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DECLARATORY RELIEF IN INSURANCE COVERAGE DISPUTES

BY JOSEPH F. CUNNINGHAM

In the fairly recent decision of *Allstate Insurance Co. v. Atwood*,¹ the Court of Appeals of Maryland provided claimants, insurance carriers, and their attorneys guidance as to when a carrier might seek judicial interpretation of policy language related to the facts in the course of a policy coverage dispute. Indeed, some would suggest that this case posits the most precise guidelines for seeking such relief anywhere. The issue is a particularly topical one for reasons that will be discussed. Its resolution in Maryland contrasts sharply with the course taken by the highest courts of other states. Practitioners will find the court's decision by Judge Eldridge for a unanimous court both logical and persuasive. Interestingly enough, a contrasting Virginia decision, *Reisen v. Aetna Life & Casualty Co.*,² if less scholarly, raises interesting policy questions which bear further thought. Other appellate courts are divided along lines set out in these two leading decisions and a review of both suggests the parameters of the topic.

Atwood is the latest in a significant line of cases in Maryland dealing with the problem of the appropriate time for an insurance carrier to raise the issue of policy coverage in cases where an underlying dispute involving its insured suggests conduct facially outside the scope of the policy's terms and conditions. While this issue has been frequently presented to courts over the years, the increase in coverage litigation generally and the ingenuity of counsel for claimants and insureds seeking to fit claims within the ambit of policy coverage have significantly increased the pace of such decision-making by courts. This increase has forced development of procedural ground rules covering the topic over the past twenty years.

A landmark decision in this area, both in Maryland and nationally, is *Brohawn v. Transamerica Insurance Co.*³ There, the court of appeals spoke definitively in a number of areas involving insurance policy rights and obligations. The decision indicated, *inter alia*, that a carrier owed its insured a complete legal defense to claims that suggest even a possibility of being covered under the four corners of policy language. The case further stands for the proposition that a conflict of interest between the carrier and its insured, once

developed,⁴ obligates the carrier to provide separate counsel of the insured's choosing to the insured at the carrier's expense. Finally, the *Brohawn* court held that an insurer ordinarily could not obtain a declaratory judgment concerning policy coverage where the coverage issue to be determined was essentially the same as an issue to be decided in the pending tort case. *Atwood*, fifteen years later, then undertook to determine precisely when this type of early declaratory relief might be appropriate. This inquiry had some guiding precedent which arose in the wake of *Brohawn*.

For over a decade after *Brohawn*, there had been a series of decisions by the Court of Appeals of Maryland that seemed to back away from its general prohibition of carriers seeking early declaratory relief in instances when they believed underlying disputes involving their insureds were outside the scope of policy coverage. Carriers persisted in seeking redress through declaratory judgment by fastening on language in *Brohawn* that, where policy coverage "questions are independent and separable from the claims asserted in a pending suit by an injured third-party,"⁵ such claims could still be resolved by means of declaratory judgment. As the court in *Atwood* noted, a number of decisions were made in the interim which permitted anticipatory rulings on coverage before the underlying suit was tried. The *Atwood* court did not indicate, of course, the degree of confusion felt by many attorneys arising from the manner in which cases after *Brohawn* fudged the "independent and separable" standard to the point where it was often guesswork as to when a carrier might properly file suit to determine a coverage issue involving a pending case.

The *Atwood* court cited *Brohawn's* reference to disputes between a carrier and its insured in determining whether the insured had given the insurer adequate notice of an underlying claim to preserve policy rights and/or whether the insured had cooperated with the insurer in defending a claim or refused to pay premiums. Such issues are fit for a declaratory ruling prior to the trial of an underlying tort case. Conceptually, it makes sense for a court to initially resolve these kinds of questions because they involve, not interpretation of policy coverage, but rather policy exclusions.

