



## The Possibility of Parallel Litigation

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**Litigants must carefully frame their claims at the pleading stage, with an eye toward maintaining federal jurisdiction.**

# Federal Abstention and Declaratory Judgment Actions

Federal courts have authority to hear state law claims under diversity jurisdiction. Although relatively rare, this concurrent jurisdiction of state and federal courts can give rise to parallel litigation—separate lawsuits

involving the same parties and subject matter proceeding simultaneously in state and federal court. Sometimes the federal court has a duty to yield its jurisdiction in favor of the state court action; sometimes it does not. Sometimes the federal court's ability to sustain jurisdiction depends on precisely how the claims have been framed.

This article focuses on insurance coverage litigation because it is one area particularly susceptible to parallel litigation. There are two classic fact patterns that look much alike but suggest different results.

In the first scenario, a coverage dispute arises and the insured files a state court lawsuit accusing the insurer of breaching the policy and acting in bad faith. The insured joins a related, non-diverse defendant such as the agent who sold the policy or the third-party adjuster who handled the claim. Because of the non-diverse defendant, the insurer cannot remove to federal court. In the meantime, the insurer has filed a lawsuit in federal court, seeking a declaratory judgment that the insured's loss is not cov-

ered. As explained below, the federal court will likely have a duty to abstain from hearing the declaratory judgment action under the *Brillhart/Wilton* doctrine, a narrow abstention doctrine that applies only to declaratory judgment actions.

The second scenario also involves a coverage dispute, but in this case, the insurer has discovered misrepresentations in the insured's application for insurance. The insured files the same state court action for breach of contract and bad faith—again naming a non-diverse party. This time, however, instead of seeking a declaratory judgment, the insurer files a lawsuit in federal court seeking rescission of the policy (that is, "coercive" relief). Though similar to the first scenario, this case is probably governed by the *Colorado River* doctrine, which gives federal courts greater leeway in retaining state law cases. Because the federal court is not likely to have a duty to abstain, parallel litigation may ensue.

This article discusses and compares these two abstention doctrines. (There



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are other abstention doctrines beyond the scope of this article.) Because many cases will not clearly fall into one fact pattern or the other, we will turn to how the circuits have handled cases involving both coercive and declaratory relief. Although this article and many of the cases discussed are limited to insurance disputes, the general principles governing abstention apply—and

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parallel litigation could result—in any fact pattern in which a party could seek declaratory judgment on a state law issue.

### The Federal Declaratory Judgment Act

The Federal Declaratory Judgment Act (FDJA), passed in 1934, permits federal courts to render declaratory judgments in any cases within their jurisdiction—including diversity cases. 28 U.S.C. §2201. Insurers can use the FDJA to put their coverage questions or disputes before federal judges, assuming they otherwise meet the requirements for diversity jurisdiction. Nothing in the statute precludes an insurer from filing such a declaratory judgment action, even if the parties are already embroiled in state court litigation involving the same claim dispute.

### *Brillhart v. Excess Insurance Company of America*

It did not take the United States Supreme Court long to recognize that the parallel litigation available under the FDJA was a problem. In 1942, the Court gave guidance to federal courts exercising jurisdiction over FDJA claims in *Brillhart v. Excess Ins. Co. of America*, 316 U.S. 491 (1942). *Brillhart* was an insurer's federal court action seeking a declaration that it need not indemnify its insured for liability litigated in a separate state court action (in which the plain-

tiff obtained default judgment against the insured). *Id.* at 492–93. The insurer was eventually named as a garnishee in the state court action. *Id.* The district court declined to exercise its discretion to retain the case. *Id.* at 494. The court of appeals reversed, ordering the district court to hear the case on the merits. *Id.* The Supreme Court did not decide whether the district court should have abstained. Instead, it set forth guidelines for federal courts to consider when deciding whether to retain jurisdiction over declaratory actions.

Describing parallel litigation as “unecological as well as vexatious,” the Court opined that “[g]ratuitous interference with the orderly and comprehensive disposition of a state court litigation should be avoided.” *Id.* at 495. In what was admittedly *not* “a comprehensive enumeration” of factors, the Supreme Court said federal courts in declaratory judgment actions:

should ascertain whether the questions in controversy between the parties to the federal suit, and which are not foreclosed under the applicable substantive law, can better be settled in the proceeding pending in the state court. This may entail inquiry into the scope of the pending state court proceeding and the nature of defenses open there. The federal court may have to consider whether the claims of all parties in interest can satisfactorily be adjudicated in that proceeding, whether necessary parties have been joined, whether such parties are amenable to process in that proceeding, etc.

