THEORIES OF WAIVER AND ESTOPPEL IN THE DUTY TO DEFEND

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I. INTRODUCTION

A liability policy is, in many ways, a living, breathing creature that expands and contracts in response to the facts surrounding a particular claim. It begins with a fairly broad coverage grant and then is modified by endorsements, exclusions, conditions and other provisions of the policy. When a claim is made against the insured, the policy will expand and contract as appropriate based on the allegations asserted and their impact on the coverage grant and the provisions that modify that general coverage under the policy.

The duty to defend under a liability policy is frequently the most significant obligation a carrier has under the policy from the standpoint of the insured. Litigation is expensive, and the cost to defend often exceeds any eventual settlement or judgment amount that is owed to a claimant. In a case in which there is no liability on the insured to a claimant, the defense costs may be the only monetary exposure for the insured. Many times, an insured has little or no ability to adequately pay for the cost of its own defense absent the existence and applicability of an appropriate liability policy. It is difficult to overstate the importance of a carrier's defense obligation for the average insured- it can mean the difference between success or bankruptcy and ruin for an insured without the financial ability to pay the cost of litigating suits in this country.

The purpose of this paper is, first, to generally explore the nature and scope of the duty to defend under a liability policy in Texas. Then the paper will explore a more specific subpart of the defense obligation, that being the issue of how waiver and estoppel affect any duty to defend. In this regard, the paper will review a recent Texas Supreme Court decision and analyze how it may have modified previous Texas law on waiver and estoppel.

II. DUTY TO DEFEND

A. Existence of Duty to Defend

In Texas, the duty to defend is a contractual obligation. *Farmers Texas County Mutual Insurance Co. v. Griffin,* 955 S.W.2d 81 (Tex. 1997); *Houston Petroleum v. Highlands Insurance Co.,* 830 S.W.2d 153, 155 (Tex.App.—Houston [1st Dist.] 1990, writ denied). Texas does not provide any common law or statutory defense obligation. Because of this, the scope and determination of the duty to defend will be controlled by the language of the contract. It should be noted that in some liability policies, such as directors and officers liability policies, there is no duty on the insurer to assume the defense of the insured. Instead, such policies may provide for a duty of reimbursement of defense costs on covered claims. Other liability policies, such as excess or umbrella policies may provide for a defense at the option of the insurer. The language of the contract is the key in determining exactly what obligations may exist.

A typical liability provision that includes a duty to defend is as follows:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result.
>
> But:
>
> (1) The amount we will pay for damages is limited as described in Section III—Limits of Insurance; and
>
> (2) Our right and duty to defend end s when we have used up the applicable limit of insurance in the payment of judgments or settlements under

Coverage A or B or medical expenses under Coverage C.

ISO Properties, Inc., 2001 Occurrence Form (CG 0001 1001).

An insurer has an obligation to defend its insured against only those claims that are potentially within the coverage of the policy. The general rule in Texas is that, if the insurer has a duty to defend any part of a lawsuit, then it is obligated to defend the entire lawsuit, including parts of the lawsuit that are excluded from coverage. *Rhodes v. Chicago Insurance Co.,* 719 F.2d 116, 119 (5th Cir. 1983); *Steel Erection Co. v. Travelers Indemnity Co.,* 392 S.W.2d 713, 716 (Tex.Civ.App.—San Antonio 1965, writ ref'd n.r.e.). If a duty to defend exists, it includes both covered and non-covered claims, including alternatively pled claims. However, the duty to defend is not unlimited. For example, if an insured is pursuing affirmative relief of its own in the same lawsuit, the insurer has no obligation to pay for the prosecution of such affirmative claims. Further, the attorney hired to provide a contractual defense is limited to the costs involved with such defense and not with regard to any coverage issues that may exist based on the defense being provided under any reservation of rights letter sent by the insurer.

