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Beyond the Eight Corners: Use of Extrinsic Evidence to Determine the Duty to Defend

Standard liability policies, including commercial general liability, automobile, and homeowners policies, require the carrier to defend the insured in suits that allege facts within the policy's coverage provisions. The Texas Supreme Court has never addressed the question of whether evidence extrinsic to the underlying allegations against the insured can be considered in determining this duty to defend, but several Texas decisions have considered such evidence in declaratory judgment actions on coverage.³ A recent Fifth Circuit decision, *Northfield Insurance Co. v. Loving Home Care, Inc.*,⁴ predicts the Texas Supreme Court would reject any use of extrinsic evidence to determine the duty to defend and would adhere strictly to the so-called "eight corners" rule, which requires that the court consider only the facts alleged in the underlying suit against the insured and the provisions of the relevant insurance policy. In the alternative, however, the *Northfield* court recognized the Texas decisions that have considered certain types of extrinsic evidence in certain circumstances, and declined to consider extrinsic evidence that did not satisfy the conditions imposed by the prior cases. This latter approach comports more closely with decided Texas cases, including recent decisions from the U.S. Eastern District, *Westport Insurance Corp. v. Archley, Russell Waldrop and Hlavinka*,⁵ and the Fort Worth Court of Appeals, *Fielder Road Baptist Church v. Guideone Elite Insurance Co.*⁶

Because of its impact on insurance coverage litigation, this issue seems destined to be decided by the Texas Supreme Court, particularly in light of the predictions being made about what the Court will do. Prior to *Northfield*, *Westport*, and *Fielder Road*, a distinguished commentator on Texas insurance law urged the adoption of a rule that would permit the use of extrinsic evidence whenever the policyholder's defense in

underlying liability litigation would not be "prejudiced." See E. Pryor, "Mapping the Changing Boundaries of the Duty to Defend in Texas," 31 Tex. Tech L. Rev. 869, 890-897 (2000).⁷ Professor Pryor suggested the following rule: (1) with respect to extrinsic evidence that addresses facts relating solely to the insured's liability in the underlying case, the eight corners rule would always govern the duty to defend; (2) as to coverage-only extrinsic evidence, the carrier would be permitted to deny a duty to defend at the outset based on such evidence and the court would also be permitted to consider such evidence in a coverage action; and (3) with respect to "overlapping" extrinsic evidence, that is, evidence related to coverage facts as well as to the validity of the underlying claim, the eight-corners rule would govern the carrier's decision whether or not to defend at the outset, but in a declaratory judgment action on coverage, the court could consider the evidence if (and only if) "the insurer can establish that it will not pose any substantial risk of disadvantaging the insured in the underlying case." *Id.*

After reviewing the development of the eight corners rule and the recent decisions addressing the use of extrinsic evidence, including *Northfield*, *Westport*, and *Fielder Road*, we conclude that Texas law supports, and the Supreme Court should adopt, a narrow exception to the "eight corners" rule incorporating the first two prongs of the rule suggested by Professor Pryor. Such an exception will serve the interests of judicial economy, fairness and justice implicated by the eight corners rule, as well as those market interests discussed by Professor Pryor. See E. Pryor, 31 Tex. Tech L. Rev. at 890-897. However, we conclude that the Texas Supreme Court is unlikely to adopt a rule that permits consideration of extrinsic evidence relating to "overlapping" facts. Limiting the exception to coverage-only facts has all the advantages of simplicity

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and avoids the complexities inherent in proving, during coverage litigation, that certain facts will cause prejudice to the insured in the underlying litigation.

A. THE EIGHT CORNERS DOCTRINE AND ITS RATIONALE

The virtually universal rule, known in Texas as the "eight corners" or "complaint allegation" rule, provides that "[a]n insurer's duty to defend is determined solely by allegations in the pleadings and the language of the insurance policy." *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex.2002). See generally Annotation, *Allegations in Third Person's Action Against Insured as Determining Liability Insurer's Duty to Defend*, 50 A.L.R.2d 458 (1956). The rule derives from standard liability policy language creating the duty to defend, which provides, in at least one version, that the carrier will "have the right and duty to defend" any suit seeking covered damages "even if the allegations of the suit are groundless, false or fraudulent." See, e.g., *Maryland Cas. Co. v. Moritz*, 138 S.W.2d 1095, 1097 (Tex. Civ. App.—Austin 1940, writ refused) (where the policy binds the carrier to defend suits, even if groundless, false or fraudulent, the insurer's duty to defend depends upon the allegations of the plaintiff's petition).