*Brillhart*, 316 U.S. at 495. First, “[t]he district court should avoid needless determination of state law issues.” *Id.* Next, the district court “should discourage litigants from filing declaratory actions as a means of forum shopping.” *Id.* Finally, the district court “should avoid duplicative litigation.” *Id.*

### *Colorado River Water Conservation District v. United States*

Thirty-four years after *Brillhart*, the Supreme Court decided the seminal case *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976). The federal lawsuit involved a claim by the United States to determine its water rights and the water rights of two tribes under Colorado's

water regulation scheme. *Id.* at 805–06. One of the defendants sought—under the McCarran Act—to join the United States as a defendant in a separate state court action to determine the water rights. *Id.* at 806. That defendant then sought to dismiss the federal case for lack of jurisdiction. *Id.* The district court did not reach the question of jurisdiction, but decided (without elaboration) that abstention was appropriate. *Id.* The Tenth Circuit reversed. *Id.*

The Supreme Court held none of the traditional abstention doctrines applied and reaffirmed the “virtually unflagging obligation of the federal courts to exercise the jurisdiction given them.” *Id.* at 817. The Court said:

Given this obligation, and the absence of weightier considerations of [established abstention doctrines], the circumstances permitting the dismissal of a federal suit due to the presence of a concurrent state proceeding for reasons of wise judicial administration are considerably more limited than the circumstances appropriate for abstention.

*Id.* at 818. Indeed, dismissal of a parallel federal court case under *Colorado River* is only warranted in “exceptional” circumstances. *Id.* The Court outlined:

[i]t has been held, for example, that the court first assuming jurisdiction over property may exercise that jurisdiction to the exclusion of other courts.... In assessing the appropriateness of dismissal in the event of an exercise of concurrent jurisdiction, a federal court may also consider such factors as the inconvenience of the federal forum; the desirability of avoiding piecemeal litigation; and the order in which jurisdiction was obtained by the concurrent forums. No one factor is necessarily determinative; a carefully considered judgment taking into account both the obligation to exercise jurisdiction and the combination of factors counseling against that exercise is required. *Only the clearest of justifications will warrant dismissal.*

*Colorado River*, 424 U.S. at 818–19 (internal citations omitted) (emphasis added).

Under the particular facts of *Colorado River*, the Court ultimately determined that the case was best heard in state court. The McCarran Act—under which the government had been joined in the state

action—expressed an intent by the federal government that the states determine water rights. *Id.* at 819–20.

### **Wilton v. Seven Falls Company**

*Colorado River* created confusion as to whether *Brillhart* was overruled and what standard applied to abstention from declaratory judgment actions. Thus, the Supreme Court revisited the issue in *Wilton v. Seven Falls Co.*, 515 U.S. 277 (1995). The *Wilton* Court confirmed that both earlier cases are still good law. *Brillhart* governs cases brought under the FDJA. *Id.* at 286, 289. Inferentially, *Colorado River* governs all other cases. See, e.g., *Gov't Employee's Ins. Co. v. Dizol*, 133 F.3d 1220, 1226 n.6 (9th Cir. 1998). Additionally, the *Wilton* Court clarified that a district court's determination of whether or not to abstain under *Brillhart* is reviewed for an abuse of discretion. *Wilton*, 515 U.S. at 289–90.

Later, some circuits expanded on or clarified *Brillhart/Wilton* by specifying additional factors to consider when considering whether to abstain. See, e.g., *Scottsdale Ins. Co. v. Flowers*, 513 F.3d 546, 554 (6th Cir. 2008); *State Farm Fire & Cas. Co. v. Mhoon*, 31 F.3d 979, 983 (10th Cir. 1994); *Nautilus Ins. Co. v. Winchester Homes, Inc.*, 15 F.3d 371, 377 (4th Cir. 1994); *Ameritas Variable Life Ins. Co. v. Roach*, 411 F.3d 1328 (11th Cir. 2005).

### **Deciding Which Abstention Doctrine to Apply**

Over the 53 years between *Brillhart* and *Wilton*, two distinct abstention doctrines emerged that are still applicable today. The *Brillhart/Wilton* doctrine, which applies only to cases filed under the FDJA, instructs federal courts to yield to state courts in most instances of parallel litigation. In contrast, the *Colorado River* doctrine, which generally applies to all other cases, commands federal courts to maintain jurisdiction, despite parallel state court cases, unless there are “exceptional circumstances.”