At the point that a carrier assumes control of a claim, investigates the accident and retains an attorney to represent the interests of the insured, the insurer becomes the agent of the insured and the attorney becomes a subagent of the insured. *Ranger County Mutual Insurance Co. v. Guin,* 723 S.W.2d 656, 659 (Tex. 1987). As a result of this agency relationship, Texas courts have imposed certain duties on the insurer. Chief among these duties is the concept that an insurer owes its insured the duty to exercise reasonable care in deciding whether or not to settle a claim against its insured when it can be done within the policy limits. *G.A. Stowers Furniture Co. v. American Indemnity Co.,* 15 S.W.2d 544, 547 (Tex.Comm'n.App. 1929, holding approved).

In Texas, a defense obligation does not arise until after the lawsuit has been tendered to the carrier. *E & L Chipping Co. v. Hanover Insurance Co.,* 962 S.W.2d 272, 278 (Tex.App.—Beaumont 1998, no writ); *Members Insurance Co. v. Branscum,* 803 S.W.2d 462 (Tex. App.—Dallas 1991, no writ). Providing proper notice in compliance with the policy terms is a condition precedent to the obligation of the insurer under the policy. Because no obligation begins prior to the tender of defense, Texas courts have held that the insured is not entitled to reimbursement of pre-tender defense costs, even if there has been no prejudice to the insurer in the late tender. *L'Atrium on the Creek I, L.P. v. National Union Fire Insurance Co.,* 326 F.Supp.2d 787, 792 (N.D.Tex. 2004).

B. The Complaint Allegation or "Eight Corners" Rule

Under the duty to defend doctrine employed by Texas courts, the complaint allegation or "eight corners" rule is utilized to determine a carrier's obligations. *Guideone Elite Insurance Co. v. Fielder Road Baptist Church,* 197 S.W.3d 305, 308 (Tex. 2006); *Fidelity & Guaranty Insurance Underwriters, Inc. v. McManus,* 633 S.W.2d 787 (Tex. 1982); *Northfield Insurance Co. v. Loving Home Care, Inc.,* 363 F.3d 523 (5th Cir. 2004). Under this rule, the duty to defend is determined by comparing the allegations contained in the live pleading of the claimant to the terms of the insurance policy without any regard to the truth or falsity of the allegations. *King v. Dallas Fire Insurance Co.,* 85 S.W.3d 185, 191 (Tex. 2002); *Northfield,* 363 F.3d at 528.In most cases, the complaint or pleading against the insured and the policy of insurance are the only two documents necessary for a carrier to determine its duty to defend. Any facts discovered prior to litigation, developed during litigation or determined ultimately by a court or jury do not generally affect the duty to defend (although such facts may certainly affect any indemnification obligation). *Trinity Universal Insurance Co. v. Cowan,* 945 S.W. 819, 829 (Tex. 1997). Therefore, the duty to defend is a question of law except in very limited circumstances. *State Farm Lloyds v. Kessler,* 932 S.W.2d 732, 736 (Tex. App.—Fort Worth 1996, writ denied).

The Texas Supreme Court has explained the complaint allegation rule as follows:

> Where the [complaint] does not state facts sufficient to clearly bring the case within or without coverage, the general rule is that the insurer is obligated to defend if there is, potentially, a case under the complaint within the coverage of the policy. Stated differently, in case of doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in the insured's favor.

National Union Fire Insurance Co. v. Merchants Fast Motor Lines, Inc., 939 S.W.2d 139,141 (Tex. 1997)(quoting *Heyden Newport Chemical Corp. v. Southern General Insurance Co.,* 387 S.W.2d 22, 26 (Tex. 1965).

The complaint allegation rule requires that an insurer defend a suit against the insured if the pleadings against the insured contain one or more allegations, which if taken as true, set forth a claim that falls within the scope of the policy. *Argonaut Southwest Insurance* Co*. v. Maupin,* 500 S.W.2d 633, 635 (Tex. 1973). In the analysis of the defense obligation, a court will focus on the factual allegations only and not on the legal theories asserted. *Clemons v. State Farm Fire & Casualty Co.,* 879 S.W.2d 385 (Tex.App.—Houston[14th Dist.] 1994, no writ).If all of the allegations in the petition set forth claims that are clearly excluded from coverage, no duty to defend exists and a carrier may properly deny coverage. *McManus,* 633 S.W.2d at 788.

