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Staying Alive When Your Insurance Company Seeks a No Coverage Declaration

By Diana Shafter Gliedman and Daniel J. Healy

It's a familiar and frustrating situation: your company is facing a bet-the-company lawsuit. You reach out to your insurance company, just to have them assert that there's no coverage under your policy. And if that wasn't bad enough . . . your insurance company is taking you to court, seeking a declaration that they don't have to cover you in the underlying suit. Now you're facing not one but two suits.

Requiring a policyholder to litigate a coverage action while the underlying claims are in flux could prejudice the underlying case. When this is the case, policyholders should consider seeking a stay of the insurance company's coverage lawsuit until the underlying action is resolved.

A Stay May Be Appropriate When the Underlying Causes of Action Are In Flux

Insurance companies often ask the court to issue a declaration that there is no coverage for the causes of action in the underlying lawsuit. But if the defendant has a motion to dismiss pending in the underlying lawsuit, the plaintiff may be permitted to amend its complaint. What happens if the amended complaint contains new causes of action? And why is the insurance company asking for a declaration of no coverage when the underlying claims are in flux?

In New York and other jurisdictions, courts have held that "the interests of judicial economy and orderly procedure are important considerations in determining whether a stay should be granted.[1] In *Lupoli v. Lupoli*, the Supreme Court in Kings County ruled that a stay should be granted where issues in one proceeding may dispose of issues in another.[2] In *Hill v. Hill*, the same court granted a stay of action pending a determination by Surrogate's Court that might dispose of the entire issue between the parties.[3] And in *Buzzell v. Mills*, the First Department ruled that a stay is justified where the determination of the prior action might dispose of or limit issues involved in the subsequent action.[4]

Policyholders can argue that it serves the interest of judicial economy and orderly procedure to stay the insurance company's case. In fact, it

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may be entirely premature to attempt to decide the coverage issues before certain issues in the underlying case have been resolved. It is not necessary that the underlying case determine all of the issues in the coverage case for entry of a stay to be proper. In many jurisdictions, a stay may be granted "[e]ven [where] there was not a complete identity of parties, [but] there were overlapping issues and common questions of law and fact," as the First Department ruled in *Belopolsky v. Renew Data Corp.*[5] In this case, the Appellate Division permitted a stay because determinations in the underlying action could dispose of or limit issues in the subsequent action.[6]

Courts may also stay cases to avoid making needless and possibly inconsistent or moot adjudications and to prevent the waste of judicial resources. In *Kwiatkowski v. National Student Marketing Corp.*, the court reversed vacatur of stay where underlying litigation was nearing disposition and the vacatur posed a threat of duplicative litigation and inconsistent determinations.[7]

Finally, it is well established that a declaratory judgment action should not be an advisory opinion. That means that an insurance company's declaratory action should be stayed if the facts and allegations underpinning the underlying claims are not sufficiently fixed. In *First State Ins. Co. v. J & S United Amusement Corp.*, the First Department ruled, "A declaratory judgment should not be granted where it would effectively be nothing more than an advisory opinion. Such relief is deemed premature in cases where a final determination on the underlying theories of liability has not been made."[8] Similarly, in *Prashker*, the court held that "[c]ases on the appropriateness of declaratory judgments construing insurance contracts apply to situations where issues of fact on which the insurance coverage depends do not await to be adjudicated in the principal action," and dismissing an insurance company's declaratory action against a policyholder as premature because it had not yet been ascertained which grounds of liability would be adjudicated against the policyholder.[9] In *Health Ins. Plan of Greater N.Y. v. Calvary Hosp.*, the Supreme Court in New York County held that "a plaintiff is not entitled to a declaratory judgment absent concerted legal issues presented in actual disputes, not abstraction . . . courts will not entertain a declaratory judgment action when any decree that the court might issues will become effective only upon the occurrence of a future event that may or may not come to pass."[10]

Policyholders Should Not Be Required to Litigate Against Themselves by Identifying the Weaknesses in Their Own Case