The Supreme Court originally adopted the "eight-corners" rule in the course of rejecting a claim by the carrier that the insured's underlying liability to the injured party had to be determined by a trial on the merits before the carrier's duty to defend could be determined. *Heyden Newport Chem Co. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965). The Court disagreed with that proposition and held:

We think that in determining the duty of a liability insurance company to defend a lawsuit the allegations of the complainant should be considered in the light of the policy provisions 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.

Id. Thus, in adopting the "eight corners" approach, the Court rejected the proposition that the insured's liability to the injured party determines the duty to defend.⁸ The court did not reject the argument — and has never rejected the argument — that courts may look beyond the pleadings in limited circumstances to consider evidence that relates solely to coverage and does not touch upon the insured's underlying liability.

The court further refined the doctrine by observing that courts should interpret the underlying pleadings liberally and

"[w]here the complaint does not state facts sufficient to clearly bring the case within or without the coverage," to resolve doubts in favor of coverage. *Heyden Newport*, 387 S.W.2d at 26. More recently, the Court noted that this "liberal interpretation" approach has its limits. It does not allow a court to "read facts into pleadings" or "imagine factual scenarios which might trigger coverage." *National Union Fire Ins. Co. of Pittsburgh, PA v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997). That is, the pleadings must contain at least enough facts to "create that degree of doubt which compels resolution of the issue for the insured" before the issue of "liberal interpretation" even arises. *Id.* In Texas, moreover, the carrier has no duty to investigate whether there was a reasonable basis for denying coverage because, under the eight corners rule, the carrier "is entitled to rely solely on the factual allegations contained in the petition in conjunction with the terms of the policy to determine whether it has a duty to defend." *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997).

As a hedge against the requirement that pleadings be interpreted "liberally," the "eight corners" rule requires that courts look only to the facts alleged in the underlying petition, not to legal theories isolated from or in conflict with alleged facts. *Merchants Fast Motor Lines, Inc.*, 939 S.W.2d at 142. Thus, if the pleading alleges only intentional conduct, excluded by the policy, a legal allegation seeking relief under a negligence or gross negligence theory will not overcome the factual allegations that preclude coverage. *Farmers Texas County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82-83 (Tex.1997).

Why did the court adopt these rules? Why should the court and the parties be restricted to the allegations against the insured to determine the duty to defend regardless of their truth, when, by contrast, the actual underlying facts determine the duty to indemnify? In the first place, the use of the "groundless, false or fraudulent" language or its equivalent in standard policies requires erring on the side of coverage when there is doubt about the merits of the underlying claim. Nevertheless, some policies do not contain such language. Other considerations, however, justify the rule even in the absence of explicit policy language. One set of justifications stems from the preferences of both policyholder and insurer. For example, defendant policyholders will incur defense costs regardless of the validity of the suits against them, so it is reasonable for them to purchase "litigation" insurance to cover such costs. See, e.g., E. Pryor, "The Tort Liability Regime and the Duty to Defend," 58 Md. L. Rev. 1, 16 (1999). By the same token, an insurer with potential indemnity coverage on a claim may want to be involved in the conduct of such litigation, even if the suit is not meritorious. *Id.* at 15. Thus, the rule properly gives the policyholder the benefit of the doubt in terms of the merits of the suit.

But the eight corners doctrine also gives the policyholder the benefit of the doubt with respect to whether the allegations are within coverage. The "groundless, false or fraudulent" phrase does not refer to issues of coverage, only to the merits of the underlying suit. Justification for this facet of the rule rests, in part, on the nature of liberal pleading rules, as well as on concerns for efficiency. For example, most jurisdictions permit notice pleading and do not require the injured plaintiff to allege every material fact with specificity, thus leaving unstated many facts that may affect liability coverage. Cf. *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 452-53 (Tex. App.—Corpus Christi 1992, writ denied) (noting that state petitions may be broadly drafted with little detail and may not include sufficient facts to consider the applicability of a particular exclusion). The uncertainty relating to coverage facts, as well as fairness and economies of scale, favor insurer defense until the true facts are known. Depriving the insured of such protection would severely reduce the value of defense coverage under liberal pleading rules.