When analyzing the duty to defend based on the "live" pleadings, it must be remembered that pleadings can always be altered and that can, in turn, affect the duty to defend. In Texas, an amended pleading completely supersedes or replaces the pleading that it is amending. (Tex.R.Civ.P. 65). On the other hand, a "supplemental" pleading merely adds to existing pleadings and does not replace them. (Tex.R.Civ.P. 69). A petition that does not set forth a covered claim may be amended to state a potentially covered and trigger a duty to defend that did not previously exist. *Rhodes v. Chicago Insurance Co.,* 719 F.2d 116, 119 (5th Cir. 1983). Similarly, a pleading that does initially raise a duty to defend may be amended to eliminate such an obligation. *Rhodes,* at 119. The liability insurer must review all pleadings tendered to it to determine if any defense obligation has been created or eliminated. *Rhodes,* at 119. It must also be kept in consideration that if a carrier obtains a declaratory judgment as to its defense obligation, that judicial determination is only binding as to the pleadings in existence at the time of such determination and would not be applicable to any amended pleadings that substantively change the nature of the claims asserted against the insured. *Bernard v. Gulf Insurance Co.,* 542 S.W.2d 429, 431 (Tex. Civ.App.—El Paso 1976, writ ref'd n.r.e.).

The burden of proof is the same as that applied to the duty to indemnify. An insured has the burden of demonstrating that a claim against it potentially falls within the scope of coverage of the policy. *Federated Mutual Insurance Co. v. Grapevine Excavation, Inc.,* 197 F.3d 720, 723 (5th Cir. 1999). If the insurer intends to rely on policy exclusions or affirmative defenses to defeat the duty to defend, the burden shifts to the insurer that one or more of the exclusions or other provisions eliminate the duty to defend. TEX.INS.CODE ANN. Art. 554.002; *Guaranty National Insurance Co. v. Vic Manufacturing Co.,* 143 F.3d 192, 193 (5th Cir. 1998). Once the insurer proves that an exclusion to coverage applies, the burden shifts back to the insured to show that the claim falls within some exception to the exclusion. *Guaranty National,* 143 F.3d at 193; *Telepak v. United Services Automobile Ass'n,* 887 S.W.2d 506, 507-508 (Tex.App.—San Antonio 1994, writ denied).

III. WAIVER AND ESTOPPEL

The issue of waiver and estoppel in the context of duty to defend centers around what circumstance will cause a carrier to lose its coverage defenses in a coverage dispute as a result of actions inconsistent with the exercising of such defenses. It is important to first define the terms that are being analyzed.

Waiver has been frequently defined as an intentional relinquishment of a known right or

intentional conduct inconsistent with claiming it. *Miller v. Progressive County Mutual Ins. Co.,* Cause No. 12-04-00141-CV (Tex. App.—Tyler 2005, no pet.) (mem. op.) (citing *Ford v. State Farm Mut. Auto. Ins. Co.,* 550 S.W.2d 663, 666 (Tex. 1977)). Waiver is essentially unilateral in character. *United States Fidelity & Guaranty v. Bimco,* 464 S.W.2d 353, 358 (Tex. 1971). It results as a legal consequence from some act or conduct of the party against whom it operates, and no act of the party in whose favor it is made is necessary to complete it. Id. Waiver need not be based on estoppel. Id. Estoppel arises where by fault of one, another has been induced to change his position for the worse. *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.,* 416 S.W.2d 396, 401 (Tex. 1967). Thus, estoppel requires a showing that the insured was prejudiced by the conduct of the insurer. *American Eagle Ins. Co. v. Nettleton,* 932 S.W.2d 169, 174-75 (Tex. App.—El Paso 1996, writ denied).

