Exploring the 8 Corners Rule: Extrinsic Evidence & The Duty to Defend

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"OLD" EIGHT CORNERS RULE

- Duty to defend is based only upon the four corners of the lawsuit and four corners of the insurance policy.

- But three new Texas Supreme Court cases permit the use of extrinsic evidence, especially *Monroe v. Bitco* (*Monroe* exception).

EIGHT CORNERS RULE

- The duty to defend is governed by the "eight-corners" rule, which holds that the duty to defend is determined solely from the terms of the policy and the pleadings of the third-party claimant.
- Only these two documents are ordinarily relevant to the duty-to-defend inquiry. If the complaint alleges facts that are within the scope of coverage, the insurer ordinarily is held to owe the insured a duty to defend.
- However, if the complaint clearly alleges facts that exclude coverage under the insurance policy, there is no duty to defend. The insured bears the initial burden of showing that there is coverage; while the insurer bears the burden of showing that any exclusion in the policy applies.

EIGHT CORNERS RULE

- Courts focus on the "petition's factual allegations showing the origin of the damages rather than on the legal theories alleged."
- "The insurer's duty to defend is limited to those claims actually asserted" and does not extend to "a claim that might have been alleged but was not" made against the insured.
- Facts outside the pleadings, even those easily ascertained, are not ordinarily material to the determination of whether the duty to defend exists, and allegations against the insured are liberally construed in favor of coverage.

EIGHT CORNERS RULE

- The rationale behind the eight-corners rule is to require insurers to defend the insured against all claims, even those without merit.
- Likewise, “ambiguous provisions in insurance policies are strictly construed against the insurer in favor of coverage to the insured.” In short, “insurers are advised to chart a cautious course” and “when in doubt, defend.”
- When faced with a coverage dispute, the court must give effect to the intention of the parties as that intention is expressed in the insurance policy itself.

TEXAS COURTS PERMIT EXTRINSIC EVIDENCE IN LIMITED CIRCUMSTANCES

- *International Service Ins. Co. v. Boll*, 392 S.W.2d 158 (Tex. Civ. App.--Houston [1st Dist.] 1965, writ ref'd n.r.e.)
- *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712 (Tex. Civ. App.--Texarkana 1967, no writ)
- *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448 (Tex. App.--Corpus Christi 1992, writ denied)

EXCEPTION IN FEDERAL COURTS

- *Ooida Risk Retention Grp v. Williams*, 579 F.3d 469 (5th Cir. 2009) (allowing extrinsic evidence in the absence of sufficient allegations to determine application of fellow employee exclusion)

- *Star-Tex Resources, LLC v. Granite State Ins. Co*., 553 F. Appx 366 (5th Cir. 2014) (allowing consideration of extrinsic evidence in absence of sufficient allegations to determine application of auto exclusion)

- *Evanston Ins. Co. v. Kinsale*, 7:17-cv-327(S.D. Tex. July 12, 2018) ("[T]he Court also agrees with Defendant that this is a situation in which the extrinsic evidence exception applies. The alleged date of construction goes solely to a fundamental issue of coverage and does not implicate the merits or depend on the truth of the facts alleged.)

EXCEPTION IN FIFTH CIRCUIT

- "[1]When it is initially impossible to discern whether coverage is potentially implicated and [2] when the extrinsic evidence goes solely to a fundamental issue of coverage [3] which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004).

TEXAS SUPREME COURT TRILOGY

- *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006)
- *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487 (Tex. 2008)
- *Pine Oak Builders v. Great American Lloyds*, 279 S.W.3d 650, 655 (Tex. 2009)

TWO 2020 TXSC CASES – *State Farm v. Richards*

- Jayden Meals was killed in an all-terrain vehicle accident while under the temporary care of his grandparents, the Richards. Jayden's mother sued the Richards in Texas state court, essentially alleging they were negligent in failing to supervise and instruct Jayden. The Richards sought a defense from State Farm Lloyds pursuant to their homeowner's insurance policy.

