

## The Insurance Company's Conditional Defense Offer<sup>1</sup>

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The facts go something like this in the construction context. Your company is sued because someone claims your work was improperly performed resulting in damage to some other property or person, or, your company is sued alleging an independent contractor that worked for you improperly performed work which damaged some another persons property or person. To trigger the insuring company's duty to defend you, you are required to tender the defense of the suit to your Commercial General Liability carrier.

After the tender, the insuring company is required to determine whether to offer you an unconditional defense based upon the "eight corners rule", i.e. the four corners of the insuring policy and the four corners of the suit. The insuring company is not legally allowed, except in limited circumstances, to go outside of these two documents in determining whether to offer you, as the insured, an unconditional defense. Many times, however, your insuring company can't decide in good faith, from looking at the two documents, whether the policy it issued to you covers the loss, and so it doesn't know whether it should offer you an unconditional defense. At this point the insuring company has basically three choices. (A fourth choice, when the insuring company sues you for declaratory judgment to determine its rights under the policy, is beyond the scope of this article.)

First, the insuring company can outright deny the claim, saying the claim is not covered by the policy therefore it has no duty to defend you. This decision is fraught with economic peril for the insuring company if its denial is wrongful. Among other things, it loses its right to control the defense of the case, select counsel, and to complain about a settlement. Not many insuring companies take this option.

Second, it can provide you with an unconditional defense of the suit. This is great for you, but not great for the insuring company if the loss ultimately is found not to be covered by the insuring policy. If the insuring company defends you unconditionally while knowing of defenses to coverage, the insuring company likely waived its rights to deny liability under the policy at a later date, and will have to pay for a loss and a defense when it otherwise wasn't required to do so under the insuring policy. Not many insuring companies take this option either.

Finally, and most likely, the insuring company will offer you a conditional defense, through a "reservation of rights" letter. In the letter, the insuring company points out various facts of which it is aware that trigger exclusions to coverage in your policy, and "reserves its right" to later deny liability under the policy. Instead of providing an unconditional defense, the insurer offers to defend you (and control the defense, and select counsel) while still reserving its rights to deny the claim at a latter date.

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Because of the potential conflict created between your insuring company and you as a result of the insuring company reserving its rights, you, as the insured, have the option of demanding that the insurer withdraw its reservation and provide an unqualified defense. The insurer can then either comply or decline to do so. If it complies, it likely waives all of its coverage defenses. If it declines, it must withdraw from the defense and allow you to personally conduct your defense.

To decide whether to demand that the insurer withdraw its reservation of rights will be governed by your insuring document and requires the advice of an attorney qualified to advise you in making this decision. Although the facts of cases vary, there are some **practical considerations** on which you should reflect in making the decision.

1. If you, as the insured, accept the conditional defense, you agree through implication that the insurer does not waive coverage defenses, and that the insuring company can control the defense and select counsel.

2. If you demand that the insuring company withdraw its reservation and it does not, but instead withdraws from the defense, you gain control of your defense of the case and your right to select your own counsel. The insuring company is still legally responsible to pay your reasonable attorney's fees and costs and is barred from asserting voluntary assumption of liability and no action clauses. However, to settle the case without an actual trial, you as the insured will likely still be required to allow the insuring company to participate and obtain the insuring company's consent to settle. If this consent to settle is negligently withheld, the insuring company will likely be responsible for any damages resulting therefrom.

There are several reasons why you may want to select counsel and control the defense. You may be more comfortable with your regular counsel's knowledge of you and your company, the type of work you do, and how the defense of your case should be presented to keep you "within coverage." Additionally, some insureds fear that with the insuring company controlling the defense and using counsel it selected, the insuring company will attempt to manipulate the defense to eventually deny coverage. Remember, however, that the counsel selected by the insuring company owes his ethical responsibilities to you, not the insuring company. Counsel hired by the insuring company is not allowed to get involved in coverage disputes between you and the insuring company and can not advise you or the insuring company on these matters.

3. The down side to selecting your own counsel is that, while the insuring company is still legally responsible to pay your reasonable fees and costs to defend the suit, you may be required to sue the insuring company for payment while you must continue to pay for the defense yourself. While this is possible, the insuring company has incentive to pay because there are significant penalties (interest at 18% per annum as damages and reasonable attorney's fees) which can be recovered in addition to the reasonable fees and costs of defense, if the insuring company does not timely pay.

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