Texas law on waiver and estoppel in the duty to defend appeared to be a fairly settled body of law until a recent case in which the Texas Supreme Court implied that it was creating new law. *See, Ulico Casualty Co. v. Allied Pilots Association,* 262 S.W.3d 773 (Tex. 2007). This paper will analyze the existence of any changes by first analyzing the state of the case law prior to *Ulico* and then by analyzing the *Ulico* case itself and the cases decided after it.

A. Law on Waiver and Estoppel Pre-Ulico

Under Texas law, "[w]hen an insurer is faced with duty to defend, it has four options: (1) completely decline to assume the insured's defense; (2) seek a declaratory judgment as to its obligations and its rights; (3) defend under a reservation of rights or a non-waiver agreement; or (4) assume the insured's unqualified defense." *Farmers Texas County Mutual Ins. Co. v. Wilkinson,* 601 S.W.2d 520, 522 (Tex.Civ.App.--Austin 1980, writ ref'd n.r.e.). Various consequences arise from the exercise of these options. For instance, if a carrier declines to assume the insured's defense (option 1), but does so improperly, the carrier may be estopped from enforcing the terms and conditions of a policy, even those which potentially apply. *Rhodes v. Chicago Insurance Company,* 719 F.2d 116 (5th Cir. 1983). Conversely, a carrier may elect to file a declaratory judgment action to determine its rights (option 2). However, Texas courts will generally only determine a carrier's duty to defend, but not its duty to indemnify prior to a resolution of the underlying suit – which at times leaves little incentive for a carrier to go through the expense of litigation when pleadings in the underlying case can be amended, which would potentially obviate any favorable judgment. *J.E.M. and S.J.B. v. Fidelity & Cas. Co. of New York,* 928 S.W.2d 668 (Tex.App.-Houston [1st Dist.] 1996, n.w.h.).

If a carrier fails to properly exercise its options, a carrier may be faced with the doctrines of waiver and estoppel, under which the carrier "waives" its coverage defenses and is therefore "estopped" from asserting them. However, the doctrines of waiver and estoppels, though harsh, cannot be applied to create coverage where none exists under the terms of the liability policy. *Texas Farmers Insurance Co. v. McGuire,* 744 S.W.2d 601, 602-03 (Tex.1988) (op. on reh'g); *Paradigm Insurance Co. v. Texas Richmond Corp.,* 942 S.W.2d 645, 652 (Tex.App.--Houston [14th Dist.1997], writ denied). The only exception to this is when an insurer, having knowledge of facts indicating non-coverage of the claims against its insured, assumes the defense of its insured without obtaining a reservation of rights or a non-waiver agreement at all. In that event, the insurer may waive all policy defenses, including that of non-coverage, or it may be estopped from asserting those defenses. *Farmers Texas County Mutual Ins. Co. v. Wilkinson,* 601 S.W.2d 520, 522 (Tex.Civ.App.-- Austin 1980, writ ref'd n.r.e.); *State Farm Lloyds Inc. v. Williams,* 791 S.W.2d 542, 550 (Tex.App.--Dallas 1990, writ denied).

Even then, however, a carrier will only be estopped from asserting its coverage defenses if the insured can show clear and unmistakable prejudice by the carrier's failure to reserve its rights. *Pennsylvania National Mutual Casualty Insurance Co. v. Kitty Hawk Airways, Inc.,* 964 F.2d 478 (5th Cir. 1992); *Katerndahl v. State Farm Fire & Casualty Co.,*961 S.W.2d 518 (Tex.App. – San Antonio 1998, n.w.h.);

