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The Texas duty to defend eight-corner rule's prohibition against considering extrinsic evidence is facing two tests this term in the Texas Supreme Court. There are a wide variety of possible outcomes and results could give rise to significant changes.

Texas Supreme Court to Decide Two Eight-Corner Duty to Defend Cases This Term

ABOUT THE AUTHOR

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The Insurance and Reinsurance Committee members, including U.S. and multinational attorneys, are lawyers who deal on a regular basis with issues of insurance availability, insurance coverage and related litigation at all levels of insurance above the primary level. The Committee offers presentations on these subjects at the Annual and Midyear Meetings.

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The Texas Insurance Law bar is currently abuzz with anticipation of now two upcoming Texas Supreme Court decisions this term regarding the eight-corner rule for determining an insurer's duty to defend. The first of the two cases, *State Farm Lloyds v. Richards,* 2019 WL 4267354 (5th Cir. 2019), came to the Texas Supreme Court by certified question from the Fifth Circuit and it will analyze whether the absence of the policy language requiring an insurer to defend its insured when the allegations are "groundless, false and fraudulent" permits an insurer to consider extrinsic evidence to seek a denial of a defense obligation. It was argued on January 8, 2020 and the video of the oral argument is accessible at: http://www.texasbarcle.com/CLE/SCPlayer5.asp?sCaseNo=19-0802&bLive=&k=&T=.

Next, on Friday January 17, 2020, the Texas Supreme Court announced that it would hear another eight-corner duty to defend case this term when it granted the Petition for Review in *Avalos v. Loya Ins. Co.,* 2018 WL 3551260 (Tex. App.—San Antonio 2018, pet. granted). *Avalos* involves whether an auto insurer can rely on extrinsic evidence to withdraw from a defense of its policyholder in a car wreck case when it learns that an excluded driver, and not the insured, was driving the car at the time of the accident.

It is noteworthy that the Texas Supreme Court recently adopted the United States Supreme Court's practice of deciding all cases argued within a term before the term ends. Accordingly, there will be two new Texas Supreme court decisions on the eight-corner duty to defend rule by July 2020 when the court recesses for the summer. Past experience indicates that the opinions will be coordinated and likely issued simultaneously.

Also, notable is that the rules espoused in these upcoming decisions will impact every type of liability coverage. In other words, whether extrinsic evidence exceptions to the eight-corner rule for the duty to defend will be recognized by the Texas Supreme Court will impact the most garden-variety of car wreck cases; as well as situations in which multiple millions of dollars are at stake.

The Texas Supreme Court took an interest in the potential utilization of extrinsic evidence to determine the duty to defend in 2006 in *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church,* 197 S.W.3d 305 (Tex. 2006). In *GuideOne,* the insurer of a church being sued for the alleged sexual harassment of one of its ministers could show by extrinsic evidence that the minister had left the church prior to the inception of its policy and so, it filed a declaratory judgment action seeking a declaration that it did not owe the church a duty to defend. *Id.* at 307.

The Texas Supreme Court recognized that although some of Texas' courts of appeals had carved out certain exceptions to the eight-corner rule, the Texas Supreme Court had never done so. *Id.* at 308. It also noted that the Fifth Circuit predicted that if the Texas Supreme Court were to recognize an exception to the eight-corner rule, it would be a narrow exception such as "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." *Id.* at 309 *quoting Northfield Ins. Co. v. Loving Home Care, Inc.,* 363 F.3d 523, 531 (5th Cir. 2004) (emphasis in original).

The Texas Supreme Court considered adopting a "true-facts" exception to the eight-corner rule in order to prevent the rule's recurring use as a tool for fraud; however, rejected it because the record did "not suggest collusion or the existence of a pervasive problem in Texas with fraudulent allegations designed solely to create a duty to defend." *Id.* at 311. In the end, the Texas Supreme Court refused to consider the extrinsic evidence and held that the insurer owed the church a duty to defend. *Id.* at 311. It is interesting to note that four members of the court, including then Justice Don Willett (now a Fifth Circuit judge), joined in a concurring opinion, which commented that there was "no need to consider what exceptions the [eight-corner] rule might have, and given the importance of this difficult issue, I would express no opinion on it." *Id.* at 314.

