IN THE SUPREME COURT OF TEXAS

NO. 06-0247

ULICO CASUALTY COMPANY, PETITIONER,

v.

ALLIED PILOTS ASSOCIATION, RESPONDENT

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE SECOND DISTRICT OF TEXAS

Argued April 11, 2007

CHIEF JUSTICE JEFFERSON, joined by JUSTICE O'NEILL, concurring.

As I understand the Court's opinion, the Court (1) resolves the tension between our holdings in *Craddock* and *Ferris* by making it clear that while estoppel cannot create coverage, the benefits that would have been paid had the insurer not denied coverage remain the appropriate measure of damages; and (2) requires that the insured show prejudice in order to recover those damages. *See* __ S.W.3d __, __ ("Under some circumstances, insurers who take control of their insured's defense without a valid reservation of rights or non-waiver agreement can and should be prevented from denying benefits that would have been payable had the claim been covered because the insured is actually prejudiced by the insurer's actions."). With this understanding, I join the Court's opinion.

In *Washington National Insurance Co. v. Craddock*, we held that the doctrine of estoppel cannot be used to create insurance coverage when none exists by the terms of the policy. *Craddock*, 109 S.W.2d 165, 166-67 (Tex. 1937). *Craddock* was decided October 20, 1937. *Id.* at 165. One

month later, we refused the writ of error in *Ferris v. Southern Underwriters,* in which the court of civil appeals stated, "[t]he rule is settled in this state that 'a defense by the insurer, in an action on the policy, that a certain claimed liability is not within the policy terms, is waived when it assumes absolute control, under the terms of its contract with insured, of the action brought against the insured to recover damages.'" *Ferris*, 109 S.W.2d 223, 226 (Tex. Civ. App.—Austin 1937) (quoting *Am. Indem. Co. v. Fellbaum*, 225 S.W. 873, 874 (Tex. Civ. App.—San Antonio 1920), *aff'd*, 263 S.W. 908 (Tex. 1924)), *writ ref'd*, 128 Tex. 669 (Nov. 24, 1937).

The tension inherent in those holdings is explained, I think, by the unique concerns involved when an insurer assumes control over its insured's defense without reserving the right to later deny coverage. As other Texas courts have noted, "[w]e have found no case, nor has either party cited a case, in which the general rule (that coverage cannot be created by waiver or estoppel) was applied where there was an assumption of the insured's defense by an insurer. All of the cases that we have found applying the general rule involved entirely different situations." *State Farm Lloyds v. Williams*, 791 S.W.2d 542, 551 (Tex. App.—Dallas 1990, writ denied) (citations omitted); *see also Denison Custom Homes, Inc. v. Assurance Co. of Am.*, No. V-03-24, 2006 U.S. Dist. LEXIS 34930, at *20-21 (S.D. Tex. May 26, 2006) ("Just as *Ferris* and *Murrah* do not address the general rule against creating coverage in equity, neither *Craddock* nor *Ruddock* address the situation of a defense willingly assumed and then rejected by an insurer. The clear implication is that these cases did not contemplate their interdependence. . . . Cases contemporary to *Ferris* and *Craddock* and treatment of the waiver rule in secondary sources indicate that the *Wilkinson* exception did not follow from the general rule, but stated a separate principle that developed independently.").

Nor is this distinction unique to Texas law. As noted in a leading insurance treatise:

> Although the doctrine of waiver and estoppel cannot generally be used to create insurance coverage where none exists under [the] terms of the policy, an exception to the rule exists where a liability insurer assumes the insured's defense with knowledge of facts indicating noncoverage and without declaring a reservation of rights or obtaining a nonwaiver agreement in which case all policy defenses, including those of noncoverage, are waived.

14 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D § 202.54 (2005) [hereinafter COUCH] (citations omitted); *see also* R.D. Hursh, Annotation, *Liability Insurance: Insurer's Assumption of or Continuation in Defense of Action Brought Against the Assured as Waiver or Estoppel as Regards Defense of Noncoverage or Other Defense Existing at Time of Accident*, 38 A.L.R.2d 1148 (1954).

The general rule, and the rule established in our precedent, is that "[t]he courts will not allow an insurer to lull an insured into a belief that coverage exists in a situation where it does not, or even where the insurer simply believes it does not," COUCH at § 202.54, and thereby induce the insured to give up the right to manage its own defense. If the insurer is able to later deny liability, however, the basis for its assumption of the defense is undermined, and thus many courts have bound insurers to provide coverage in these cases without a further showing of harm, either because prejudice is conclusively presumed, or, similarly, because "the loss of the right of the insured to control and manage the defense is itself prejudicial." COUCH at §§ 202.67–68 (collecting cases). Other courts, however, have required a further showing of prejudice under the *Ferris/Wilkinson* rule. *See Williams*, 791 S.W.2d at 553 ("unless a conflict of interests or other harm is clear and unmistakable, we are inclined to the view that the insured must show how he was harmed").

If the insurer defends without reserving its rights, and the insured shows prejudice, the insured is entitled to recover the benefits that would have been due under the policy. To that extent, it matters little whether a court says coverage was created or that the benefits are those that would have been payable had there been coverage; a rose by any other name would smell as sweet.

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Wallace B. Jefferson
Chief Justice

OPINION DELIVERED: August 29, 2008