These questions relate to facts clearly "separable" from issues likely to arise in third-party claims against an insured. The harder questions of independence and separability related to coverage language in a policy were presented by the cases *Northern Assurance Co. v. EDP Floors*,⁶ *St. Paul Fire & Marine Insurance v. Pryseski*,⁷ *Truck Insurance Cycle v. Mark's Rentals*,⁸ and *Bankers & Ship Insurance v. Electro Enterprises*.⁹

In these related cases, it appeared that the clear line drawn by *Brohawn* had significantly blurred. This may have been due to the highest Maryland court's second thoughts with regard to whether the near-prohibition of prompt declaratory relief to carriers in cases involving seemingly obvious noncovered acts nonetheless obligated the carriers to provide their insureds a complete defense. The *Atwood* court, in a footnote, suggests that a look at *St. Paul Fire & Marine Insurance v. Pryseski* cited previously will clarify which coverage issues are separate and which are not separate and independent from issues in pending tort suits.¹⁰ However, this clarity, as a studied review of *Pryseski* will show, is far from apparent. Indeed, *Pryseski* created more confusion than it eliminated for commentators and practitioners alike. The reason is simply that this case also seemed to suggest that, contrary to *Brohawn*, declaratory actions to determine the existence of policy coverage generally might lie prior to resolution of the underlying suit involving the insured.

Atwood, like *Brohawn*, concerned a mixed bag of allegations involving intentional and negligent wrongdoing. Thus, it permitted the court of appeals to voice the propriety of having the underlying litigation proceed before any coverage issues were resolved. At the same time, the *Atwood* court wisely alluded to the reality that clever attorneys for both plaintiffs and defendants in underlying suits, in an attempt to make possible the availability of insurance proceeds, were styling and accepting pleadings artfully coined as "negligent sexual molestation," "negligent rape," and "negligent sodomy." The court adverted to the risk of fraudulent pleading and tactics "in order to manipulate insurance coverage," where the particular parties' interests are best served only when "a jury return[s] a verdict finding that even the most . . . blatant criminal and/or intentional acts [to be] negligent conduct."¹¹ Upon refusing to permit insurers to intervene in the underlying dispute as an obviously interested party, the court concluded such intervention would be mischievous by putting an insured to the defense of its position as to the plaintiff in the underlying case and also as to the insurer seeking to prove intentional wrongdoing.¹² The court further stated that permitting the carrier to intervene would run counter to the long-standing prohibition on direct action suits involving insurers before the liability of an insured is decided.¹³ The court was also reluctant to permit the issue of insurance to be presented to a jury when the acknowledged prejudicial impact of such information had traditionally been excluded from jury consideration in Maryland.¹⁴

Nonetheless, while emphasizing its dislike for pre-trial declaratory litigation by insurers, the court of appeals went on to spell out procedural rights for insurers challenging their obligation to pay judgments and related costs should its insureds not prevail in the primary case. It permitted insurers to subsequently litigate any coverage issue they chose, despite an adverse judgment against their insured. Yet, it required that such suit be filed within ten days of the entry of judgment in the tort suit.¹⁵

The trial judge must then determine as a matter of law whether or not the issue resolved at the underlying trial to determine coverage was fairly litigated. If so, the second proceeding ends. If not, then the insurer must present evidence as to the absence of such fairness and, ostensibly, the circumstantial reality of whether or not policy coverage exists. It seems unclear as to why a two-step process is required here while a single hearing, preceded by briefing, should normally suffice to resolve the fairness issue. But the court, in permitting a trial judge to take an extended look at the coverage question, has permitted more.

Regardless, the decision has an analytical consistency in dealing with a thorny problem which should provide fairness to both sides in this kind of increasingly frequent dispute. It will be interesting to observe the impact of such ruling on future insurance-related tort litigation, both with respect to volume and complexity.

The Supreme Court of Virginia chose a different course a few years earlier in the previously mentioned case of *Reisen v. Aetna Life & Casualty Co.* Rejecting *Brohawn* and other similar decisions from foreign jurisdictions, the court simply concluded that the existing Virginia declaratory judgment act allowed a carrier who could show the existence of a justiciable controversy to promptly pursue disposition of such controversy before its insured's tort trial. Not persuaded by the *Brohawn* line of cases, but citing none to the contrary, the court instead relied upon general language from a 1941 tome by one of the draftsman of the Uniform Declaratory Judgments Act.¹⁶ It then suggested that the carrier's acknowledged duty of good faith owed to its insured, in responding to a plaintiff's settlement demand in the tort suit, clearly obligated it to resolve the coverage question promptly (a duty, no doubt, the insured would happily waive). While such rationalization may seem feeble, a reading of the case displays the sense that the court was outraged that "unscrupulous litigants" would disregard the facts and falsely allege claims to set up an insurer to assume policy obligations. The opinion seems to imply that common sense dictates no judicial dalliance with these preposterous "negligent rape" type pleadings¹⁷ and their prompt adjudication as a quick purgative for such mischief.