But most cases do not fall neatly into one category. An insurer commonly asks for a declaratory judgment regarding payment in addition to coercive relief (e.g., rescission). Often the insured counterclaims for breach of contract or bad faith—both coercive claims.

The circuits are split on how to handle these hybrid cases. As outlined by the Fifth Circuit earlier this year, courts have developed four approaches for handling cases that seek both coercive and declaratory relief. See *New England Ins. Co. v. Barnett*, 561 F.3d 392, 395–96 (5th Cir. 2009). The Supreme Court has not yet stepped in to resolve the dispute. The four methods highlight the importance of pleading claims carefully to enable the federal court to retain jurisdiction.

### **Independent Coercive Claim**

In the Ninth Circuit, courts look at the coercive claim to determine whether it can “provide an independent basis for federal diversity jurisdiction.” *Gov't Employee's Ins. Co. v. Dizol*, 133 F.3d 1220, 1226 n.6 (9th Cir. 1998); see also *United Nat'l Ins. Co. v. R & D Latex Corp.*, 242 F.3d 1102, 1112 (9th Cir. 2001) (court should determine “whether there are claims in the case that exist independent of any request for purely declaratory relief, that is, claims that would continue to exist if the request for a declaration simply dropped from the case”). If an independent claim exists, *Brillhart/Wilton* does not apply.

Indeed, when other claims are joined with an action for declaratory relief (e.g., bad faith, breach of contract, breach of fiduciary duty, rescission, or claims for other monetary relief), the district court should not, as a general rule, remand or decline to entertain the claim for declaratory relief. If a federal court is required to determine major issues of state law because of the existence of non-discretionary [independent coercive] claims, the declaratory action should be retained to avoid piecemeal litigation.

*Id.* at 1225–26.

According to the Ninth Circuit, the risks of parallel litigation must be balanced against a party's constitutional right to a federal forum. *First State Ins. Co. v. Callan Associates, Inc.*, 113 F.3d 161, 162 (9th Cir. 1997). Federal courts cannot simply abstain every time there is a claim for declaratory relief:

Although occasionally stigmatized as “forum shopping,” the desire for a federal forum is assured by the constitutional provision for diversity jurisdiction and the congressional statute imple-

menting Article III. While federal courts already sustain a heavy burden of litigation, their doors cannot be closed to a suitor who qualifies under the rigorous criteria for federal jurisdiction. In the proper case, as this one has turned out to be, the obligation to exercise jurisdiction is “virtually unflagging.”

*Id.* (citing *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976)). “Nonetheless,” the Ninth Circuit has taken care to confirm, “courts should generally decline to entertain reactive declaratory actions.” *Dizol*, 133 F.3d, at 1225.

Earlier this year, the Seventh Circuit found Ninth Circuit law persuasive and adopted the “independent coercive claim” test. *R.R. Street & Co., Inc. v. Vulcan Materials Co.*, \_\_\_ F.3d \_\_\_, 2009 WL 1794397 (7th Cir. June 25, 2009) (“Where state and federal proceedings are parallel and the federal suit contains claims for both declaratory and non-declaratory relief, the district court should determine whether the claims seeking non-declaratory relief are independent of the declaratory claim.”).

### **Dealing with the Declaratory Judgment Claim in Isolation**

While the Ninth Circuit allows a declaratory claim to piggy-back on a coercive claim, the Fourth Circuit (as observed by the Fifth Circuit in *Barnett*) appears to apply *Brillhart/Wilton* any time there is a declaratory judgment claim, regardless of the presence of accompanying coercive claims. In *United Capitol Ins. Co. v. Kapiloff*, 155 F.3d 488, 493–94 (4th Cir. 1998), the Fourth Circuit ignored the defendant's counterclaim for breach of contract (an independent coercive claim) and performed the *Brillhart/Wilton* analysis solely to the declaratory judgment claim. The Fourth Circuit then applied its own additional factors to the *Brillhart/Wilton* analysis:

- (1) whether the state has a strong interest in having the issues decided in its courts;
- (2) whether the state courts could resolve the issues more efficiently than the federal courts;
- (3) whether the presence of “overlapping issues of fact or law” might create unnecessary “entanglement” between the state and federal courts; and
- (4) whether the federal action is mere “procedural fencing,” in the sense that the action is merely the product of forum-shopping.