A further rationale for resolving doubt in favor of coverage is efficiency: if the duty to defend depended, from the beginning, on the actual facts, insurer and policyholder alike would have to either wait until the underlying case is fully litigated to determine whether the insurer owes a defense, or they would have to litigate the merits of certain aspects of the underlying action in a parallel declaratory judgment suit. The expense and inefficiency of forcing the insurer and the insured to litigate the underlying merits to determine defense obligations - at the same time that some of the same facts are being litigated in the underlying liability suit - would unnecessarily burden the justice system and undermine the purpose of liability insurance. Further, the carrier may not always have the same incentive to present the merits of the suit as the injured party. Finally, concerns for efficiency favor a "bright line" rule; at some point a court must decide the duty to defend without trying the underlying liability case. Thus, when in doubt about coverage, the insurer generally must defend.

Texas courts have nevertheless departed from the eight corners rule to consider extrinsic evidence in a narrow range of cases. Although every opinion approving the use of extrinsic evidence does not explicitly discuss the policies outlined above, admission of extrinsic evidence is justified in cases in which the facts remove the policy concerns that would otherwise require adherence to the eight corners rule.

B. POTENTIAL EXCEPTIONS TO THE "EIGHT CORNERS" RULE.

The cases that recognize the admissibility of extrinsic evidence tend to agree on the following criteria: (1) the evidence must pertain to coverage, not to the insured's underlying liability to the injured party; (2) the evidence must not contradict factual allegations of the petition (this includes the principle that the underlying petition must not allege facts sufficient to determine application of an exclusion or other coverage fact); and (3) the evidence must be readily ascertainable from objective proof. The three most recent extrinsic evidence decisions, more or less following Judge Folsom's exhaustive review of the cases in *Westport*, formulate the exception in a similar way. See *Felder Road Baptist Church v. Guideone Elite Ins. Co.*, 2004 WL 1119494, slip op. at *2 (Tex. App.—Fort Worth May 20, 2004, no pet.); *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004); *Westport Ins. Corp. v. Atchley, Russell Waldrop and Hlavinka*, 267 F.Supp.2d 601, 621 (E.D. Tex. 2003). See also *Tri-Coastal Contractors, Inc. v. Hartford Underwriters Ins. Co.*, 981 S.W.2d 861, 863 n.1 (Tex.App.—Houston [1st Dist.] 1998, pet. denied).

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As noted above, *Northfield* noted the limited extrinsic evidence exceptions, despite its prediction that the Texas Supreme Court would not recognize any exception to the eight corners rule. *Northfield*, 363 F.3d at 531. The court held that if the Supreme Court adopted an exception to the eight corners rule, it "would only apply in very limited circumstances: 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.* (emphasis in original). As the following discussion makes clear, this statement is in line with other Texas cases that recognize the admissibility of extrinsic evidence. In fact, the holding in *Northfield*, on its facts, fits comfortably within the framework set forth by earlier cases, as do the results in both *Westport* and *Felder Road*.

As currently formulated, the extrinsic evidence exception may require the proponent to meet all or a combination of the following conditions. Although the Texas cases recognizing an exception for extrinsic evidence impose several conditions on admissibility, only two of those conditions - the requirement that the evidence relate only to coverage facts, not to liability facts, and the requirement that the evidence be readily ascer-

tainable from objective facts - comport with underlying policy considerations.

1. The underlying petition does not allege facts sufficient to determine coverage. The evidence does not contradict the facts alleged in the petition.

These two statements are aspects of the same rule: if the extrinsic evidence supplies a fact missing from the petition, the evidence will not contradict the facts that are alleged. In *State Farm Fire & Cas. Co. v. Wade*, the leading Texas case on this issue, the court permitted the use of extrinsic evidence, in a declaratory judgment action on coverage, to show that a business pursuits exclusion in a private boat-owners policy applied to an accident resulting in the drowning of the underlying plaintiff. 827 S.W.2d 448, 451-52 (Tex. App.-Corpus Christi 1992, writ denied). The exclusion precluded coverage for accidents involving paying passengers on the boat or other business pursuits. *Id.* at 451. The underlying plaintiff was a passenger on the boat, but the underlying petition did not allege facts indicating whether he was a paying passenger, and the court decided extrinsic evidence was admissible because of these factual gaps in the petition. *Id.* The court held that if "the petition... does not allege facts sufficient for a determination of whether those facts, even if true, are covered by the policy, the evidence adduced at trial in a declaratory judgment action may be considered along with the allegations in the underlying petition." *Id.*

