

Opinion delivered February 11, 2022

TEXAS SUPREME COURT EXPRESSLY APPROVES THE PRACTICE OF CONSIDERING EXTRINSIC EVIDENCE IN DETERMINING THE DUTY TO DEFEND

Background

The eight-corners namesake is derived from the rule that under many common duty-to-defend clauses, only the petition and the policy are relevant to the initial inquiry into whether a claim fits within a policy's coverage.

Facts and Underlying Lawsuit

In *Monroe v. BITCO*, the Supreme Court of Texas refined the rule regarding the use of extrinsic evidence to determine an insurer's duty to defend. In 2014, David Jones d/b/a J & B Farms of Texas ("Jones") contracted with 5D Drilling & Pump Service, Inc. ("5D") to drill a commercial well on his farmland. 5D was insured under two consecutive one-year commercial general liability ("CGL") policies through BITCO General Insurance Corporation ("BITCO") (2013-2015), and by another one-year CGL policy through Monroe Guaranty Insurance Co. ("Monroe") (2015-2016).

In 2016, Jones filed suit against 5D for breach of contract and negligence and sought damages resulting from 5D's drilling operations. Jones alleged 5D drilled the well in a way that "deviates in an unacceptable fashion." Furthermore, Jones alleged that 5D "stuck" the drilling bit in the bore hole, rendering the well practically useless for its intended/contracted for purpose," and "failed and refused to plug the well, retrieve the drill bit, and drill a new well." Jones' pleading asserted different allegations to support the negligence claim, but was silent as to when 5D began or stopped the work on Jones' farmland, or when the purportedly negligent acts occurred.

Details

5D demanded a defense from both insurers, and BITCO defended 5D under a reservation of rights. Although Monroe acknowledged the 5D policy requires Monroe to "pay those sums that the insured becomes legally obligated to pay as damages because of . . . 'property damage,'" it refused to defend. Monroe contended that the policy limits the scope of the duty to defend to cover property damage only if it "occurs during the policy period," and that coverage applies only if, "[p]rior to the policy period, no insured . . . knew that the . . . 'property damage' had occurred, in whole or in part."

Declaratory Judgment

BITCO filed suit against Monroe in The United States District Court for the **Western District of Texas—San Antonio** seeking a declaration that Monroe also owed a defense to 5D. BITCO and Monroe stipulated that 5D's drill bit became stuck "in or around November 2014." Monroe argued that the stipulation proved that property damage occurred during BITCO's policy period. Thus, Monroe's policy deemed all property damage to have been known during BITCO's policy period.

In applying the "eight-corners" rule, the Western District determined it could not consider the stipulated extrinsic evidence of when the drill bit stuck. The court decided the property

damage could have occurred anytime between contract formation in 2014 and Jones' lawsuit in 2016, i.e., during either or both insurers' policy periods.

On Monroe's appeal, the **United States Court of Appeals** for the **Fifth Circuit** concluded that the question whether the court could consider the stipulated extrinsic evidence was key to deciding the case. Finding no controlling Texas law, the Fifth Circuit certified two questions:

- 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; and,
- Is the date of an occurrence the type of extrinsic evidence that may be considered when the requirements are satisfied?

Use of Extrinsic Evidence

Under Texas law, the insurer's duty to defend is determined by comparing the allegations in the plaintiff's petition to the policy provisions, without regard to the truth or falsity of those allegations and without reference to facts otherwise known or ultimately proven. While the eight-corners rule is a well-settled rule, the Texas Supreme Court confirmed it is not absolute.

Citing to cases highlighting the practice of evaluating extrinsic evidence, the Texas Supreme Court acknowledged the principles governing when, and what, extrinsic evidence could be considered have not been uniform. In *Northfield*, the Fifth Circuit articulated a detailed standard and opined that if the Texas Supreme Court were to recognize 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."

Through *Monroe*, the Texas Supreme Court expressly approved the practice of considering extrinsic evidence. Further, the Texas Supreme Court states it does not abandon the eight-corners rule as the initial inquiry on a duty to defend given, in most cases, it will resolve coverage determinations. However, where the underlying petition states a claim that could trigger the duty to defend but, after an eight-corners analysis, a gap in the 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.

Refinement of the Prior Standard

This newly articulated standard refines *Northfield*, which approves of extrinsic evidence only if it is initially impossible to determine from the pleadings and policy "whether coverage is potentially implicated." The Texas Supreme Court held this standard invites courts to do what Texas authorities prohibit: "read facts into the pleadings" or "imagine factual scenarios which might trigger coverage." Thus, the new standard provides a better threshold inquiry and asks whether the pleading contain the facts necessary to resolve the question of whether the claim is covered.

The second refinement address the types of extrinsic evidence that may be considered. *Northfield* required that the extrinsic evidence addresses a "fundamental" coverage issue, i.e., whether a defendant has been excluded by name or description, or whether the property

in suit is included or expressly excluded from coverage. In Monroe, BITCO argued that if extrinsic evidence is allowed, it should be limited accordingly. Monroe responded that the Northfield list is not exhaustive and that the date of loss is also fundamental to determining coverage. Rather than task courts with determining which coverage issues are or are not fundamental, the Texas Supreme Court responded to the Fifth Circuit's questions by eliminating this requirement altogether.

Unlike Northfield, Texas law requires that the extrinsic evidence conclusively establish the coverage fact at issue. The coverage fact need not be the subject of a stipulation and other forms of proof 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.

Summary

The Texas Supreme Court reiterated there is no categorical prohibition against extrinsic evidence of the date of an occurrence, but ultimately opined that Monroe and BITGO's stipulation could not be considered. In cases involving allegations of continuing damage, evidence of the date of property damage may overlap with the merits, given a dispute regarding when the damage occurred implicates whether damage occurred. This potentially forces an insured to confess damages at a particular date to gain coverage, when its position may be that no damage occurred.

Thus, to obtain coverage, 5D would have to argue that some of the damages occurred after 2014, which would undermine its liability defense, best served by asserting it did not cause any of the alleged damages. Because use of the stipulation in the manner proposed by Monroe would overlap with the merits of liability, it could not be considered in determining whether Monroe owed a duty to defend.

E.R. Hamilton has extensive experience litigating insurance coverage disputes such as preparing coverage opinions, seeking declaratory judgments in personal injury and contract matters, and filing summary judgments based on policy exclusions on behalf of his clients. He represents insurers in first-party lawsuits in Texas state and federal courts, and has handled a wide array of insurance-related matters.

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