Richards

- Insurance policy required State Farm to provide a defense "[i]f a claim is made or a suit is brought against an insured for damages because of bodily injury . . . to which this coverage applies, caused by an occurrence."
- State Farm initially defended this suit pursuant to a reservation of rights, but later sought a declaration that it had no duty to defend or indemnify the Richards. In a summary judgment motion, State Farm argued that two exclusions barred coverage.

Richards

- In support of its summary judgment motion, State Farm attached a vehicle crash report showing that the accident occurred away from the Richards' premises, as well as the Richards' admissions that the accident occurred off an insured location.

Richards

- According to State Farm and the district court, the eight-corners rule does not apply if a policy does not include language requiring the insurer to defend “all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent.”
- Fifth Circuit certified to TXSC based upon policy language.

Richards

- The Supreme Court found that the insurer had not "contracted around" the "eight corners" rule by omitting the "express agreement to defend claims that are 'groundless, false or fraudulent.'"
- Rather, the court specifically held that the duty-to-defend is a "creature of contract" and "'a valuable benefit granted to the insured by the policy.'"
- The court stated that insurers should be aware of the decades of Texas jurisprudence ruling this way, and that if the insurer wished to draft policies to avoid the "eight corners" rule, it could certainly do so in light of that understanding.

Loya Insurance Company v. Avalos

- Loya issued policy to wife but specifically excluded husband.
- Claimants and husband got into an accident.
- Claimants and husband agreed that Claimants would file suit that alleged wife caused accident.
- Wife agreed to plot, until after her husband died and shortly before her deposition.

Loya

- Based on the wife's admission that she knowingly lied about driving the insured vehicle to secure coverage and avoid the named driver exclusion, Loya considered any coverage forfeited, denied the claim, and withdrew its defense of the wife in the underlying lawsuit.

Loya

- Despite their complicity in the fraud, Claimants pursued their claim against wife and obtained a default judgment awarding them $450,343.34, prejudgment interest, and costs. Wife assigned her rights against Loya to Claimants.
- Claimants filed suit against Loya.

Loya

- Trial court granted summary judgment in favor of Loya.
- But appellate court reversed, relying upon eight corners rule. Loya appeals to TXSC.

Loya

- The Supreme Court in *Loya Insurance* recognized, for the first time ever, a very narrow exception to the "eight corners" rule where "collusive fraud" exists.
- In that case, the court stated that an insurer can rely on extrinsic evidence if there is "conclusive evidence that groundless, false, or fraudulent claims against the insured have been manipulated by the insured's own hands in order to secure a defense and coverage where they would not otherwise exist."
- Given the egregious facts and the manner in which the court framed the exception, the likelihood is that this particular exception will be applied only in extremely narrow circumstances.

Monroe v. Bitco (TX 2022)

- In the summer of 2014, a farm hired 5D Drilling & Pump Service, Inc. ("5D") to drill a 3600-foot deep commercial irrigation well through the Edwards Aquifer.
- In June 2016, the farm sued 5D for breach of contract and negligence after 5D purportedly drilled the well with "unacceptable deviation" and then abandoned the well after it "stuck" the drill bit in the bore hole.
- 5D notified two insurance companies claiming they both had a duty to defend it against the suit.

Monroe

- One of the insurers refused to defend, claiming it had no duty to do so because the alleged property damage occurred outside the policy's coverage period.
- The policy provided coverage from October 6, 2015 to October 6, 2016, and, according to the parties' stipulation, the drill bit became stuck "in or around November 2014."
- Key to deciding this case is whether a court, applying Texas law, can consider extrinsic evidence-the stipulated date the drill bit became stuck-when deciding whether a duty to defend exists.

Monroe

- BITCO filed a declaratory action against Monroe seeking a determination that Monroe owed a defense to its insured.
- The insurers stipulated that the insured's drill bit stuck in the bore hole during the insured's drilling operations "in or around November 2014", or about 10 months before BITCO's policy would end and Monroe's would begin.
- The federal district court concluded that it could not consider the stipulated extrinsic evidence of when the drill bit stuck and concluded that Monroe owed a duty to defend because the property damage could have occurred anytime between the formation of the drilling contract in 2014 and the 2016 filing date of plaintiff's lawsuit.