Several other decisions cite this non-contradiction principle. Two Texas cases admitted extrinsic evidence because it did not contradict the petition. See *Western Heritage Ins. Co. v. River Entertainment*, 998 F.2d 311, 313-15 (5th Cir.1993) (allowing extrinsic evidence of intoxication of the insured's "guest" to show a liquor liability exclusion applied where petition did not allege how the guest/driver became incapacitated); *Acceptance Ins. Co. v. Hood*, 895 F. Supp. 131, 134 n. 1 (E.D. Tex. 1995) (considering extrinsic evidence to show employee exclusion applied). Most of the cases that cite this principle, however, preclude admission of extrinsic evidence because it relates to liability facts and/or contradicts the underlying petition. E.g., *Felder Road Baptist Church v. Guideone Elite Ins. Co.*, 2004 WL 1119494, slip op. at *2 (declining to consider extrinsic evidence because it pertained to liability as well as coverage); *Gonzales v. American States Ins. Co.*, 628 S.W.2d 184, 186-87 (same); *City of Dallas v. Csaszar*, 1999 WL 1268076, slip op. at * 3 n.2 (Tex. App.-Dallas Dec. 30, 1999, pet. denied) (declining to consider extrinsic evidence because the petition alleged sufficient facts to determine whether police officers were acting within the scope of their employment); *Calderon v. Mid-Century Ins. Co.*, 1998 WL 898471, slip op. at *3-4 (Tex.App.—Austin Dec. 29, 1998, pet. denied) (not designated for publication)

(holding extrinsic evidence relating solely to a coverage fact – whether driver was an insured – was not admissible because it contradicted the facts alleged); *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d at 529 (declining to consider extrinsic evidence).

Finally, one federal case appears to violate this rule, permitting extrinsic evidence that contradicted conclusory allegations in the petition. *Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 194 (5th Cir. 1998) (permitting extrinsic evidence that release was not within "sudden and accidental" exception to pollution exclusion, even though the petition alleged conclusory that release of pollutants was "sudden and accidental").¹⁰

In our view, *Wade's* stated rationale for considering extrinsic evidence – that it was impossible to discern from the petition whether the exclusion applied – is troublesome and difficult to apply. A comparison of *Wade* and *Heyden Newport* illustrates the problem. The *Wade* court distinguished *Heyden Newport* on the ground that, in that case, "the court was able to discern, without addressing the truth or falsity of the allegations and by broadly construing the alleged facts in the plaintiff's petition, whether the claim potentially came within the coverage of the insurance policy." *Wade*, 827 S.W.2d at 452. In *Wade*, on the other hand, the court said that it was "impossible to determine whether or not there is coverage under the private boat-owner's policy" without "addressing the truth or falsity of the allegations in the underlying petition," because it was "impossible to know how the boat was used when it left the... dock." *Id.* at 453.¹¹

This observation does not distinguish the cases meaningfully. The issue in *Heyden Newport* was whether the insured/owner of a vehicle involved in an accident was an agent of Heyden Newport, thus entitling Heyden Newport to a defense under the owner's auto policy, pursuant to the policy definition of the term "insured." *Heyden Newport*, 387 S.W.2d at 23-24. The underlying petition asserted that the owner was in fact an agent, but Heyden Newport had informed the insurer that the owner of the vehicle was not its agent. *Heyden Newport*, 387 S.W.2d at 24. Thus, the allegations alleged facts within the policy definition of the term "insured." *Id.* The petition in *Wade*, like the petition in *Heyden Newport*, alleged only facts covered by the policy; there was no allegation in *Wade* that the boat was being used in a business pursuit at the time of the accident. *Wade's* notion that the inconclusiveness of the petition should permit extrinsic evidence, does not really hold water. Under a strict application of the "eight corners" rule, if the petition alleges only facts within coverage, the benefit of the doubt favors coverage for the insured and requires the court to find that the exclusion does not apply for purposes of the duty to defend. *Heyden Newport*, 387 S.W.2d at 26.

