akerman

Practice Update

Texas Supreme Court Carves Out Narrow Exception to "Eight-Corners" Rule

February 22, 2022

By Kelly E. Almeter and Xakema L. Henderson

The Texas Supreme Court in *Monroe Guaranty Insurance Company v. BITCO General Insurance Corporation*, No. 21-0232, slip op. (Tex. Feb. 11, 2022), available here, recently approved a narrow exception to the long-standing "eight-corners" rule—where an insurer's duty to defend is determined solely by comparing the four corners of the complaint against the four corners of the policy—allowing the use of extrinsic evidence in limited circumstances to determine an insurer's duty to defend.

In *Monroe*, the insured, a drilling contractor, had consecutive one-year commercial general liability policies issued by two different carriers, BITCO General Insurance Corporation and Monroe Guaranty Insurance Company. BITCO's policies were effective October 2013 to October 2015 and Monroe's between October 2015 and October 2016. In 2016, a property owner sued the insured for breach of contract and negligence for alleged damage to the owner's property. The petition alleged the owner contracted with the insured in 2014 to drill a commercial irrigation well and that the insured had improperly drilled the well. The owner alleged, among other things, that the insured caused the drilling bit to be stuck in the bore hole, rendering the well practically useless and damaging the land. The petition, however, was silent on when this damage allegedly occurred or was discovered.

Related People

Kelly E. Almeter
Jason B. Heep
Xakema L. Henderson
Matt Schroeder
Elliot Strader

Related Work

Litigation

Related Offices

Dallas

The insured demanded a defense from BITCO and Monroe. BITCO agreed to defend subject to a reservation of rights. Monroe, however, refused to defend, arguing any property damage occurred before its policy incepted in October 2015. As is typical in CGL policies, coverage turned on the property damage occurring during the policy period and the insured not having knowledge of the damage before the policy's inception. BITCO sued Monroe in federal district court, seeking a declaration that Monroe had a defense obligation to their mutual insured. BITCO and Monroe stipulated that the insured's drill bit stuck in the bore hole in or around November 2014, about 10 months before the Monroe policy's inception. The insurers filed cross-motions for summary judgment on the duty to defend, with Monroe's motion premised on the admissibility of the extrinsic stipulation.

Under the eight-corners rule, an insurer's duty to defend is analyzed by comparing only the allegations in the claimant's petition and the applicable policy provisions without regard to the truth or falsity of the allegations or facts otherwise known or developed in litigation. The district court disagreed with Monroe and did not consider the extrinsic evidence. The court held Monroe had a defense obligation because the property damage could have occurred any time between 2014, when the drilling contract was executed, and 2016, when the property owner sued. On appeal, the United States Court of Appeals for the Fifth Circuit certified questions to the Texas Supreme Court, seeking clarity on whether Texas law permitted an exception to the eight-corners rule and allowed the consideration of extrinsic evidence in certain circumstances.

The Texas Supreme Court said it did and refined the Fifth Circuit's test in in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), which permitted extrinsic evidence to be considered but only to determine "fundamental" coverage issues. The supreme court reiterated the eight-corners rule

remains the initial test to determine whether a defense obligation exists. But if the petition states a claim that could trigger the duty to defend, and if application of the eight-corners rule is not determinative of whether coverage exists because of a gap in the plaintiff's pleading, the supreme court held Texas law permits consideration of extrinsic evidence when the evidence:

- goes solely to an issue of coverage and does not overlap with the merits of liability;
- does not contradict facts alleged in the pleading; and
- conclusively establishes the coverage fact to be proved.

Unlike in *Northfield*, the Texas Supreme Court's threshold inquiry in applying the exception is whether the operative pleading contains facts necessary to *resolve* the coverage question, as opposed to whether coverage is *potentially* implicated. Further, the supreme court clarified that extrinsic evidence is not limited to "fundamental" coverage issues. Instead, extrinsic evidence can be considered so long as it conclusively establishes the coverage fact at issue.

Even though the Texas Supreme Court recognized a limited exception to the eight-corners rule, the supreme court held the exception did not apply here, so the stipulation could not be considered in evaluating Monroe's duty to defend. Monroe could not satisfy the first prong of the analysis 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 invoke coverage, when its position may very well be that no damage was sustained at all."

Monroe provides insurers with the long-sought clarification that courts applying Texas law can consider extrinsic evidence in some circumstances.

That said, *Monroe* exemplifies just how narrow the exception is.[1] While the Texas Supreme Court provided much needed clarity on whether parties may consider extrinsic evidence in determining the duty to defend and a test to make that determination, the devil will be in the detailed application of the new test. Duty-to-defend disputes will now likely shift to whether the extrinsic evidences goes solely to an issue of coverage, contradicts the allegations within the operative pleading, or conclusively establishes the coverage fact.

[1] The Texas Supreme Court analyzed the eight-corners rule exception explained in *Monroe* in *Pharr-San Juan-Alamo I.S.D. v. Texas Political Subdivisions Prop./Cas. Joint Self Ins. Fund*, No. 20-0033, slip op. (Tex. Feb. 11, 2022), *available at* https://www.txcourts.gov/media/1453573/200033.pdf, but did not apply the exception because there was no "gap" in the pleading.