However, before dismissing as overbroad the approach taken by the Supreme Court of Virginia, it is worth considering some policy reasons that favorably weigh on the side of the *Reisen* approach. First, the availability of prompt

resolution of the coverage issue, as the court suggested, undoubtedly has a tempering impact on meritless pleadings and subsequent trial tactics in the insured's tort suit. Additionally, any inclination towards fraud implicit in "negligent rape" style pleading, in combination with lowering of public respect for the judicial process and its potential subversion of which the *Atwood* court warned, is stymied.

Rapid determination of policy coverage questions should also favor settlements in cases similar to *Reisen* where the court quickly establishes a lack of coverage and, thus, defines certain limits on a defendant's "deep pockets." This approach contrasts with the delayed adjudication approach of *Atwood* where a carrier, doubting coverage exists, will ordinarily not entertain any settlement proposals. An initial determination that a policy lacks coverage may well eliminate a number of tort suits against defendants who are clearly uninsured for the wrongs claimed, thus arguably promoting judicial economy.

Finally, perhaps an up-front ruling as to coverage provides an insured a degree of certainty as to its position at trial of the underlying dispute and the finality of a judgment in the dispute, which the *Atwood* approach denies. While the *Reisen* court never articulated these considerations, they clearly suggest themselves.

Other courts have addressed, with varying degrees of sophistication, the timing of a declaratory judgment in the context of supposedly applicable exclusions under an insurance policy. In *Travelers Insurance Co. v. Emery*,¹⁸ the Court of Appeals of Florida may have provided the most recent and, perhaps, the most practical approach. There, the carrier appealed a lower court's decision denying its complaint for declaratory relief as premature because no suit had yet been filed against the insured. The insurer contended that a "business pursuits" exclusion in its homeowner's policy applied and, therefore, terminated any duty to defend the insured against a third party in the prospective litigation growing out of a business related claim.¹⁹ The *Emery* court, upon review, fell in line with the letter and spirit of the holding of the Supreme Court of Virginia in *Reisen*. Citing *American Fidelity Fire Insurance Co. v. Johnson*,²⁰ the court wrote, "the better part of wisdom should have dictated . . . the resolution of the question of . . . liability to the insured under the claimed renewal of the policy by the simple expedient of a declaratory judgment proceeding, at the inception of the litigation."²¹ The court ruled that the coverage issue was separate from the negligence issue in the threatened litigation and that the lower court erred in adjudging the petition "premature" despite the absence of an existing suit against its insured.²²

California, conversely, at least at the intermediate appellate level, seems to have flatly refused to allow an insurance company to maintain any declaratory judgment action against an insured while the main action is still pending. In *United Services Automobile Ass'n v. Martin*,²³ the insurer sought

declaratory relief due to the insured's failure to cooperate, as required by the policy. In Maryland, Virginia and most other states, such preliminary action would clearly be permitted because resolution of the applicability of the cooperation clause is obviously a separate matter from any underlying litigation. In California, however, the lower court sustained a demurrer to the amended complaint seeking a declaratory judgment and dismissed the action. The insurer appealed. The Court of Appeals of California, upon review, ruled that a required showing of prejudice could not be made while the main tort action was pending, thus making its outcome uncertain. Consequently, declaratory relief against the insured was inappropriate at that time.²⁴ One can only ponder the fairness and wisdom of a judicial mandate that demands proof of prejudice as a pre-condition to a carrier even proceeding in such cases to seek declaratory relief.²⁵

