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ONE YEAR LATER: THE SIGNIFICANT IMPACT OF THE "MONROE EXCEPTION" UPON THE DUTY TO DEFEND IN TEXAS

A little over one year ago, the Texas Supreme Court decided that extrinsic evidence may be used to determine an insurer's obligation to defend an insured when the insurance policy and pleading are insufficient to make that determination. This ruling significantly alters Texas law, as many Texas courts previously refused to consider any documents beyond the policy and petition. With the Court's new approach, Texas courts will be allowed to examine extrinsic evidence under certain rules.

This article will examine a brief history of the Texas duty to defend standard. Next, it will discuss the *Monroe*[1] and *Pharr*[2] decisions. Then, it will review how courts have applied the *Monroe* exception over the past year. And finally, this article will analyze the duty to defend standard going forward, as well as other significant issues that will likely be subject to future coverage disputes.

I. Discussion of the Duty-to-Defend Standard

The duty to defend generally requires a liability insurer "to defend its insured against claims or suits seeking damages covered by the policy."[3] The duty to defend is a creature of contract arising from a liability insurer's agreement to defend its insured from those claims or suits.[4] Over fifty years ago, the Texas Supreme Court held that the duty to defend depends not "on what the facts are or what might finally be determined to be the facts," but rather "only on what the facts are alleged to be."[5] To determine whether the duty existed, Texas courts considered only the allegations made within the petition in the underlying lawsuit and the terms of the insurance policy, "without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof."[6]

Under this "eight-corners" rule, the insurer has a duty to defend if the underlying petition alleges facts that fall within the scope of the insurance policy's coverage.[7] Prior to *Monroe*, Texas courts applied this rule liberally in favor of the insured by resolving "all doubts regarding the duty to defend in favor of the duty," and by recognizing the duty if the petition alleges facts that "*potentially* support a covered claim."[8] As the Fifth Circuit bluntly put it to insurers, "[w]hen in doubt, defend."[9]

II. Prior Case Law on Extrinsic Evidence

A small dent in the inflexible eight-corners rule occurred at the Texas Supreme Court two years prior to *Monroe*. In *Loya Insurance Co. v. Avalos*[10], the Court recognized a narrow exception to the eight-corners rule for the first time by allowing courts to consider evidence that the insured colluded with the plaintiff in the underlying suit to fraudulently create coverage that otherwise would not exist.[11]

The *Avalos* decision raised the prospect of the Court approving a broader exception. In *Northfield Ins. Co. v. Loving Home Care, Inc.*[12], the Fifth Circuit predicted that if the Texas Supreme Court were to recognize such an exception to the eight-corners rule, it would apply only "when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case" ("*Northfield* exception").[13] The Court later acknowledged the *Northfield* exception without adopting or rejecting it in *GuideOne*.[14]

In the ensuing years, Texas state and federal courts have disagreed on the validity of the *Northfield* exception. Some courts rejected extrinsic evidence altogether;[15] but other courts considered extrinsic evidence under *Northfield* or similar standards.[16]

Prior to *Monroe*, the Court never directly addressed the so-called "*Northfield* exception," although the Court twice acknowledged its widespread use.[17] In *Avalos* and *Richards*, the Fifth Circuit did not certify the appropriateness of the *Northfield* exception. Most recently, in *Richards v. State Farm Lloyds*, the Court concluded its opinion with the following statement:

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> As noted above, it is often the case that the petition states a claim that could trigger the duty to defend, but the petition is silent on facts necessary to determine coverage. In such cases, some courts often allow extrinsic evidence on coverage issues that do not overlap with the merits in order to determine whether the claim is for losses covered by the policy. The Fifth Circuit did not ask for our opinion on that practice, so we express none. We also reserve comment on whether other policy language or other factual scenarios may justify the use of extrinsic evidence to determine whether an insurer must defend a lawsuit against its insured. The varied circumstances under which such arguments for the consideration of evidence may arise are beyond imagination.[18]

This changed with *Monroe*.

III. Discussion of *Monroe*

In *Monroe*, the Fifth Circuit placed the *Northfield* exception squarely before the Court. Specifically, the Fifth Circuit certified the following questions:

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 pleadings alone; and (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 alleged in the third party pleadings?[19]

Thus, with *Monroe*, the Fifth Circuit directly asked the Court for its opinion on the practice of using extrinsic evidence, and the Court provided an answer despite ultimately concluding that the new extrinsic evidence exception did not apply.

A. Procedural Background

The *Monroe* coverage litigation arose out of the insured drilling company allegedly causing damage to an aquifer. Specifically, the property owner hired the insured drilling company ("5D") to drill a 3600-foot-deep commercial irrigation well through the Edwards Aquifer. The property owner sued 5D for breach of contract and negligence after 5D allegedly drilled with an unacceptable deviation, stuck the drill bit in the borehole, abandoned the well, and failed to case the well—allowing detritus to fall down the bore and fill up the well.[20]

The property owner contracted with 5D "in the summer of 2014."[21] The underlying pleading was silent on the date that the property damage occurred. However, the two carriers in the coverage suit stipulated that the drill bit became stuck "in November 2014."[22] The carrier for the 2015–16 policy period ("Monroe") refused to defend because the alleged property damage occurred outside its policy period. The carrier for the 2014–2015 policy period ("BITCO") defended under a reservation of rights.[23]

BITCO sued Monroe in the Western District of Texas, seeking a declaration that Monroe owed a duty to defend 5D. BITCO argued that even though it stipulated to the date that the drill bit became stuck, such extrinsic evidence could not be considered under Texas's eight-corners rule. The federal court agreed, holding that (1) the allegations in the underlying petition potentially triggered coverage; (2) the stipulation did not conclusively defeat coverage under the Monroe policy; (3) the stipulation could not be considered in any event because it overlapped with the merits of the underlying lawsuit; and (4) even if the stipulation could be considered to establish the first date of property damage, it did not conclusively establish that 5D *knew* that the property damage occurred before Monroe's policy period.[24]

Monroe appealed. The Fifth Circuit concluded that the question whether the court could consider extrinsic evidence—"the stipulated date the drill bit became stuck"—was "[k]ey to deciding this case."[25] The Fifth Circuit then certified its two questions to the Texas Supreme Court.