*Id.* at 493–94 (citing *Nautilus*, 15 F.3d at 377). Under these additional factors, the court did consider the convenience of keeping the declaratory claim in the same lawsuit as the coercive claim. *Id.* The Fourth Circuit ultimately determined that the district court had not abused its discretion by retaining the case. *Id.*

Similarly, the Fourth Circuit applied its modified *Brillhart/Wilton* analysis to an insurer's lawsuit in which two of the three counts sought coercive relief. *Myles Lumber Co. v. CNA Financial Corp.*, 233 F.3d 821, 824–25 (4th Cir. 2000). Though there was no parallel state court proceeding, *Myles Lumber* illustrates that the Fourth Circuit's approach is to assess any declaratory judgment under *Brillhart/Wilton*, even if it is pled alongside a coercive claim.

#### Heart of the Action

Another approach is to look at the “heart of the action” to determine whether the outcome of the coercive claim hinges on the outcome of the declaratory claim; if the coercive relief is dependent on the grant of the declaratory relief, the *Brillhart* standard applies to a district court's decision to stay.” See *Barnett*, 561 F.3d at 395 (discussing cases).

The Southern District of Alabama has cited this approach as reasonable because it does not “exalt[] form over substance.” *Lexington Ins. Co. v. Rolison*, 434 F. Supp. 2d 1228, 1237 (S.D. Ala. 2006). It does not deprive the district courts “of the discretion granted them by the Declaratory Judgment Act to hear or not to hear what are fundamentally declaratory judgment actions” just “because a coercive claim has been tacked onto what is, at its core, a declaratory judg-

ment action.” *Id.* The court specifically warned against “savvy litigants” circumventing *Brillhart/Wilton* through “creative pleading of tagalong coercive claims.” *Id.*

The *Rolison* court described the “heart of the action” rule as “flexible,” noting that it allows “district courts to treat different cases differently based on the fundamental character of a particular action.” *Id.* at 1238. The court then contrasted two hypothetical cases. If the “plaintiff has brought a dozen substantial claims for monetary damages, with a tangential claim under the Declaratory Judgment Act appended as an afterthought at the end of the initial pleading,” *Colorado River* should apply. *Id.* In contrast, if a complaint for declaratory relief is answered by a counterclaim for coercive relief based on the interpretation of the insurance policy at issue, *Brillhart/Wilton* should apply. *Id.*

Without specifically discussing the “heart of the action” test, it appears that the Eighth Circuit has recently applied it as well. *Royal Indem. Co. v. Apex Oil Co.*, 511 F.3d 788, 793–94 (8th Cir. 2008) (“a court may still abstain in a case in which a party seeks damages as well as a declaratory judgment so long as the further necessary or proper relief would be based on the court's decree so that the essence of the suit remains a declaratory judgment action”).

Both the Eastern District of Wisconsin and the Eastern District of Pennsylvania have adopted the “heart of the action” approach. *Nissan N. Am., Inc. v. Andrew Chevrolet, Inc.*, 589 F. Supp. 2d 1036, 1040 (E.D. Wis. 2008); *ITT Indus., Inc. v. Pac. Employers Ins. Co.*, 427 F. Supp. 2d 552, 555–57 (E.D. Pa. 2006). The Wisconsin

decision, however, was impliedly overruled by the Seventh Circuit's adoption of the Ninth Circuit's approach earlier this year in *R.R. Street*, discussed above.

#### The Bright-Line Approach

A final approach, used by the Fifth and Second Circuits, is to apply the more liberal *Colorado River* doctrine “whenever an action includes both declaratory and non-frivolous coercive claims for relief.” *Barnett*, 561 F.3d at 395; *Vill. of Westfield v. Welch's*, 170 F.3d 116, 124 n.5 (2d Cir. 1999). It is truly a “bright-line” test.

The Seventh Circuit (in rejecting this approach and adopting the Ninth Circuit's test) described the advantages and disadvantages of a bright-line rule: “While that approach is commendable for its ease of application by both litigants and courts, it unduly curtails a district court's ‘unique and substantial discretion’ to abstain from hearing claims for declaratory relief.” *R.R. Street & Co., Inc.*, \_\_\_ F.3d at \_\_\_, 2009 WL 1794397.

#### Conclusion

*Brillhart/Wilton*, *Colorado River*, and their progeny highlight the need for federal court litigants carefully to frame their claims at the pleading stage, with an eye toward maintaining federal jurisdiction. Because the circuits vary widely in their approaches to abstention, a complaint that succeeds in the Fifth Circuit may cause the Eighth Circuit to abstain. Once the federal court decides to maintain jurisdiction, of course, a new set of issues, challenges, and strategy decisions will arise due to the existence of the parallel state court case. 