Monroe

- Fifth Circuit certified the following questions of state law to the Supreme Court of Texas:
  1. Is the exception to the eight-corners rule articulated in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), permissible under Texas law?
  2. When applying such an exception, may a court consider extrinsic evidence of the date of an occurrence when (1)it is initially impossible to discern whether a duty to defend potentially exists from the eight-corners of the policy and pleading alone; (2) the date goes solely to the issue of coverage and does not overlap with the merits of liability; and (3) the date does not engage the truth or falsity of any facts alleges in the third party pleadings?

Monroe

- The court ruled that the eight corners rule remains the initial inquiry to determine whether a duty to defend exists reasoning that it will resolve the coverage determination in most cases.
- However, if the underlying petition states a claim that could trigger the duty to defend, and the application of the eight corners rule, due to a gap in the plaintiff's pleading, is not determinative of whether coverage exists, consideration of extrinsic evidence is permissible provided the evidence (1) goes solely to an issue of coverage and does not overlap with the merits of liability; (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage of fact to be proved.

Monroe

- The court rejected a heightened standard, previously adopted by the Fifth Circuit Court of Appeals in *Northfield*, that extrinsic evidence may be considered only if it is initially impossible to discern from the pleadings and policy "whether coverage is potentially implicated" noting that this standard invites reading facts into the pleadings or imagine factual scenarios that might trigger coverage.

Monroe

- Instead, the court ruled that the better threshold inquiry is: "does the pleading contain the facts necessary to resolve the question of whether the claim is covered".
- Additionally, the court eliminated the *Northfield* standard which required that the extrinsic evidence go to a "fundamental" coverage issue.
- Importantly, the court made clear that its ruling was based in the language of the contract of insurance. The court stated that its holding "advances our dual goals of effectuating the parties' agreement as written, while protecting the insured's interests in defending against the third party's claims...[and] avoid a windfall to the insured, requiring coverage for which the insured neither bargained nor paid.

Monroe

- On the second certified question, the court ruled that consideration of extrinsic evidence of the date of an occurrence is permissible if it meets the requirements outlined above.
- However, the court ruled that extrinsic evidence overlapped with the merits of liability in the case because a dispute as to when property damage occurs also implicates whether property damage occurred on that date, forcing the insured to confess damages at a particular date to involve coverage, when its position may very well be that no damage was sustained at all. Thus, the court ruled that Monroe owed a duty to defend the insured.

Pharr v. Texas Political Subdivisions Property (TX 2022)

- The parties disputed whether an auto policy required an insurer to defend and indemnify the insured against claims for damages arising from an accident involving the negligent use of a “golf cart.”
- The policy applied only to liability that the insured had for damages caused by an accident and resulting from the use of a covered auto.
- The insurer had refused to provide coverage, asserting that a “golf cart” was not an “auto” under the policy because a “golf cart” is not designed for travel on public roads.[.

Pharr

- The Court refused to look to extrinsic evidence. Pursuant to the *Monroe* Exception, extrinsic evidence would only be admissible to fill a "gap" in the pleading that would otherwise leave the court unable to determine whether coverage applied.
- Because the pleading asserted that the injured person was thrown from a "golf cart" and the Court determined that a "golf cart" is not a "vehicle designed for travel on public roads," there was no "gap" to prevent the court from determining if the duty to defend was triggered.

Pharr

- Absence of such a gap, any extrinsic evidence that the injured person was actually thrown from something other than a golf cart would contradict the facts alleged in the petition.
- The Court commented that if the pleading had simply referred to a “vehicle” being involved, without any indication of the type of vehicle or whether it was designed for travel on public roads, this would potentially create the “gap” referenced in the *Monroe* Exception.

Summary

- TXSC has yet to find a case that fits the extrinsic evidence exception.
- But new exception/framework is inconsistent with prior law, regarding when in doubt defend. Now, when it doubt, look to extrinsic evidence.
- Potentially huge shift in the law.

QUESTIONS?

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