B. Factual Background

The Texas Supreme Court started its opinion by discussing the lack of specific dates in the underlying petition. The property owner's petition did not detail when 5D's negligent acts allegedly occurred or even when 5D began or stopped the work.[26] But the petition did allege that the insured was negligent in various respects: (1) the insured drilled the well in a way that "deviates in an unacceptable fashion from vertical"; (2) the insured "'stuck' the drilling bit in the bore hole, rendering the well practically useless for its intended/contracted for purpose"; (3) the insured "failed and refused to plug the well, retrieve the drill bit, and drill a new well"; and (4) the insured "failed to case the well through the Del Rio clay, allowing detritus to slough off the clay, falling down the bore and filling up the well."[27]

Similarly, the pleading alleged that the property owner's land

was damaged in different ways but was silent as to when any of the alleged damage occurred.[28] More specifically, the petition alleged that 5D "damaged [the property owner]'s property by lodging a drill bit and part of a bottom hole assembly in the aquifer under [his] property, damaging the aquifer and damaging the free flow of water in the aquifer."[29] And while the petition made clear that the insured's failure to case the well allowed detritus to fall down it, the petition did not say when this occurred or when 5D or Jones learned about it.[30]

The Court laid out the basis for Monroe's coverage position. The Monroe policy limited the scope of the duty to defend to cover property damage only if it "occurs during the policy period."[31] The Monroe policy also provided that Monroe will have no duty to defend 5D against any suit "to which this insurance does not apply." Further, coverage applies only if, "[p]rior to the policy period, no insured . . . knew that the . . . 'property damage' had occurred, in whole or in part."[32] Moreover, if the insured "knew, prior to the policy period, that the . . . 'property damage' occurred, then any continuation, change or resumption of such . . . 'property damage' during or after the policy period will be deemed to have been known prior to the policy period."[33]

Based upon the policy language, Monroe argued it had no duty to defend because the stipulation of the drill bit becoming stuck in November 2014 proved that property damage occurred during BITCO's policy period.[34] As a result, Monroe asserted that its policy deemed all property damage to have been known during BITCO's policy period, which was before Monroe's policy became effective in October 2015.[35]

C. The New *Monroe* Exception

Next, the Court articulated its newly minted "Monroe exception" for extrinsic evidence. In cases where *Avalos* does not apply (*i.e.*, no evidence of fraud), the Court instructed that the eight-corners rule would be the initial inquiry to determine whether a duty to defend exists.[36] The Court explained that the eight-corners rule would resolve coverage determinations in most cases.[37] However:

> [I]f 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, Texas law permits consideration of extrinsic evidence 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 fact to be proved.[38]

The Court then explained how this new exception is different from the *Northfield* exception. First, *Northfield* applies only if it is initially impossible to discern from the pleadings and policy "whether coverage is *potentially* implicated."[39] The Court rejected this limitation because it was concerned that this could invite courts to improperly "read facts into the pleadings" or "imagine factual scenarios which might trigger coverage."[40] Instead, the Court adopted the following inquiry: does the pleading contain the facts necessary to resolve the question of whether the claim is covered?[41]

The second difference from the new exception when compared to the *Northfield* exception relates to the types of extrinsic evidence that may be considered. *Northfield* required that the extrinsic evidence go to a "fundamental" coverage issue, such as: (1) whether the person sued has been excluded by name or description from any coverage, (2) whether the property in suit is included in or has been expressly excluded from any coverage, and (3) whether the policy exists.[42] But the Court determined that "the rationale for considering extrinsic evidence is sound regardless of whether the coverage issue in dispute meets *Northfield*'s 'fundamental' qualifier."[43] As a result, the Court determined that the better approach is to eliminate the "fundamental" requirement altogether.[44]

Third, the Court determined that, unlike *Northfield*, Texas law requires that the proffered extrinsic evidence must conclusively establish the coverage fact at issue.[45] The coverage fact need not be the subject of a stipulation, as other forms of proof may suffice.[46] However, "extrinsic evidence may not be considered if there would remain a genuine issue of material fact as to the coverage fact to be proved."[47]

Before moving on to the second certified question, the Court articulated policy reasons for adopting its new rule. The Court stated:

> [C]onsideration of extrinsic evidence under these standards 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. A contrary rule that ignores conclusively proven facts showing the absence of coverage would create a windfall for the insured, requiring coverage for which the insured neither bargained nor paid. Such a windfall would come at the expense of all consumers of insurance, who ultimately shoulder the expense of the insurer's increased defense costs through higher premiums.[48]