American Eagle Insurance Co. v. Nettleton, 932 S.W.2d 169 (Tex.App.-El Paso 1996, n.w.h). By "prejudice," Texas courts mean "clear and unmistakable" harm. *Certain Underwriters at Lloyd's London v. Oryx Energy Co.,* 142 F.3d 255, 257 n. 2 (5th Cir.1998)(Texas law); *Pennsylvania National Mutual Casualty Insurance Co. v. Kitty Hawk Airways, Inc.,* 964 F.2d 478, 479 (5th Cir.1992)(Texas law); *Nutmeg Insurance Co. v. Clear Lake City Water Authority,* 229 F.Supp.2d 668, 694 -695 (S.D.Tex. 2002); *Katerndahl v. State Farm Fire and Casualty Co.*, 961 S.W.2d 518, 524 (Tex.App.-San Antonio 1997, no writ); *State Farm Lloyds, Inc. v. Williams,* 960 S.W.2d 781, 785 (Tex.App.--Dallas 1997, writ dism'd by agr'mt); *Paradigm Insurance Co. v. Texas Richmond Corp.,* 942 S.W.2d 645, 652-53 (Tex.App.--Houston [14th Dist.] 1997, writ denied).

In *Pennsylvania National Mutual Casualty Insurance Co. v. Kitty Hawk Airways, Inc.,* 964 F.2d 478, 479 (5th Cir.1992) the issue was whether Pennsylvania National was estopped from raising a defense of non-coverage by its assumption and continuation of Kitty Hawk's defense for more than one year before tendering a reservation of its rights. Finding that the doctrines of estoppel and waiver did not apply, the Fifth Circuit reversed the portion of the district court's judgment holding that Pennsylvania National was estopped from denying coverage and rendered judgment in favor of Pennsylvania National on its non-coverage claim. The court found that Pennsylvania National, the drafter of the exclusion upon which it relied to extend the reservation of rights, had sufficient knowledge to challenge its coverage of Kitty Hawk but assumed and continued Kitty Hawk's defense for more than a year before obtaining an effective reservation of rights--thereby satisfying the first two requirements for applying the Wilkinson exception. Id. at 481-482. The court then analyzed the facts before it concerning prejudice:

> [T]he facts of this case do not support a conclusion that Pennsylvania National's defense of Kitty Hawk resulted in a "clear and unmistakable" conflict of interest or harm, or that Kitty Hawk has demonstrated that it suffered actual harm or prejudice. Kitty Hawk has produced no evidence that the attorneys provided by Pennsylvania National acted in any manner, during the course of the defense, that was prejudicial to Kitty Hawk. Kitty Hawk points to no evidence that Pennsylvania National in its defense of Kitty Hawk manipulated the defense of its insured to better its future claim of non-coverage. Indeed, Pennsylvania National does not base its non-coverage defense on an issue that was material to the underlying suit: Exclusion (c), on which Pennsylvania National premises its non-coverage defense, withdraws coverage for defamatory statements that relate directly or indirectly to the employment of the defamed person, and this issue of employment relatedness was not contested in the underlying suit. In fact, the defamatory letter specifically refers to Pollard's employment-related conduct. Kitty Hawk points to no evidence reflecting that Pennsylvania Mutual had an opportunity to manipulate the facts on this point to bolster its non-coverage defense.

Id. at 482.

In *Nutmeg Insurance Co. v. Clear Lake City Water Authority,* 229 F.Supp.2d 668, 694-695 (S.D.Tex. 2002), the court held that the insured was not prejudiced by Nutmeg's alleged failure to provide it with a timely and sufficient reservation of rights letter. The letter was sent within one month of receipt of the claim and clearly notified Clear Lake that it would be investigating the bases of the claims subject to a reservation of rights and that there were coverage issues, without specifying the policy terms upon which the coverage issues were based. The court held the letter was sufficient even though it did not specifically identify the coverage defenses. The court found it significant that Clear Lake is a large governmental entity with the benefit of counsel and operating on an equal footing with Nutmeg. Moreover, Nutmeg paid for and allowed

Clear Lake to select its counsel for its representation in the underlying suit and permitted Clear Lake to direct that defense. On these facts, the court found no prejudice to the insured. Id. at 695. See also *Ideal Mutual Insurance Co. v. Myers,* 789 F.2d 1196, 1201-1202 (5th Cir. 1986) (letter that was delivered two years after notice of plane crash, but immediately upon lawsuit, did not prejudice insured by the delay, if any, between Ideal's discovery of a possible basis for non-coverage and its delivery of the reservation of rights letter).