Ohio also recently reviewed the propriety of an early declaratory judgment action in a case where an underlying dispute involving the insured with third-parties suggested conduct facially outside the scope of a policy's terms and conditions. In so doing, it has embraced the other pole of absolutism in dealing with this type of declaratory action. In *Preferred Risk Insurance Co. v. Gill*,²⁶ the insurer sought a declaratory judgment that it did not have to defend or indemnify its insured in an unresolved, pending civil lawsuit arising out of a murder perpetrated by the insured. The lower court ruled in favor of the insurer that it had no duty to defend or indemnify the insured. However, the court of appeals reversed in part, ruling that the insurer must defend the insured when negligence is alleged because such negligence was covered. The insurer moved to certify the record. Pursuant to *Transamerica Insurance Co. v. Taylor*²⁷ and *State Farm Fire & Casualty Co. v. Pildner*,²⁸ Ohio courts previously followed the rule that the duty to defend was not a proper subject for a declaratory judgment action.²⁹ Nevertheless, upon review, the Supreme Court of Ohio took the opportunity to reexamine the rule of law set forth in *Taylor* and, despite two judges dissenting, reversed the lower court's decision. Relying on *Farm Bureau Mutual Automobile Insurance Co. v. Hammer*,³⁰ and ignoring the more sweeping and more recent holding in *Reisen*, the court cited an "ethical dilemma" which an insurer supposedly faces in its duty to defend when the insured's own conduct arguably takes it outside the coverage of the policy.³¹ The court then ruled that consistently permitting the insurer to bring preliminary declaratory judgment actions may eliminate this perceived ethical predicament by relieving the insurer of any duty to defend despite the potential coverage mandated by the pleading.³²

Such emphasis on "ethical" concerns by the carrier seems misplaced at best. Surely the issue is simply one of contractual duty. The Ohio court has traveled from one pole to the other in a short period of time on the present topic and, at least in this last instance, simply used judicial fiat to open

the court room door to early resolution of coverage issues.

Based on the foregoing discussion, it is clear that divergent paths have been followed by the respective jurisdictions in dealing with the topic of litigation timing involving insurance coverage questions. The comparative increase or decrease in pretrial suits by insurance carriers in the referenced states may provide the ultimate answer as to the better course. Reflection on the "all or nothing" approach of the Ohio and California courts is interesting for its divergence, but hardly for the subtlety of the reasoning displayed by either. Conversely, it is apparent that the Court of Appeals of Maryland in *Atwood* has provided sophisticated, albeit far from perfect guidelines for declaratory relief to carriers that, for fairness and analytical precision, other state courts might well consider. It surely can be said to be the leading case on the subject presently.

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Endnotes

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¹319 Md. 247, 572 A.2d 154 (1990).

²302 S.E.2d 529 (Va. 1983).

³276 Md. 396, 347 A.2d 842 (1975).

⁴For a recent, insightful analysis of how far the separation of interests between a carrier and its insured may proceed before a

conflict exists, see *Cardin v. Pacific Employers Ins. Co.*, 745 F. Supp. 330 (D. Md. 1990).

⁵*Brohawn*, 276 Md. at 405, 347 A.2d at 848.

⁶31 Md. 217, 533 A.2d 682 (1987).

⁷292 Md. 187, 438 A.2d 282 (1981).

⁸288 Md. 428 418 A.2d 1187 (1980)

⁹287 Md. 641, 415 A.2d 278 (1980).

¹⁰*Atwood*, 319 Md. at 252 n.2, 572 A.2d at 162 n.2.

¹¹*Id.* at 253, 572 A.2d at 157 (quoting Petitioner's Brief at 15, *Atwood*).

¹²*Atwood*, 319 Md. at 257, 572 A.2d at 159.

¹³*Id.*

¹⁴*Id.* at 258, 572 A.2d at 159.

¹⁵See the filing requirements in Md. R. P. 2-532, 2-433, or 2-534, as appropriate.

¹⁶*Reisen*, 302 S.E.2d at 533.

¹⁷Here, the insured had driven his truck on to a sidewalk to injure a person with whom he was having an argument. The resultant claim was for negligent and intentional conduct.

¹⁸579 So.2d 798 (Fla. Dist. App. 1991).

¹⁹*Id.* at 799-800.

²⁰177 So.2d 679 (Fla. Dist. Ct. App. 1965).

²¹*Emery*, 579 So.2d at 801 (emphasis added).

²²*Id.* at 802.

²³120 Cal. App. 3d 963, 174 Cal. Rptr. 835 (1981).

²⁴*Id.* at 836.

²⁵It may be argued that the prejudice bar to early declaratory judgment relief applies only to California disputes involving the cooperation clause in a policy. The case does not, however, limit its holding to this provision.

²⁶507 N.E.2d 1118 (Ohio 1987).

²⁷504 N.E.2d 15 (Ohio 1986).

²⁸321 N.E.2d 600 (Ohio 1974).

²⁹*Taylor*, 504 N.E.2d at 17.

³⁰177 F.2d 793 (4th Cir. 1949).

³¹*Gill*, 507 N.E.2d at 1122.

³²*Id.*

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