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You Snooze; You Lose: When The Carrier's "Investigation" (Read: Delay) Breaches The Duty To Defend

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Earlier this month, a California federal court issued a stern warning to liability carriers: failing to provide an immediate defense forfeits your right to control the policyholder's defense, including any right to select counsel, and, once forfeited, the right to control irrevocably vests with the policyholder. The carrier cannot regain control, even if it reimburses pre-acceptance defense fees. *Travelers Indem. Co. v. Centex Homes*, Case No. 11-CV-03638-SC (N.D. Cal. Oct. 7, 2015).

Carriers and policyholders have long been engulfed in the battle as to *when* a carrier's delay (usually couched in terms of an "investigation") leads to forfeiture of the right to control; and, when it does, *whether* the carrier may re-gain control by paying pre-acceptance defense fees. Policyholders are all too familiar with the situation in which they tender a defense, the carrier delays accepting the tender, the policyholders use their own resources to retain counsel and mount a defense (and possibly retain coverage counsel to pursue coverage), then, after several months pass (and possibly a coverage suit), the carrier reverses course and accepts the tender. In doing so, the carrier insists on hijacking the underlying defense by replacing the policyholder's counsel with panel counsel.

Policyholders resisting this attempt to change horses mid-stream often find themselves in receipt of a declaratory action. Carriers are quick to argue that policyholders have breached the duty to cooperate by rejecting panel counsel and, alas, their duty to defend has eviscerated. Carriers argue that any delay is a "no

harm no foul" situation because they reimbursed the policyholder for pre-acceptance defense fees. With some consistency, courts have accepted this notion—finding policyholders in breach of the duty to cooperate and terminating the carrier's duty to defend.

In the new *Centex* case, the California federal court rejected this notion and laid a bright-line rule where few exist. This time, the policyholder came out on top. The court reversed its prior decision and answered "yes" to the question of "whether an insurer loses its right to control the defense of its insured if it fails to provide the insured with a defense immediately after its duty to defend is triggered, where the insurer subsequently accepts the insured's tender and offers to provide a defense, and where the insurer reimburses the insured for any legal costs incurred prior to its acceptance of the insured's tender."

The court reiterated that, "when an insurer breaches its duty to defend, the insurer forfeits its right to control the defense of the action." In considering whether the delay constituted breach, the court noted that neither the parties nor the court were able to find "a case clearly delineating the point at which an insurer's delay amounts to a breach of its duty to defend." The court, however, reasoned that a carrier's delay results in breach when it extends beyond the deadline for responsive pleadings. Because the carrier did not accept tender until thirteen days *after* the answer was due, the court found that it breached its duty to defend and, in doing so, lost its right to control the policyholder's defense.

The court rejected the carrier's (previously effective) arguments that it did not breach the duty to defend because (1) it had a right to conduct a reasonable investigation before accepting the tender, and (2) it reimbursed the policyholder for legal costs incurred prior to accepting the tender. The court held that "[a] failure to provide counsel or to guarantee the payment of legal fees immediately after an insurer's duty to defend has been triggered constitutes a breach of the duty to defend, even if the insurer later reimburses the insured." The court unsympathetically pointed out that "[o]f course, an insurer is free to conduct an investigation beyond the point at which its duty to defend has been triggered," but that does not necessitate delaying its acceptance of tender.

Two results will come from this case: (1) carriers will be more expeditious in providing a defense, and (2) policyholders will have another argument for gaining control of the defense. In truth, most sophisticated policyholders (with resources to mount an upfront defense) would prefer the latter. They take comfort in choosing counsel, setting the litigation style and strategy, and foregoing the inherent conflicts and litigation protocols associated with panel counsel.

Of course, even if the carrier expeditiously accepts tender (and this case will have carriers on high alert to do so), coverage conflicts may necessitate independent counsel. Otherwise, post-loss negotiations with the carrier may be worthwhile to the extent they allow the policyholder to select counsel or have input on counsel (for example, agreeing to provide the carrier monthly updates, agreeing to consult the carrier on big ticket items, or possibly agreeing to pay differences in counsel rates). Moreover, always remember that, in renewal negotiations, it may be worth negotiating an endorsement giving the policyholder the right to select counsel and ensuring that the carrier cannot unreasonably withhold consent.

Coverage lawyers and policyholders need to understand this case and its pro-policyholder implications. Always have this case in mind—it may very well be your trump card.