D. The Second Certified Question – Finding the Newly Minted Exception Does Not Apply

The Court next tackled the second certified question. The second certified question asked whether a Texas court may consider extrinsic evidence of the date of an occurrence.[49] The Court stated that "[b]ecause we do not categorically limit the types of potentially coverage-determinative facts that may be proven by extrinsic evidence, evidence of the date of an occurrence may be considered if it meets the other requirements described above."[50]

The Court held that the stipulation involving the date of the occurrence agreed to by BITCO and Monroe (but not the insured) did not pass the new exception because the extrinsic evidence overlapped with the merits and did not go solely to the issue of coverage.[51] The Court explained its basis for rejecting Monroe's argument that the stipulation relieved Monroe of a duty to defend because the stipulation established that property damage occurred in November 2014:

> Yet in the underlying case, the insured likely would have sought to prove the sticking of the drill bit was not the cause of any damage. And to obtain coverage in the face of Monroe's refusal, the insured would necessarily argue that some of plaintiff's alleged damages (e.g., the sloughing of material into the well) occurred after November 2014. This would undermine its liability defense, which is best served by asserting there was no damage either in November or anytime thereafter.[52]

The Court concluded that "[b]ecause the use of the stipulation in the manner urged by Monroe would overlap with the merits of liability in these ways, it cannot be considered in determining whether Monroe owes a duty to defend."[53]

IV. Making Sense Out of *Monroe*

The Court's unanimous opinion fundamentally alters over fifty years of insurance coverage law by adopting an extrinsic evidence exception that applies far beyond cases of collusion. The Court likely wanted to provide some clarity and guidance on the use of extrinsic evidence after repeatedly being able to avoid deciding the issue. However, coverage attorneys are now testing the boundaries of the new exception and particularly the meaning of the Court's analysis as to the second certified question.

While the Court stated that extrinsic evidence could be used to establish the date of an occurrence, the Court ultimately rejected Monroe's attempted use of extrinsic evidence. With the stipulation, Monroe appeared to try to establish: (1) the date of the occurrence (sticking of the drill bit) was when property damage also occurred; (2) the insured's knowledge of the existence of property damage prior to the Monroe policy period; (3) the insuring agreement known loss language deemed that all of the property damage occurred prior to the inception of the Monroe policy period; and (4) the Monroe policy did not provide coverage due to the property damage occurring during the BITCO policy period and not during the Monroe policy.

Arguably, the Court could have determined that the known loss language was not triggered. Indeed the Court stated that the petition alleged that the claimant's property suffered damage "in different ways." If the petition alleged the claimant's property suffered different types of "property damage," the known loss provisions may not apply as the newest "property damage" would not be the "continuation, change or resumption of *such* [*i.e.*, prior] 'property damage.'"[54]

Instead, the Court took a different approach. The Court determined that the drill bit becoming stuck was the occurrence, *i.e.*, the insured's alleged defective work. And the date of the occurrence could not be used against the insured to establish that property damage occurred on the same date and that the known loss language applied. These two sentences from the Court's opinion will likely be the subject of future coverage disputes:

> In cases of continuing damage like the kind alleged here, evidence of the date of property damage overlaps with the merits. 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 invoke coverage, when its position may very well be that no damage was sustained at all.[55]

Fortunately, the Court provided context for these two sentences. The Court rejected Monroe's attempt to use the insurers' stipulation against the insured to escape the duty to defend. The Court observed that the insured would seek to prove in the underlying case that the drill bit getting stuck caused no property damage. But to obtain coverage from Monroe, the insured would have to argue that the plaintiff suffered damage and some of the damage occurred after the inception of the Monroe policy period. According to the Court, "[t]his would undermine [the insured's] liability defense, which is best served by asserting there was no damage either in November [2014] or anytime thereafter."[56]

It is important to note that the stipulation was between two carriers. The insured—who would obviously be impacted by any ruling on coverage—was not part of the stipulation.

Further, the stipulation involved the date of alleged faulty workmanship. As a result, the existence of faulty workmanship and the date of such faulty workmanship were conclusive facts. But the existence of property damage caused by the faulty workmanship, much less the date of property damage, was not a conclusive fact. While the claimant alleged property damage, it was not established that any property damage actually occurred. Thus, to eliminate coverage, the insurer tried to use conclusive evidence regarding the date of faulty workmanship to establish that the faulty workmanship caused property damage at a certain time point to eliminate coverage. The Court did not permit the usage, as it would intrude on the merits of the case and damage the insured's liability defense by forcing it "to confess damages" (*i.e.*, acknowledge property damage caused by its faulty workmanship) to trigger coverage under the Monroe policy. Ultimately, the Court's rejection of an insurer trying to use a stipulation against its insured in this manner is not surprising.[57]

V. The Second Extrinsic Evidence Opinion - *Pharr*

On the same day that it issued the *Monroe* decision, the Court issued another opinion involving the use of extrinsic evidence to determine an insurer's duty to defend. The Court determined once again that the *Monroe* exception did not apply, but for a different reason: the duty to defend could be determined based upon the eight corners of the petition and policy.

