

## CORPORATE INSURANCE LAW

## Expert Analysis

# Second Circuit Clarifies Justiciability Standard for Declaratory Judgment Actions Concerning the Duty to Defend

Parties to insurance coverage disputes often file declaratory judgment actions in an attempt to resolve disagreements over the duty to defend and the duty to indemnify. The Declaratory Judgment Act permits federal courts to declare the rights and obligations of parties prior to the time that further relief, such as a coercive remedy, can be sought. But the duty to defend and the duty to indemnify are distinct in ways that may impact whether a federal district court has jurisdiction to resolve a dispute under the Declaratory Judgment Act. For example, the duty to defend is triggered by the mere filing of a lawsuit against the insured whereas the duty to indemnify is not triggered until the insured is held liable to a third party for loss.

In some cases, a dispute over the duty to defend may be justiciable but a dispute over the duty to indemnify involving the same facts may not be. The United States Court of Appeals for the Second Circuit recently addressed this issue and clarified the applicable standards in *Admiral Insurance Co. v. Niagara Transformer Corporation*, No. 21-2733, 2023 WL 115364 (2d Circuit Jan. 6, 2023).

On appeal, the Second Circuit affirmed the Southern District's ruling dismissing



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the plaintiff insurer's action for lack of a justiciable case or controversy to the extent it sought a declaration regarding the duty to indemnify but remanded the case for further review of whether the Southern District had jurisdiction with respect to the duty to defend.

In doing so, the Second Circuit clarified the applicable standard, explaining that a declaratory judgment action with respect to the duty to defend becomes justiciable when there is a "practical likelihood" that the alleged duty to defend will be triggered. *Id.*

### The Underlying Dispute

During the 1960s and 1970s, Niagara Transformer Corporation purchased polychlorinated biphenyls (PCBs) from Monsanto Co. for use in its transformers. PCBs were later discovered to be toxic and carcinogenic and their manufacture, processing and distribution has been banned under federal law since approximately 1979.

Monsanto sold PCBs to Niagara pursuant to an agreement, known as the "Special

Undertaking", under which, according to Monsanto, Niagara agreed to defend, indemnify and hold harmless Monsanto from liabilities, claims and damages arising out of the use, sale or disposition of PCBs by Niagara.

Beginning in 2009, various plaintiffs began asserting claims for damages against Monsanto in lawsuits alleging personal injury or property damage caused by exposure to or contamination by PCBs. In 2016, Monsanto sent Niagara a letter demanding that Niagara defend and indemnify Monsanto for loss related to current and future PCB-related litigation and alleged that Niagara was liable to Monsanto under the terms of the Special Undertaking. Niagara responded with a letter denying any and all liability to Monsanto.

### The Coverage Dispute

Although Monsanto did not file suit, Niagara undertook to identify its historical insurance program and provided notice to Admiral of Monsanto's claims. Admiral denied coverage for the claims on several grounds, including alleged late notice. Admiral then filed a declaratory judgment action seeking an order declaring that it had no duty to defend or indemnify Niagara with respect to Monsanto's claims.

Niagara responded with a motion to dismiss the complaint for lack of subject matter jurisdiction, arguing that the suit did not present a justiciable case or

controversy. Admiral cross-moved for summary judgment.

The Southern District granted Niagara's motion to dismiss on jurisdictional grounds finding that there was no case or controversy because there was no "practicable likelihood" that Niagara will be held liable to Monsanto in connection with the PCB claims at issue. The District Court relied primarily on the fact that Monsanto had not filed a lawsuit against Niagara and questions over the "validity, scope and enforceability" of the Special Undertaking. *Id.* at \*2.

### The Second Circuit Ruling

Admiral appealed and the Second Circuit affirmed the Southern District's ruling with respect to the duty to indemnify but remanded the case for further review with respect to the duty to defend because the Southern District had not adequately applied the practical likelihood analysis with respect to the duty to defend.

The Second Circuit explained that "a district court's jurisdiction to declare an insurer's duty to defend and its duty to indemnify turns on different inquiries—each involving the practical likelihood that the triggering event will occur [citations omitted] ... With respect to the duty to defend, the district court must find a practical likelihood that a third party will commence litigation against the insured. With respect to the duty to indemnify, the court must find a practical likelihood that the third party will prevail in such litigation." *Id.* at \*5.

The Second Circuit found that the Southern District had properly concluded that it lacked jurisdiction to address the duty to indemnify claim based on its finding that it was unlikely that Niagara would incur liability to Monsanto.

In contrast, the Second Circuit held that the Southern District had not assessed the practical likelihood that Monsanto would file suit against Niagara and instead had improperly relied on the fact that Monsanto had neither filed suit nor expressly threatened to do so.

According to the Second Circuit, the proper inquiry with respect to the duty to defend claim would be whether the alleged facts "evinced a practical likelihood that Monsanto will sue Niagara." *Id.* at 5.

Consequently, the case was remanded to the Southern District for reconsideration of the justiciability of the duty to defend claim based on an assessment of the practical likelihood that Monsanto would commence formal litigation with respect to its claims pursuant to the Special Undertaking.

### Discretionary Factors

Although the Second Circuit remanded the case in part, it emphasized that even if the Southern District determines that it

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has jurisdiction over the duty to defend claim, the Court has discretion to refuse to hear the case.

In evaluating whether it should decline to assert jurisdiction even where the case does meet the threshold jurisdictional requirements, the Southern District must consider the following six factors: (1) whether the declaratory judgment "will serve a useful purpose in clarifying or settling the legal issues involved"; (2) whether a declaration will finalize the controversy and "offer relief from uncertainty"; (3) "whether the proposed remedy is being used merely for procedural fencing or a race to *res judicata*"; (4) "whether the use of a declaratory judgment would increase friction between sovereign legal systems

or improperly encroach on the domain of a state or federal court"; (5) "whether there is a better or more effective remedy" and (6) "whether concerns for judicial efficiency and judicial economy favor declining to exercise jurisdiction." *Id.* at \*10.

The Second Circuit also cautioned that while a district court has broad discretion to evaluate and apply these factors, it may be held to have abused that discretion in the following scenarios: (1) "when a relevant factor should have been given significant weight and is not"; (2) "when an irrelevant or improper factor is considered and given significant weight"; and (3) "when all proper factors, and no improper ones, are considered, but the court, in weighing these factors, commits a clear error of judgment." *Id.* at \*10.

### Looking Forward

The Second Circuit's ruling is useful in that it both clarifies the justiciability standard for declaratory judgment actions related to the duty to defend and the duty to indemnify and also clears up confusion over the discretionary factors that a district court should use to assess whether to assert jurisdiction over an action that does satisfy threshold justiciability requirements.

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