.Supp.2d 601, 621-22 (E.D. Tex. 2003)(finding Texas allows only narrow exception); *but see Gonzales v. American States Ins. Co.*, 628 S.W.2d 184 (Tex. App. -- Corpus Christi 1982, no writ)(could not consider facts of ownership that conflicted with petition); *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 139 S.W.3d 384 (Tex. 2006)(refusing to allow extrinsic evidence of dates of employment to show allegations false).

4. Issues Material to the Outcome of Underlying Suit

Courts have struggled with the issue of what can be resolved in the declaratory judgment action, when the issue determining coverage may also be material in the underlying case. In *Gonzales v. American States Ins. Co.*, 628 S.W.2d 184 (Tex. App. -- Corpus Christi 1982, no writ), the court declared that the rule was that use of extrinsic evidence was allowed to determine coverage, but not to determine facts that would establish the insurer's liability. *See Tri-Coastal Contractors, Inc. v. Hartford Undw'rs Ins. Co.*, 981 S.W.2d 861 (Tex. App. -- Houston [1st Dist.] 1998, pet. denied)(disallowing evidence of workers' compensation payments to establish employment).

It is still likely a court will not allow dual-track litigation of issues that affect liability and coverage. One reason proffered is the possibility of inconsistent outcomes. But, because courts have recognized that, where a coverage issue exists, there is no privity between the insured and the insurer, there is an argument that an insurer should be allowed to litigate facts in a declaratory judgment, regardless of whether the facts are also being litigated in the underlying suit. Because the insurer would be allowed to re-litigate, after the underlying case is resolved, there is no reason to delay the inevitable. *Cf. Cluett v. Medical Protective Co.*, 829 S.W.2d 822, 826 (Tex. App. -- Dallas 1992, writ denied) (insurer not collaterally estopped from challenging findings); *United States Fire Ins. Co. v. Deering Mgmt. Group, Inc.*, 946 F.Supp. 1271 (N.D. Tex. 1996)(insurer not estopped from litigating employment issue).

VIII. DISCOVERY

A number of issues arise in regard to discovery in a declaratory judgment action. In part, of course, the scope of discovery will be determined by the nature of the issue. In duty to defend cases, the issue of whether extrinsic evidence is even relevant would likely arise. In cases involving duty to indemnify, there may be issues as to whether the indemnity facts were fully litigated in an actual trial, or whether the facts can be re-litigated, construing *Gandy* and *Maldonado*. The issue of what evidence can be used, beyond the jury's verdict and the judgment, to evaluate coverage is still in flux. *See, e.g., Commercial Underw'rs Ins. Co. v. Royal Surplus Lines Ins. Co.*, 345 F.Supp.2d 652 (S.D. Tex. 2004)(recognizing that, in many cases, indemnity can be determined from the jury's findings, but finding entire trial record relevant to determine whether injuries were caused by "related 'medical incidents'" and "related 'occurrence'").

Issues also arise, when the underlying case is still proceeding, as to the extent to which the insurer can discover information which could also be relevant, and potentially damaging, in the underlying liability suit. Where the insurer is providing a defense, it is a party to the attorney-client privilege, and can share in communications between the insured and defense counsel, without waiver. *See, e.g., Boring & Tunneling Co. v. Salazar*, 782 S.W.2d 284, 289-90 (Tex. App. -- Houston [1st Dist.] 1989, no writ); *In re Fontenot*, 13 S.W.3d 111 (Tex. App. -- Fort Worth 2000, no pet.). Defense counsel may, nonetheless, have protected certain information from disclosure, for fear that it was effect coverage, and violate counsel's own ethical obligations. Despite the insurer's right to review any such documents without waiver of the privilege, and the likelihood that defense counsel's concerns would be abrogated by the right to conduct discovery, there is still a question as to what extent defense counsel's opinions or observations would be relevant to coverage. A separate issue exists, however, as to the facts and testimony relating to the liability event, and the evidence that has been accumulated or produced in the underlying case. Clearly, the insurer should be entitled to discovery of anything that has been discovered in the underlying suit. If the discovery is limited, or poorly conducted, or does not address the coverage issues, however, the insurer may seek additional testimony and evidence. In this instance, there may be legitimate concerns that the insurer's discovery will inure to the benefit of the liability plaintiff, which is likely not in the interest of either the insured or the insurer. As a preliminary consideration, counsel for the insurer should be careful and selective as to what is requested. In addition, in many instances, a protective order will allow broad discovery, without fear of disclosure to the plaintiff. Protective orders are still relatively simple, and can usually be subject to an agreed motion in federal court. In state court, an order to seal documents requires that the parties jump through a number of additional hoops, but protective orders are still available. *See* Fed. R. Civ. P. 26; Tex. R. Civ. P. 76A; 192.6(b)(5).

Obviously, the nature of the coverage issue to be determined will also determine the scope of discovery. In a straight complaint allegation case, for instance, there should be extremely limited discovery, beyond verification of the pleadings and the policy. Where extrinsic evidence is offered, however, the scope of discovery should be broader. Further, while it is unlikely that an insurer wishes to proceed, without protective order, to establish evidence that demonstrates the insured's liability – as the insurer has not yet prevailed on its coverage defenses – it is also unclear under what standard the insured should be able to protect otherwise discoverable information, simply because it is damaging.

