

TEXAS COURTS ACKNOWLEDGE POLICYHOLDERS' RIGHT TO SELECT DEFENSE COUNSEL

One of the most hotly contested issues in insurance law has been whether, and under what circumstances, an insured who is sued has the right to select its defense counsel. Most commercial general liability policies provide that the carrier has the "right and duty to defend" and, pursuant to this contractual provision, the carrier generally selects defense counsel and controls the defense and settlement. Policyholders have argued, however, that in some situations they should be permitted to reject the carrier's selection of defense counsel, choose their own counsel, and still have the carrier pay for the defense. In a recent decision, *Northern County Mutual Ins. Co. v. Davalos*, the Texas Supreme Court addressed this question for the first time and recognized the policyholder's right to select defense counsel in certain situations.

While acknowledging that the carrier generally has the contractual right to control the defense, including the right to select defense counsel, the *Davalos* court stated that the carrier may be precluded from insisting on that contractual right where there is a "conflict of interest" between the carrier and the insured. The court then spoke directly to the most common situation giving rise to such a conflict -- where there is a dispute between the carrier and the insured as to the existence or scope of coverage. The court stated that where the carrier issues a reservation of rights challenging coverage and the facts to be adjudicated in the underlying lawsuit are the same facts upon which coverage depends, the conflict of interest prevents the carrier from conducting the defense. As a result, the insured has the right to select defense counsel and have the carrier pay for the defense.

The court in *Davalos* indicated that other types of conflicts may also justify an insured's refusal of a defense offered by the carrier, such as:

- When the defense tendered "is not a complete defense under circumstances in which it should have been"
- When "the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interest at the expense of the insured's"
- When "the defense would not, under the governing law, satisfy the insurer's duty to defend"
- When, although the defense is otherwise proper, "the insurer attempts to obtain some type of concession from the insured before it will defend"

Thus, the court stated that the insured may rightfully refuse an inadequate defense and may also refuse any defense conditioned on an unreasonable, extra-contractual demand that threatens the insured's independent legal rights.

In a significant post-*Davalos* decision, *Dallas Housing Authority v. Northland Ins. Co.*, the United States District Court for the Northern District of Texas squarely held that the insured's tender of a defense subject to a reservation of rights letter created a disqualifying conflict of interest that triggered the insured's right to select its own counsel in the action



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against it. Relying on *Davalos*, the court held that because the facts to be decided in the underlying case were the same facts upon which coverage depended, the carrier could not conduct the defense. Therefore, according to the court, the insured properly refused the carrier's qualified tender of a defense, and the carrier was liable for the attorney's fees incurred by the insured in the defense of the lawsuit.

Obviously, the *Davalos* and *Dallas Housing Authority* decisions do not give the insured the right to select counsel in all cases. For example, if the carrier provides the insured with an *unqualified* defense (i.e., not subject to a reservation of rights), then the carrier retains its right to select defense counsel. In addition, the *Davalos* court stressed that not every disagreement between the insured and the carrier about how the defense should be conducted creates a conflict of interest that would give the insured the right to select counsel. Indeed, the court held in *Davalos* that a disagreement concerning the appropriate venue for the defense of a third-party claim was not a conflict of interest giving rise to the insured's right to select counsel.

Nevertheless, *Davalos* should be considered a significant victory for policyholders because, for the first time, the Texas Supreme Court acknowledged the right of the insured to select defense counsel in certain situations. The court also provided some guidelines as to the scope of that right. We can expect that future litigation between policyholder's and carriers will seek to test and clarify the limits of the *Davalos* decision.

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