The Pharr-San Juan-Alamo Independent School District ("School District") obtained automobile liability insurance from the Texas Political Subdivisions Property/Casualty Joint Self Insurance Fund ("Insurance Fund").[58] The insurance policy required the Insurance Fund to indemnify the School District by paying "all sums" the School District "legally must pay as damages because of bodily injury or property damage to which this self-insurance applies," if those damages are "caused by an accident and result[ ] from the ownership, maintenance or use of a covered auto."[59] The policy defined "auto" as "a land motor vehicle . . . designed for travel on public roads but does not include mobile equipment."[60] And, the policy defined "mobile equipment" to mean certain types of "land vehicles," including "[b]ulldozers, farm machinery, forklifts and other vehicles designed for use principally off public roads."[61]

The coverage dispute arose when Lorena Flores, acting as next friend of her minor daughter Alexis, sued the School District and its employee, Cristoval DeLaGarza, Jr. ("DeLaGarza").[62] Flores alleged in her petition that Alexis "was severely injured after being thrown from a golf cart."[63] More specifically, Flores alleged that DeLaGarza, while acting within the course and scope of his employment with the School District, "recklessly and negligently operated" the "golf cart" when "he suddenly, and without warning, turned the golf cart abruptly, thereby throwing Alexis Flores ("Flores") from the vehicle."[64] The underlying petition did not provide any additional details about the accident or the golf cart.[65]

The School District requested that the Insurance Fund defend it against Flores's claims and indemnify it against any resulting liability.[66] The Insurance Fund refused, asserting that the policy did not provide coverage because a golf cart did not qualify as an "auto" under the policy as it was not designed for travel on public roads; instead, it qualified as "mobile equipment," which was not covered under the policy.[67] The Insurance Fund ultimately filed a declaratory judgment lawsuit seeking a ruling that it had no duty to defend the School District.[68]

Relying upon the exception set forth in *Monroe*, the Court determined that it need not resort to extrinsic evidence because the Insurance Fund's duty to defend could be determined by the eight corners of the petition and insurance policy.[69] Applying the eight-corners rule, the Court concluded that the Insurance Fund had no duty to defend the School District against the plaintiff's claims because the petition alleged that the minor was "thrown from a golf cart" and did not include an allegation that the minor was thrown from a "vehicle designed for travel on public roads," *i.e.*, an "auto."[70] As a result, there was not a "gap" as to coverage in the underlying lawsuit.[71] Therefore, the duty to defend analysis started and ended with the eight-corners rule.[72]

VI. Cases considering the *Monroe* Exception

As of the date of this article, neither the Texas Supreme Court nor any state intermediate appellate courts have considered the *Monroe* exception since the Texas Supreme Court issued the *Monroe* and *Pharr* opinions in February of last year. However, each of the four federal district courts in Texas have meaningfully analyzed the exception on at least one occasion. Five of those nine cases are from the Southern District, and two are from the Northern District. The Western and Eastern Districts have each analyzed the *Monroe* exception once.[73]

A. Cases declining to apply the *Monroe* Exception

In five of the nine cases that have grappled with the *Monroe* exception, the courts determined that it did not apply because the proffered extrinsic evidence did not meet the requirements set forth in *Monroe*.

The Southern District reached that conclusion in *Everest National Insurance Co. v. Megasand Enterprises, Inc.*[74] There, Megasand sought a defense for three lawsuits alleging that Megasand negligently discharged materials into certain waterways, reducing the capacity of those waterways and contributing to flooding.[75] The initial complaints alleged that "runoff dust, sand, construction materials, and other

products produced and/or used by Defendants" caused the alleged damages.[76] However, the amended live pleadings referred only to "materials and substances produced and/or used and/or maintained by some Defendants."[77] On summary judgment, Everest argued that it owed no duty to defend Megasand due to the policy's Pollution Exclusion.[78] Everest sought to introduce the initial pleadings as evidence, presumably believing that their description of the discharged materials more clearly implicated the exclusion.[79] Applying *Monroe*, the magistrate refused the extrinsic evidence because it was clear from the live amended pleadings what the underlying plaintiffs alleged entered the waterways, *i.e.*, there was no factual gap in the pleadings to fill.[80]

In *Allstate Fire & Casualty Insurance Co. v. Hurtado*, the auto policy covered the vehicle at issue only if the vehicle's primary usage was not to carry property for a fee.[81] The underlying pleadings sufficiently alleged that the insured was carrying property for a fee at the time of the accident but not that carrying property for a fee was the vehicle's primary usage.[82] Relying on *Monroe*, the insurer sought to introduce deposition testimony of the insured driver establishing that he used the van to carry property for a fee on a daily basis on 250 out of 365 days of the year and that the van did not have seating for passengers.[83] The Southern District magistrate judge held that this evidence met the first and second *Monroe* factors—that it did not overlap with the merits of liability and that it did not contradict the underlying pleadings—but the court nevertheless refused the evidence because it failed the third factor.[84] The court explained, "[t]he extrinsic evidence is consistent with Hurtado using the Van primarily to carry items for a fee. But the evidence fails to *conclusively* establish that Hurtado had no other more important or main use for the Van."[85]

In *Knife River Corp. South. v. Zurich American Insurance Co.*, Knife River sought defense and indemnity as an additional insured under the insurance policy of its subcontractor, AWP.[86] The underlying lawsuit stemmed from a single-car accident that occurred on a stretch of road where AWP and another contractor were performing construction as subcontractors of Knife River.[87] The underlying plaintiffs alleged that Knife River and the subcontractors collectively "were negligent with respect to [the] road work ... [leading] to the accident causing [the driver's] personal injuries," including that the defendants failed to place proper warning signage during the construction work.[88] In turn, AWP's insurer filed a motion to dismiss the coverage lawsuit arguing that the anti-indemnity act prohibited KRC's additional-insured claim because KRC sought defense and indemnity for its own negligence.[89] In response, Knife River offered its contract with AWP to show that AWP assumed all responsibility for signage related to the construction.[90] The Northern District ruled that the contract did not meet the requirements of the *Monroe* exception "because the provisions [of the contract] overlap with liability determinations."[91]