B. Waiver and Estoppel under Ulico and its Progeny

The relatively new holding by the Texas Supreme Court in *Ulico Casualty Co. v. Allied Pilots Association,* 262 S.W.3d 773 (Tex. 2007) has been referred to as an "emerging issue." (Wiley Rein, L.L.P. on "Texas High Court Holds Coverage Cannot be Expanded by Waiver and Estoppel."). Because the Court appears to indicate some departure from earlier precedents, it is important to carefully analyze the case to identify any novel holdings or any inferences by the Court of a new direction for waiver and estoppel.

Ulico involved a declaratory action by an insurer seeking a declaration that its claims-made policy did not provide coverage for its insured for an underlying lawsuit filed against the insured. Ulico Casualty Company ("Ulico") issued a claims-made liability policy to the Allied Pilots Association ("Allied") effective from August 25, 1998 to August 25, 1999, which was later amended to an expiration date of October 25, 1999. The policy generally covered:

> all Loss which such Insured shall become legally obligated to pay on account of any claim made during against the Insured during the Policy Period or, if exercised, during the Extended Reporting Period, for a Wrongful Act committed, attempted, or allegedly committed or attempted by such Insured before or during the Policy Period, and reported to [Ulico]…during the Policy Period or the Extended Policy Period, if elected.

Allied was sued in an underlying lawsuit on October 4, 1999, twenty-one days before the policy's new expiration date and Allied forwarded the suit papers to its insurance broker and to its private counsel. However, Ulico was not given notice of the suit until November 5, 1999. In December 1999, Ulico sent Allied a letter stating that the claim was being reviewed and that no sums expended without the permission of Ulico would be covered. In March 2000, Ulico sent Allied's defense counsel a letter stating that the policy provided for defense costs, but that Ulico was expressly reserving its rights to deny coverage. It enclosed litigation management forms, attorney evaluation forms, and a form for the attorney to estimate defense costs in the case. The attorney did not respond. In April 2001, Ulico wrote the defense attorney that, pursuant to the reservation of rights letter, "Ulico has agreed to reimburse [Allied] for reasonable and necessary defense expenses." In May 2001, the defense attorney responded and enclosed billings of $635,000 for defending Allied in the lawsuit. At that point, the firm had defended Allied and filed a motion for summary judgment that was pending, but had never provided reports or sought approval from Ulico for any of its actions. Allied's summary judgment was eventually granted and the underlying case disposed of without any liability placed on Allied.

Ulico filed suit in November 2001 seeking a declaration that it did not have coverage and did not owe any of Allied's defense costs in the underlying lawsuit. At trial the jury found that Ulico (1) granted an Extended Reporting Period during which Allied reported the underlying lawsuit; (2) agreed to pay the defense costs in the underlying lawsuit separately and apart from the policy; (3) waived its rights to assert that the policy did not cover the defense costs; and (4) was estopped from asserting that the policy did not cover the defense costs. By judgment notwithstanding the verdict, the trial court set aside the finding that an Extended Reporting Period was granted and that Ulico had separately agreed to pay defense costs. However, it entered judgment for Allied on the waiver and estoppel basis. The court of appeals affirmed that holding

and further appeal was made to the Supreme Court.

The Texas Supreme Court agreed with the trial court that a judgment notwithstanding the verdict was appropriate as there was no evidence that Ulico had agreed to an Extended Reporting Period or that its reservation of rights letters created a separate agreement to pay Allied's attorneys' fees. It also agreed that the coverage under the policy was not expanded by either the doctrine of waiver or the doctrine of estoppel, but it rejected some of the analysis used in many pre-*Ulico* cases on the so-called "*Wilkinson* exception" set out in the prior section of this paper.