Next up at the Texas Supreme Court on extrinsic evidence and the eight-corner duty to defend rule was *Pine Oak Builders, Inc. v. Great American Lloyds Ins. Co.,* 279 S.W.3d 650 (2009). This unanimous decision, in an opinion authored by then Justice Don Willett, analyzed whether to consider extrinsic evidence showing that the subcontractor's work exception to the "your work" exclusion for completed operations was invoked to preclude the application of the exclusion to deny a defense to the insured. *Id.* at 653. In other words, the refusal to consider extrinsic evidence deprived the policyholder from a defense in a situation in which the insurer owed a duty to indemnify. *Id.* at 655-56. The Texas Supreme Court held that while extrinsic evidence may be important in determining the insurer's duty to indemnify, it is irrelevant in determining the duty to defend. *Id.*

Meanwhile on a parallel track, Fort Worth federal judge John McBryde began presiding over cases in which insurers argued that the policy language change from obligating insurers to defend suits "even if the allegations of the suit are groundless, false, or fraudulent" to requiring the insurer to defend only those suits seeking damages "to which the insurance provided by the policy applies" nullified the rationale for not considering extrinsic evidence in determining the duty to defend. In these cases, Judge McBryde agreed with the insurers and he considered extrinsic evidence to rule that the insurers did not owe their insureds a duty to defend *B. Hall Contracting Co. v. Evanston Ins. Co.,* 447 F. Supp. 634 (N.D. Tex. 2006) *rev'd on other grounds,* 273 F. App'x 310 (5th Cir. 2008); *see also* GuideOne Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ, 806 F. Supp. 2d 923 (N.D. Tex. 2011)

vacated 687 F.3d 676 (5th Cir. 2012) (considering extrinsic evidence to hold that the insurer did not owe a duty to defend or a duty to indemnify).

State Farm Lloyds v. Richards is the latest in the series of cases in which Judge McBryde employed his signature policy-language exception to the eight-corner rule's prohibition of considering extrinsic evidence in determining an insurer's duty to defend. *Richards* considered the duty to defend a wrongful death suit involving an excluded all-terrain vehicle that was brought on behalf of the decedent who qualified as an insured under the subject State Farm homeowners policy and thus, also excluded from coverage under the policy. 2019 WL 4267354 at *1. Relying on extrinsic evidence invoking exclusions for bodily injuries arising from motor vehicles away from the insureds' residence and for claims brought by an insured under the policy, Judge McBryde held that State Farm did not owe either a duty to defend or a duty to indemnify. *Id.* at *2.

On appeal, the Fifth Circuit panel, which naturally included former Texas Supreme Court Justice Don Willett, certified to the Texas Supreme Court the question of: "[i]s the policy-language exception to the eight-corners rule articulated in *B. Hall Contracting, Inc. v. Evanston Ins. Co.,* 447 F. Supp. 2d 634 (N.D. Tex. 2006), a permissible exception under Texas law?" The Texas Supreme Court accepted the requested certification and it heard oral arguments on the case on January 8, 2020.

Now; nine days after the oral arguments in *State Farm v. Richards,* the Texas Supreme Court in *Avalos v. Loya Ins. Co*. agreed to consider (1) whether an exception to the eight-corners rule should be created when undisputed evidence shows the policyholder committed fraud and colluded to obtain coverage and (2) whether the insurer should have filed a declaratory action to obtain a declaration that it did not owe a duty to defend before withdrawing from the defense. Oral argument on this case is set for February 26, 2020 and the video of it will be simulcast and then available for access on the Texas Supreme Court's website.

The range of possible outcomes of these cases is very broad. It is possible that the Texas Supreme Court will double-down on the eight-corner rule and hold that the insurers in those cases cannot rely on extrinsic evidence to deny defenses to their insureds. The Texas Supreme Court could also recognize policy-language and fraud exceptions to the eight-corner rule ban on considering extrinsic evidence. Conceivably, these exceptions could be encompassed by another type of exception to the ban on extrinsic evidence. Also, in *Avalos v. Loya Ins.,* the Texas Supreme Court will consider the conduct of an insurer that withdraws from a defense without seeking a declaratory judgment. Interestingly, in the Texas Supreme Court oral argument in *State Farm Lloyds v. Richards,* counsel for State Farm argued that declaratory judgment actions should be utilized in connection with the withdrawal of a defense based on extrinsic evidence.

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