In *Certain Underwriters at Lloyd's, London v. Keystone Development, LLC*, Underwriters filed a lawsuit in the Northern District seeking a declaration that it had no duty to defend Keystone in a lawsuit brought by a condominium owners association alleging defects and resulting property damage related to the condominiums that Keystone built.[92] Underwriters relied on two exclusions – one barring coverage for projects exceeding twenty-five units and one barring coverage for projects exceeding three stories or thirty-six feet.[93] Interestingly, the court moved for summary judgment against Underwriters *sua sponte*, presumably based on its view that the pleadings stated claims potentially within coverage and did not trigger the asserted exclusions.[94] In response, Underwriters offered the master deed for the project to establish that it included thirty-nine units and offered other evidence to show that the condominiums exceeded thirty-six feet in height.[95]

Analyzing the Texas Supreme Court's holdings in *Monroe*, and particularly *Pharr*, the court rejected the evidence, finding that the pleadings contained no informational gaps regarding either exclusion.[96] The court found no gap as to whether the project exceeded twenty-five units because the pleadings clearly alleged that the condominiums consisted of two *separate* projects—one twenty-four unit project and one fifteen unit project.[97] The court's decision regarding the height exclusion was more interesting because, while the pleadings alleged that the buildings were three stories, they were silent as to the height in feet.[98] The height exclusion excluded coverage for buildings exceeding three stories or thirty-six feet, in the disjunctive—meaning the existence of either condition barred coverage.[99] The court held that there was no informational gap because the pleadings addressed at least part of the exclusion by alleging the number of stories.

In *Allied Property & Casualty Insurance Co. v. Armadillo Distribution Enterprises, Inc.*, the United States District Court for the Eastern District of Texas analyzed whether it could consider pre-suit correspondence between the insured and the plaintiff in the underlying action to determine the insurer's duty to defend an intellectual property infringement lawsuit.[100] Notably, the underlying lawsuit was filed five days before the insurer issued the applicable policy.[101] The insurer offered the pre-suit correspondence to prove its defenses that the loss did not occur during the policy period and that the Known Loss Doctrine and the policy's Knowing Violation of Rights of Another exclusion precluded coverage.[102] The insurer did not argue the *Monroe* exception to the Eight Corners Rule, but the court analyzed the exception *sua sponte*.[103] The court determined that the extrinsic evidence did not meet the exception because the live pleadings, along with the incorporated exhibits, stated a potentially covered claim.[104] As the court put it, "there is no 'gap' in Gibson's complaint that necessitates the use of extrinsic evidence to determine coverage," even though the proffered evidence presumably disproved or at least contradicted the coverage facts stated in the pleadings.[105]

In summary, one court has declined to consider extrinsic evidence because it overlapped with the merits of the underlying litigation (the contractor agreement in *Knife River* allocating responsibility for posting warning signs in the construction zone), and another court rejected proffered extrinsic evidence because it did not conclusively establish the coverage fact at issue (testimony from the insured driver offered to establish that the vehicle was primarily used to carry property for a fee). The remaining three courts declined to apply the *Monroe* exception after determining that there was no informational gap in the coverage facts stated in the underlying pleadings.

B. Cases applying the *Monroe* Exception to Allow Extrinsic Evidence

On the other hand, Texas federal courts have now applied the *Monroe* exception on four occasions to consider extrinsic evidence when determining the insurer's duty to defend. Three of those cases come from the Southern District and one from the Western District.

In *Drawbridge Energy US Ventures, LLC v. Federal Insurance Co.*, Drawbridge sought defense under a claims-made Directors and Officers policy issued by Federal.[106] In the underlying lawsuit, Molopo Energy Limited sought to void a transaction with Drawbridge because the transaction lacked required approval by Molopo's shareholders.[107] Federal denied coverage.[108] It argued that, under the policy's "Related Claim" provision, the lawsuit related back to a demand letter that Drawbridge received prior to the inception of the policy.[109] The Southern District court determined that the letter satisfied the *Monroe* requirements for extrinsic evidence.[110] The court found a gap in the underlying pleadings because "[t]he underlying pleadings are silent as to whether a related claim was made prior to the inception of the policy period."[111] The court also found that the letter went solely to an issue of coverage and did not overlap with the merits of liability, it did not contradict facts alleged in the pleadings; and it conclusively established the coverage fact at issue—namely, that the claim was first made prior to the policy period.[112]

In *Progressive Commercial Cas. Ins. Co. v. Xpress Transp. Logistics, LLC*, the Southern District admitted extrinsic evidence to show that the truck involved in an accident was not the covered auto identified in the declarations and therefore was not covered by the policy.[113] Relying on *Monroe*, the court noted that identification of the truck did not contradict the underlying pleadings and conclusively determined Progressive's defense and indemnity obligations.[114]

In *National Liability & Fire Insurance v. Turimex, LLC*, the business auto-insurer denied defense and indemnity to Turimex, a tour bus operator, for a lawsuit brought by a Turimex passenger for injuries sustained when a Turimex bus crashed on its way from Houston to Cuernavaca, Mexico.[115] The underlying pleadings were silent as to where the accident occurred.[116] The insurer offered the claim notice, an email from the underlying plaintiff's counsel and a Mexican news report to show that the accident occurred in Mexico, which was not within the coverage territory of the policy.[117] The Southern District magistrate judge allowed the evidence because the issue of where the accident occurred went solely to coverage and not the merits; the evidence did not contradict the pleadings because the pleadings did not state the location of the accident; and the evidence was conclusive of whether the accident occurred within the policy's coverage territory.[118]