"It is well settled that an insurance company's duty to defend is broader than its duty to indemnify. Indeed, the duty to defend is exceedingly broad and an insurer will be called upon to provide a defense whenever the allegations of the complaint suggest a *reasonable possibility* of coverage." So held the Supreme Court in New York County in *Tishman Constr. Co. of N.Y. v. Liberty Mut. Fire Ins. Co.* (emphasis added).[11] A declaration that there is no obligation to defend can properly be made only if it can be concluded as a matter of law that there is "no possible factual or legal basis" on which an insurance company "*might eventually be held to be obligated to indemnify*" a policyholder under any provision of the insurance policy. (emphasis added). Allegations that would permit proof of facts of a covered claim, even if inartfully alleged, trigger defense coverage.

Against this backdrop of broad defense coverage, a policyholder can obtain coverage by demonstrating that there is even a chance the insurance companies could, in the course of the litigation eventually be obligated to indemnify the policyholder. It is axiomatic, however, that the policyholder should not be required to draw the underlying plaintiffs a roadmap identifying various theories to seek damages in the future. If a policyholder is faced with a complaint filed by its own insurance company that demands the policyholder set forth how it may be held liable in the underlying lawsuit, a policyholder may prefer the alternative of a stay. It may be manifestly unfair to file public pleadings explaining facts or arguments that could be detrimental to their underlying lawsuit.

Conclusion

Until the allegations and claims in an underlying lawsuit are finally established, there may be no way to determine whether said allegations and claims will be covered under a given insurance policy. Moreover, pointing out potential future arguments that could lead to coverage may impede

the defense of the underlying action. A policyholder should not be forced to jeopardize the defense of an underlying suit because its insurance company has filed a premature coverage action. In such a circumstance, filing for a stay of the coverage action may protect the policyholder's defense and its future arguments for coverage. Policyholders facing lawsuits for a declaration of no coverage filed by their insurance company should question whether the action should proceed and whether a stay would be a better course.

ENDNOTES

[1] *Palm Bay Int'l, Inc. v Winewave, Ltd No. 005946/09, 2009 N.Y. Misc. LEXIS 6081, at *6 (Sup. Ct. Nassau Cnty. Aug. 25, 2009).*

[2] *Lupoli v. Lupoli, 205 A.D.2d 595 (2d Dep't 1994).*

[3] *72 N.Y.S.2d 720, 723 (Sup. Ct. Kings Cnty. 1947).*

[4] *301 N.Y.S.2d 645, 645–46 (1st Dep't 1969).*

[5] *41 A.D.3d 322 (1st Dep't 2007).*

[6] *See also Palm Bay, 2009 N.Y. Misc. LEXIS 6081, at *8 ("[a] stay may be warranted when there is substantial identity and overlap between [actions], and a stay is justified upon due consideration of issues of comity, orderly procedure and judicial economy.").*

[7] *85 A.D.2d 559, 560 (1st Dep't 1981). See also Asher v. Abbott Labs., 307 A.D.2d 211, 212 (1st Dep't 2003) (stay granted to avoid duplication of effort and waste of judicial resources where the scope of discovery, not the ultimate issues, depended on the federal court's disposition of defendants' appeal).*

[8] *495 N.Y.S.2d 384, 386 (1st Dep't 1985), rev'd on other grounds, 67 N.Y.2d 1044, 1046 (1986) (holding appellate court's dismissal of insurance company's declaratory judgment is proper where there are possible factual or legal bases on which the insurance company may eventually be held liable under its policy).*

[9] *1 N.Y.2d at 591-92.*

[10] *5 Misc. 3d 1015(A), 2004 N.Y. Misc. LEXIS 2185, at *6-7 (Sup. Ct. N.Y. Cnty. Nov. 8, 2004).*

[11] *No. 154366/2015, 2017 N.Y. Misc. LEXIS 13, at *14 (Sup. Ct. N.Y. Cnty. Jan. 4, 2017)*

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