In its analysis the Court first noted that insurance policies are contracts such that the rights and obligations created by them and the rules used to construe them are those generally pertaining to contracts. *Id.* at 778. If a policy covers certain risks, but the policy contains exclusions or provisions that apply to limit such general coverage, then the insurer must assert such exclusions or avoidances to avoid liability when an insured makes a claim for coverage in a particular situation. Under Tex.R.Civ.P. 94, the insurer must also plead the limiting provisions if it intends to assert them as defenses in a suit over coverage. *Id.* at 778. Still, a an insurer is not required to assert noncoverage of an event until the insured shows that the risk or loss is covered by the terms of the policy. With regard to the general Texas law on waiver and estoppel, the Court explained:

> In the context of issues presented by this case, the doctrines of waiver and estoppel are frequently referenced together, but they are different. (citation omitted). Waiver is the intentional relinquishment of a right actually known or intentional conduct inconsistent with claiming that right. (citations omitted). The elements of waiver include (1) an existing right, benefit, or advantage held by a party; (2) the party's actual knowledge of its existence; and (3) the party's actual intent to relinquish the right, or intentional conduct inconsistent with the right. (citation omitted). Estoppel, on the other hand, generally prevents one party from misleading another to the other's detriment or to the misleading party's own benefit. (citation omitted). The doctrine of equitable estoppel requires: (1) a false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; (5) who detrimentally relies on the representations. (citation omitted).

Id. at 778.

The *Ulico* court next addressed the issue of whether the waiver and estoppel doctrines could be used to rewrite an insurance policy. Citing the older Texas Supreme Court decisions in *Washington National Insurance Co. v. Craddock,* 130 Tex. 251, 109 S.W.2d 165 (Tex. 1937) and *Texas Farmers Insurance Co. v. McGuire,* 744 S.W.2d 601 (Tex. 1988), the Court noted that: (1) the doctrine of waiver cannot be made to serve the purpose of creating a liability; (2) the doctrines of waiver and estoppel cannot create a contract covering a risk not assumed by the carrier; and (3) the doctrine of estoppel cannot be used to create insurance coverage when none exists by the terms of the policy. *Ulico* at 779-780. Although waiver and estoppel may operate to avoid a forfeiture of a policy, Texas case have consistently held that waiver and estoppel cannot create a new and different contract with respect to risks covered by the policy. *Id.* at 780; (Citing *Texas Farmers Insurance Co. v. McGuire,* 744 S.W.2d 602-603. *See also, Great American Reserve Insurance Co. v. Mitchell,* 335 S.W.2d 707 (Tex.Civ.App.—San Antonio 1960,writ ref'd).

The *Ulico* court then addressed the viability of the so-called *Wilkinson* exception that was relied upon by the court of appeals and is derived from the case of *Farmers Texas County Mutual Insurance Co. v. Wilkinson,* 601 S.W.2d 520

(Tex.Civ.App.—Austin 1980,writ ref'd n.r.e.). Simply stated, the *Wilkinson* exception proposes that "if an insurer assumes the insured's defense without obtaining a reservation of rights or a non-waiver agreement and with knowledge of the facts indicating noncoverage, all policy defenses, including those of noncoverage, are waived, or the insurer may be estopped from raising them." *Wilkinson* at 521-522. The Texas Supreme Court, in *Ulico,* rejected that holding, stating instead:

> We do not agree with *Wilkinson's* statement to the effect that "noncoverage" of a risk is the type of right an insurer can waive and thereby effect coverage for a risk not contractually assumed. As we said in *Block,* 744 S.W.2d at 943-44, the insurer does not bear the burden of showing that it does not have a policy in place to cover a particular risk; the insured bears the burden to show that a policy is in force and that the risk comes within the policy's coverage. An insurer's actions can result in it being estopped from refusing to make its insured whole for prejudice the insured suffers because the insurer assumed the insured's defense, but estoppel does not work to create a new insurance contract that covers a risk not agreed to by the contracting parties. *See McGuire,* 744 S.W.2d at 602-03. Thus there is no "right" of noncoverage that is subject to being waived by the insurer, even by assumption of the insured's defense with knowledge of facts indicating noncoverage and without obtaining a valid reservation of rights or non-waiver agreement. Nor do the cases cited by *Wilkinson* support its conclusion otherwise….