In *Xavier Benites v. Western World Insurance Co.*, the balcony of Benites's Port Aransas condominium collapsed and caused injuries to several renters.[119] The renters sued Benites and the condominium owners association, and Benites sought defense from Western World Insurance under a policy issued to the condominium owners association.[120] Western denied coverage, and Benites sued it.[121] Coverage under the Western policy extended to each individual owner, "but only with respect to liability arising out of the ownership, maintenance or repair of that portion of the premises which is not reserved for that unit owner's exclusive use or occupancy."[122] On summary judgment, the Western District magistrate judge applied *Monroe* to allow the use of condominium bylaws and declarations to show that the balcony was reserved for Benites's exclusive use and, therefore, fell outside the policy's coverage.[123]

In each of the four cases where the courts applied *Monroe* to admit extrinsic evidence, the courts used the extrinsic evidence to find that insurer did not owe a defense. Importantly, before *Monroe*, the gaps in the pleadings in those cases would have been filled, not with extrinsic evidence, but with a presumption in favor of the insured and the duty to defend.

VII. Four Takeaways regarding the *Monroe* Exception

A. The duty to defend standard in Texas is now less friendly to insureds.

The eight-corners rule generally helps insureds because insurers are at the mercy of the allegations of the lawsuit. Moreover, Texas courts liberally construe factual allegations in favor of the insured. Now, insurers may use extrinsic evidence, assuming the three elements of the *Monroe* exception are satisfied. More importantly, a petition that alleges a claim that could trigger coverage does not automatically trigger a duty to defend anymore. A petition alleging a claim that *could* trigger the duty to defend is merely the first step now in the duty-to-defend analysis. If there is such a claim, but there is a gap in coverage contained within the petition, a party may use extrinsic evidence, assuming the three *Monroe* elements are satisfied.[124]

B. How high is the conclusive extrinsic evidence standard?

Many disputes will likely involve the third *Monroe* element. The Court stated that that the proffered extrinsic evidence "must conclusively establish the coverage fact at issue." The Court further stated that forms of proof other than a stipulation may suffice. However, the "extrinsic evidence may not be considered if there would remain a genuine issue of material fact as to the coverage fact to be proved."[125]

The Court appears to require the party offering extrinsic evidence to satisfy the summary judgment standard. [126] Presumably, if the party offering extrinsic evidence carries its burden, then the burden shifts to the non-movant to present to the court any issue that would preclude the use of extrinsic evidence.[127] However, where reasonable minds could not draw differing inferences or conclusions from undisputed coverage facts, there should be no genuine issue of material fact.[128]

Again, the Court did not reject the Monroe stipulation due to this element. Instead, the Court concluded that the evidence overlapped on the merits and was flawed for reasons discussed above.

C. Will insurers take the Court up on the opportunity to create different rules?

In *Richards* and *Monroe*, the Court made clear that an insurer's defense obligation is a "creature of contract," which means it can be modified. In fact, the Court expressly stated in *Monroe* that an insurer could modify its defense obligations by contract if an insurer is unhappy with the new exception.[129] It remains to be seen whether insurers will take this opportunity to amend their policies by adding new provisions, such as the use of the "true facts" to determine the duty to defend, even if the facts overlap with the merits of the underlying case.

Under current law, the extrinsic evidence cannot overlap with the merits of the underlying lawsuit, unless it meets the narrow *Avalos* collusion exception. While insureds would presumably argue that extrinsic evidence that overlaps with the merits in future cases is not allowed, insurers could preempt this argument by modifying their defense obligations by contract. However, because *Pine Oak* instructs that extrinsic evidence is not limited to insurers,[130] insurers may be reticent to rewrite policies to give insureds the ability to bring forward extrinsic evidence in favor of coverage.

D. Using extrinsic evidence for when the property damage occurred will be hotly contested.

The prospect of using extrinsic evidence to establish when the property damage occurred when the pleadings are silent is a potential game-changer. For example, if an automobile runs over a pedestrian, can the insurer use the incident date from the police report to establish when the bodily injury happened if the petition does not allege an incident date? Presumably, the answer could be "yes" under *Monroe*.

Can evidence of the date of when property damage happened ever be used? Even conclusive evidence of when property damage that first occurred may not be considered if the merits of liability involve this issue. For example, suppose the petition in *VRV Development L.P. v. Mid-Continent Casualty Co.*[131] did not allege when the retaining wall collapsed. An insurer that issued a policy after the collapse would likely attempt to use extrinsic evidence to show that the collapse occurred prior to time the insurer got on the risk.

Property damage claims involving continuing injury could present various problems. What if there is conclusive evidence that the insured did not start the work until after the insurer's policy expired? Or, what if the insurer issued a broad *Montrose* exclusion[132] referencing when work completed prior to the time the insurer issued its first policy, and it is undisputed that the insured completed its work prior to that time? Some will no doubt contend that extrinsic evidence can never be used to establish the date of property damage in continuing injury cases by referencing broad language contained within *Monroe*.

These examples are just the tip of the iceberg. There are countless scenarios that will trigger coverage disputes over the propriety of the use of extrinsic evidence to establish when property damage may have occurred.