A. Re-Litigation of Facts

When an issue has been litigated in the underlying case, when can it be re-litigated in the coverage dispute? The answer may depend upon whether the insurer has defended or simply denied coverage, and the extent to which the issue is actually material to, and fully litigated in, the underlying dispute. Courts recognize that when there are conflicting positions on coverage, as when the insurer reserves rights, there is no privity between the insured and the insurer on issues relating to coverage, which are also at issue in the underlying case. As such, there should be no collateral estoppel of the insurer, based upon the outcome of the issue in the underlying case. *E.g.*, *Cluett v. Medical Protective Co.*, 829 S.W.2d 822, 826 (Tex. App. -- Dallas 1992, writ denied); *U.S. Fire Ins. Co. v. Deering Mgmt. Group, Inc.*, 946 F.Supp. 1271 (N.D. Tex. 1996). In a number of instances, courts have concluded that an insurer is entitled to re-litigate issues. *See Employers Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1998), *overruled on other grounds, State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996); *Williamson v. State Farm Lloyds*, 76 S.W.3d 64 (Tex. App. -- Houston [14th Dist.] 2002, no pet.); *State Farm Lloyds Ins. Co. v. Borum*, 53 S.W.3d 877 (Tex. App. -- Dallas 2001, pet. denied)(judgment of negligence in underlying case did not establish that negligent acts caused bodily injury, and did not preclude insurer from establishing intentional conduct); *Deering Mgmt. Group*, 946 F.Supp. at 1280 (insurer not precluded from re-litigating course and scope of employment). In *Williamson*, a jury awarded the claimant damages against the insured for false imprisonment. The insurer refused to pay the judgment, on the basis that the insured's conduct constituted a willful violation of a penal statute, and was thus excluded by the policy. The court, in the coverage action, concluded that there was a conflict of interest and a lack of privity, and therefore the insurer was not collaterally estopped from re-litigating the existence of false imprisonment. *Id.* at 68. While some older cases find an insurer cannot re-litigate facts, if it has wrongfully refused to defend, the Supreme Court has held that an insurer is not bound, in any circumstance, where the facts allegedly establishing coverage are not fully litigated. *See State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996). In *Gandy*, the court broadened the scope of re-litigation, noting that "in no event, however, is a judgment for plaintiff against defendant rendered without a fully adversarial trial, binding on defendant's insurer . . . ." 925 S.W.2d at 714; *see also American Auto. Ins. Co. v. Grimes*, 2004 U.S. Dist. LEXIS 1696 (N.D. Tex. 2004)(explaining, in dicta, that insurer may not re-litigate liability, but may litigate coverage issues); *Swicegood v. Medical Protective Co.*, 2003 U.S. Dist. LEXIS 16556 (N.D. 2003)(allowing litigation of coverage issues, and allowing new evidence on issues necessary to resolve controlling coverage issues, and not conclusively decided in liability trial).

IX. WHAT CAN YOU GET?

In addition to a declaration regarding coverage, there is the issue of whether attorneys' fees and costs can be recovered – or awarded to the prevailing party.

A. State

Texas Civil Practice & Remedies Code §37.009 provides that "in any proceeding under this Chapter, the court may award costs and reasonable and necessary attorney's fees as they are equitable and just."

The right to award costs and fees is discretionary, not mandatory. *See Bocquet v. Herring*, 972 S.W.2d 19 (Tex. 1998); *State Farm Lloyds v. Borum*, 53 S.W.3d 877 (Tex. App. -- Dallas 2001, pet. denied). The award is subject to reversal only if it is arbitrary and unreasonable. *See McCarthy Bros. Co. v. Continental Lloyds*, 7 S.W.3d 725 (Tex. App. -- Austin 1999, no pet.)(although judgment reversed on coverage, no indication court's refusal to award fees to either party was abuse of discretion). Costs and fees are not dependent upon the outcome, and can be awarded to either the prevailing or the non-prevailing party.

B. Federal

Under federal law, the Declaratory Judgment Act, itself, does not authorize attorney's fees. Instead, a party may recover fees only where controlling substantive law permits recovery. *See Utica Lloyds of Tex. v. Mitchell*, 138 F.3d 208, 210 (5th Cir. 1998)(holding that Texas Declaratory Judgment Act was not controlling, substantive law, and did not justify fee award to defendants). Under Texas substantive law, attorney's fees may be available to the insured if the insurer has breached its duty to defend or indemnify. While for years there was a question in the Federal courts as to whether Texas Civil Practice & Remedies Code §38.001 applied to breaches of an insurance agreement, this question was resolved by the Texas Supreme Court, on a certified question from the Fifth Circuit, in *Grapevine Excavation, Inc. v. Maryland Lloyds*, 35 S.W.3d 1 (Tex. 2000).

Prior to the *Grapevine Excavation* case, the Fifth Circuit had construed Section 38.006 to exempt insurers from paying attorney's fees in breach of contract actions. The Texas Supreme Court concluded that Section 38.006 allowed recovery of attorney's fees for breach of contract unless attorney's fees are otherwise available. The Fifth Circuit overruled prior case law to conform to the Supreme Court's ruling. *Federated Mut. Ins. Co. v. Grapevine Excavation*, 241 F.3d 396 (5th Cir. 2001).

Unfortunately, while Section 38.001, *et seq.*, may allow recovery of attorney's fees by the insured, in a proper case, it provides no basis for recovery of fees by an insurer.

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