Id. at 781-782.

After reviewing the cases on which the *Wilkinson* court based its decision and pointing out that those cases do not support the *Wilkinson* holding, the Court discusses the case of *Employers Casualty Co. v. Tilley,* 496 S.W.2d 552 (Tex. 1973). The Supreme Court noted that in *Tilley* there was not a holding that the insurer waived a late notice defense that it had under the policy. Instead the carrier was estopped from using late notice to cause a forfeiture of the policy because of actions of the carrier that prejudiced the insured. The *Ulico* court notes that:

> We discussed the doctrines of both waiver and estoppel in *Tilley,* but we did not hold that Employers waived its late notice defense. We determined that Tilley had been prejudiced and held that Employers was estopped from asserting the late notice forfeiture provision of its policy. *Id.* The question was not presented as to whether either the doctrine of waiver or estoppel can expand the coverage of a liability policy to encompass a risk or period of time for which no premiums were paid. Nor did we hesitate to label the situation as an actual conflict of a most serious nature, not an "apparent conflict of interest that might arise." *See Wilkinson,* 601 S.W.2d at 522. When an insurer's defense of or controlling the defense of the insured prejudices an insured, as happened in *Tilley* and *Acel,* the insurer cannot escape liability for the detriment its actions cause its insured. In those cases, the insurer was estopped from refusing to pay the damages its actions caused, but there was no rewriting of the insurance contract.

Ulico at 786.

> Essentially, the Supreme Court agrees with the result reached by the court of appeals in *Wilkinson,* but it disagrees with the existence of any "exception" that serves to alter the terms of the policy. Instead it would require that an insured demonstrate that it was prejudiced by actions and omissions of the insurer and that may estop the carrier from being able to use a policy limitation to refuse to pay benefits on a particular claim. In this regard the

> Supreme Court stated its belief that the *Wilkinson* exception is unnecessary to protect an insured as the insured is adequately protected by the rule of *Tilley* or some variation thereof. *Ulico* at 786. Otherwise, according to the Court:
>
> In contrast, the *Wilkinson* rule would afford the insured more contractual coverage than the policy provided, even if the insurer provides a perfect defense at no cost to the insured and the insured suffers no prejudice. The question on which the insurer's liability should turn is whether an insured is prejudiced as a result of the conflict, an adequate or absent disclosure, or other actions of the insurer.

Id. at 786-787.

Although the *Ulico* opinion may appear to deal more with semantics than it does with real substantive change, especially since it does not disagree with result reached in *Wilkinson,* the holding would appear to be place a more stringent burden of proof on an insured to demonstrate prejudice to allow it recover any damages or relief from a carrier which has simply neglected to give it timely notice of a conflict. Left unanswered is the issue of whether the damages in every case will be the amount of the liability of the insured to the claimant. The opinion does not directly answer this question, even though Justice Wallace Jefferson, in a concurring opinion, states his belief that such is the case.

At the present time, there is only one case that has cited *Ulico* that has been faced with the same forfeiture issues as in *Ulico* and *Wilkinson.* In *Valley Forge Insurance Co. v. Shah,* 2008 U.S. Dist. LEXIS 107221 (S.D. Tex. 2008) the court also faces an argument that an insurer's actions that create estoppel may also be the basis of a bad faith cause of action. Finding no case law justifying this premise, the court indicates its belief that bad faith cannot be based on a waiver and estoppel basis.

IV. CONCLUSION

The fact that the Texas Supreme Court takes such great pains in *Ulico* in rejecting the existence of the *Wilkinson* exception makes the opinion significant. The full significance must await future cases. At the very least, the Supreme Court has shown its support for the sanctity of contract. The issue is whether an insurer may be able to limit its liability, in an appropriate case, to something less than the full liability of the insured to a claimant if the prejudice can be shown to have been limited.