VII. Conclusion

The duty to defend standard is arguably less favorable to insureds as parties are permitted to use extrinsic evidence when there is doubt and a gap in coverage, assuming 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 fact to be proved. Continued coverage litigation will likely focus on elements (1) and (3) as litigants will dispute whether the proffered extrinsic evidence overlaps with the merits or conclusively establishes a coverage fact. It remains to be seen if insurers will accept the Court's invitation to restrict their defense obligations further by modifying insurance contracts in a manner that permits even more extrinsic evidence. Although many questions remain, one thing is clear—Texas is not a strict eight-corners state.

1 *Monroe Guar. Ins. Co. v. BITCO Gen. Ins. Corp.*, 640 S.W.3d 195, 197 (Tex. 2022).

2 *Pharr-San Juan-Alamo Indep. Sch. Dist. v. Texas Pol. Subdivi-*

sions Prop./Cas. Joint Self Ins. Fund, 642 S.W.3d 466 (Tex. 2022).

3 *Loya Ins. Co. v. Avalos*, 610 S.W.3d 878, 880–81 (Tex. 2020).

4 *Richards v. State Farm Lloyds*, 597 S.W.3d 492, 498 (Tex. 2020).

5 *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1965).

6 *Id.* at 24.

7 *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex. 2002).

8 *id; See GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 310 (Tex. 2006) (emphasis in original).

9 *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365, 369 (5th Cir. 2008).

10 610 S.W.3d 878, 879 (Tex. 2020).

11 *Id* at 881–82.

12 363 F.3d 523 (5th Cir. 2004).

13 *Id*. at 531.

14 197 S.W.3d at 308.

15 *See, e.g., AIX Specialty Ins. Co. v. Shiwach*, No. 05-18-01050-CV, 2019 WL 6888515, at *7 (Tex. App.—Dallas Dec. 18, 2019, pet. denied).

16 *See, e.g., Nabors Drilling Techs. USA Inc. v. Deepwell Energy Servs. LLC*, 2021 WL 4924758 at *15–16 (S.D. Tex. Oct. 21, 2021);*Weingarten Realty Mgmt. Co. v. Liberty Mut. Fire Ins. Co.*, 343 S.W.3d 859, 865 (Tex. App.—Houston [14th Dist.] 2011, pet. denied).

17 *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 497 (Tex. 2008); *GuideOne*, 197 S.W.3d at 308–09.

18 *Richards*, 597 S.W.3d at 500 (citations omitted).

19 *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, 846 F. App'x 248, 252 (5th Cir. 2021).

20 *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, No. SA18CV00325FBESC, 2019 WL 3459248, at *4 (W.D. Tex. July 31, 2019), *report and recommendation adopted* No. SA-18-CA-325-FB, 2019 WL 11838850 (W.D. Tex. Sept. 27, 2019).

21 *Id.* at *5.

22 *Id.* at *6.

23 *Id.* at *2.

24 *Id.* at *5–*7.

25 846 F. App'x 248, 248 (5th Cir. 2021).

26 *Monroe*, 640 S.W.3d at 197.

27 *Id*.

28 *Id*.

29 *Id*.

30 *Id*.

31 *Id*. at 197–98.

32 *Id.* at 198.

33 *Id.*

34 *Id.*

35 *Id.*

36 *Id.* at 201.

37 *Id.*

38 *Id.* at 201-02.

39 363 F.3d at 531 (emphasis added).

40 *Monroe*, 640 S.W.3d at 202 (quoting *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Merchs. Fast Motor Lines, Inc.*, 939 S.W.2d 139, 142 (Tex. 1997)).

41 *Id.* at 202.

42 363 F.3d at 530 (citing *Westport*, 267 F. Supp. 2d at 621).

43 *Monroe*, 640 S.W.3d at 203–04.

44 *Id.* at 203.

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

49*Id.* Notably, the Court focused on the word "occurrence" instead of the term "property damage."

50 *Id.* at 204.

51 *Id.*

52 *Id.*

53 *Id.* The district court engaged in a slightly different analysis, noting that although the extrinsic evidence demonstrated that the drill bit became stuck in the borehole prior to the policy period, "it [did] not show that 5D *knew* that the drill bit became stuck in the borehole prior to the policy period." *Bitco,* No. SA18CV00325FBESC, 2019 WL 3459248, at *7. Further, the court found that the stipulation could not be considered because it overlapped with the merits of the underlying lawsuit. The court observed that "[f]or example, the alleged failure to case the well constitutes negligence only if it was the legal cause of the alleged damage to [the] property." *Id.* To answer this question, the court in the underlying lawsuit would have to determine, among other things, when the well should have been cased, when the debris fell down the borehole and filled up the well, and when the Edwards Aquifer was damaged. As the court stated, "the date on which the drill bit became stuck in the borehole is likely relevant to these issues." *Id.*

54 *Monroe*, 640 S.W.3d at 198 (emphasis added).

55 *Id.* at 204.

56 *Id.*

57 Again, there was no stipulation regarding when the different damages occurred, if at all. The case may have turned out differently if the insured was also involved in the stipulation or the stipulation involved date of physical injury to the property. The case could have also turned out different if there was a conclusive fact that the aquifer was damaged on a specific date. With

none of these conclusive facts, Monroe did not prevail.

58 *Pharr*, 642 S.W.3d at 468.

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 *Id.*

64 *Id.*

65 *Id.*

66 *Id.*

67 *Id.* at 468–69.

68 *Id.* at 469.

69 *Id.*

70 *Id.*

71 *Id.*

72 *Id.*

73 In addition to the nine cases that include a substantive review of the *Monroe* exception, the courts in *Allstate Vehicle & Property Insurance Company v. Crawford* and *Mt. Hawley Insurance Company v. J2 Resources LLC* acknowledged the exception but did not apply it, analyze it, or discuss any arguments about it from the parties. *Allstate Vehicle & Prop. Ins. Co. v. Crawford*, No. 3:21-CV-2806-K, 2022 WL 2790650, at *3 (N.D. Tex. July 16, 2022); *Mt. Hawley Ins. Co. v. J2 Res. LLC*, No. 4:20-CV-2540, 2022 WL 1785483, at *5, n.2 (S.D. Tex. June 1, 2022). Those courts determined that the insurers owned no duty to defend without resorting to extrinsic evidence. *Id.*

74 No. 4:20-CV-1265, 2022 WL 6246854, at *3 (S.D. Tex. Aug. 5, 2022), *report and recommendation adopted,* 2022 WL 6225838 (S.D. Tex. Oct. 7, 2022).

75 *Id.* at *1.

76 *Id.*

77 *Id.*

78 *Id.* at *2.

79 *Id.* at *3.

80 *Id.* at *4.

81 No. 4:21-CV-3686, 2022 WL 4390644, at *3 (S.D. Tex. Aug. 31, 2022), *report and recommendation adopted,* 2022 WL 4389704 (S.D. Tex. Sept. 22, 2022).

82 *Id.* at *1–*2.

83 *Id.* at *6.

84 *Id.* at *5–*6.

85 *Id.* at *6.

86 No. 3:21-CV-1344-B, 2022 WL 686625, at *1 (N.D. Tex. Mar. 8, 2022).

87 *Id.*

88 *Id.*

89 *Id.*

90 *Id.* at *6.

91 *Id.* at *8.

92 No. 3:21-CV-336-L, 2022 WL 6202129, at *1 (N.D. Tex. Oct. 7, 2022).

93 *Id.* at *3–*4.

94 *Id.* at *1.

95 *Id.* at *3–*4.

96 *Id.*

97 *Id.* at *3.

98 *Id.* at *4.

99 *Id.* at *4–*5.

100 No. 4:21-CV-00617-ALM, 2022 WL 3568482 (E.D. Tex. Aug. 18, 2022).

101 *Id.* at *2.

102 *Id.* at *9–*12

103 *Id.* at *6.

104 *Id.* at *5.

105 *Id.*

106 No. 4:20-CV-03570, 2022 WL 991989, at *1–*2 (S.D. Tex. Apr. 1, 2022).

107 *Id.*

108 *Id.*

109 *Id.* at *2.

110 *Id.* at *6.

111 *Id.* at *5.

112 *Id.* at *5.

113 No. CV H-21-2683, 2022 WL 6779078, at *7–*8 (S.D. Tex. Oct. 11, 2022).

114 *Id.* at *8.

115 No. 4:21-CV-3967, 2022 WL 16838038, at *1 (S.D. Tex. Oct. 20, 2022), *report and recommendation adopted sub nom.* 2022 WL 16836342 (S.D. Tex. Nov. 9, 2022).

116 *Id.* at *2.

117 *Id.*

118 *Id.* at *3–*4.

119 No. 1:21-CV-1093-RP, 2022 WL 2820669, at *1 (W.D. Tex. July 18, 2022), *report and recommendation adopted sub nom.*, 2022 WL 18034649 (W.D. Tex. Oct. 18, 2022).

120 *Id.* at *1–*2.

121 *Id.* at *2.

122 *Id.* at *1 (emphasis added).

123 *Id.* at *4–*6.

124 Extrinsic evidence is available to both insureds and insurers. In *Pine Oak*, the insured argued that a different rule should apply when a party was trying to use extrinsic evidence to create

coverage than when extrinsic evidence was being used to defeat coverage. 279 S.W.3d at 655. The Court held that "[t]his distinction is not legally significant." *Id*

125 *Monroe*, 640 S.W.3d at 203.

126 See Tex. R. Civ. P. 166a(c) (stating a court may enter summary judgment if "there is no genuine issue as to any material fact"). The Court cited *Avalos* and *Heyden Newport* in support of this proposition. *Heyden Newport*, decided in 1965, instructs insurers to resolve doubts in the insured's favor. *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965). *Avalos* requires insurers to show conclusive proof of collusive fraud to negate the duty to defend. *See* 610 S.W.3d at 879. The invocation of summary judgment-standard language may be a signal to courts and practitioners what it means to conclusively establish a coverage fact at issue.

127 *Phan Son Van v. Pena*, 990 S.W.2d 751, 753 (Tex. 1999).

128 *See, e.g., Comm'l Standard Ins. Co. v. Davis,* 137 S.W.2d 1, 2 (Tex. 1940).

129 *Monroe*, 640 S.W.3d at 203 & n 12.

130 *Pine Oak*, 279 S.W.3d at 655.

131 630 F.3d 451 (5th Cir. 2011).

132 "*Montrose*" is a reference to the California Supreme Court's decision in *Montrose Chemical Corp. v. Admiral Insurance Co.*, 913 P.2d 878, 906 (Cal. 1995), in which the court held that coverage is not precluded for damage that the insured knew existed at the time it purchased the policy, as long as the policyholder's liability for that property damage was still contingent. Although the original *Montrose*-endorsement (now incorporated into the standard CGL policy's grant of coverage) contains a knowledge element, some *Montrose* exclusions have come to encompass other types of provisions that establish the first occurrence of property damage as the end date for continuous or progressive property damage claims, even without knowledge by the insured.