This is the flip side of the rule that if the petition alleges only facts that are excluded, the exclusion does apply. *Fid. & Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex.1982). In *Wade*, the petition probably did raise "that degree of doubt which compels resolution... for the insured." See *Merchants Fast Motor Lines*, 939 S.W.2d at 142. Cf. E. Pryor, 31 Tex. Tech L. Rev. at 880 (observing that the *Wade* approach "is both too restrictive and too broad"). As in *Wade*, the courts' attempts to explain decided cases on this basis are often quite unconvincing. See *Northfield*, 363 F.3d at 531 n. 3.

The real key to the distinction between *Wade* and *Heyden Newport*, and the rationale that explains prior cases more convincingly, is the nature of the facts developed by extrinsic evidence. For example, in *Heyden Newport*, the facts about agency affected the underlying liability of Heyden Newport for the injuries in the accident.¹² In *Wade*, however, whether or not the passenger paid for the boat trip that resulted in his death would not affect the underlying liability of the boat owner; it had an impact only on coverage. The key question is whether the extrinsic facts relate to coverage, or liability or both. As discussed more thoroughly below (and as discussed at length in Professor Pryor's article), this rationale makes sense in terms of underlying policy and justifies the different results in *Wade* and *Heyden Newport*, as well as other cases. Cf. E. Pryor, 31 Tex. Tech L. Rev. at 890-897 (suggesting that the extrinsic evidence admissibility depends on whether the evidence affects underlying liability).

2. The extrinsic evidence must relate solely to a coverage fact, not to a fact bearing on the insured's underlying liability.

Beginning with *Heyden Newport*, Texas courts have distinguished between extrinsic evidence that relates solely to the insured's underlying liability, which is inadmissible to show a duty to defend, and extrinsic evidence that relates solely to fundamental coverage facts, which is admissible on the duty to defend. Of course, there is a third category in addition to coverage-only evidence and liability-only evidence, namely, "overlapping" evidence that relates both to coverage and liability. Although Texas courts are not consistent in identifying the type of evidence at issue, they generally are consistent in holding such overlapping extrinsic evidence inadmissible.¹³

Cook v. Ohio Casualty Insurance Co., 418 S.W.2d 712, 714 (Tex. Civ. App.-Texarkana 1967, no writ), decided soon after *Heyden Newport*, relied on the distinction between coverage evidence and liability evidence. The court considered extrinsic evidence to show that an exclusion – for damages incurred while the insured was operating a vehicle owned by a relative in the household – applied to preclude coverage. *Id.*

Comparing its holding with that in *Heyden Newport*, the court stated:

[T]he Supreme Court draws a distinction between cases in which the merits of the claim is the issue and those where the coverage of the insurance policy is in question. In the first instance the allegation of the petition controls, and in the second the known or ascertainable facts are to be allowed to prevail.

Id. at 715-16.

Most of the cases resting on this distinction, including the recent decisions in *Fielder Road* and *Westport*, exclude extrinsic evidence because it relates to underlying liability.¹⁴ The recent decision in *Northfield Insurance Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 529 (5th Cir. 2004), also fits this description. In *Northfield*, the insured, Loving Home Care ("LHC") was sued by one of its clients when a child died while under the care of a nanny provided by LHC. *Id.* at 525-526. The injuries included skull fractures and brain hemorrhages, the coroner ruled the death a homicide, and a jury found the nanny guilty of first-degree felony injury to a child and sentenced her to seven years in prison. *Id.* The petition filed by the child's parents against LHC alleged the injuries resulted from negligence, including negligent dropping and/or shaking of the child, and, in the alternative, reckless conduct and/or criminal negligence. *Id.* at 526. The latest petition had been amended to remove all allegations relating to the nanny's criminal conviction and the intentional nature of her behavior. *Id.*

LHC sought a defense under a CGL policy issued to LHC by Northfield, and Northfield defended under a reservation of rights and filed a declaratory judgment action to determine the duty to defend. *Id.* at 527. Northfield opposed coverage, in part, because of two exclusions relating to "criminal acts" and "physical/sexual abuse," and sought to introduce extrinsic evidence that the child's death resulted from "criminal acts" and/or physical abuse. *Id.* at 532. After a lengthy discussion of the Texas cases on extrinsic evidence, and its prediction that the Supreme Court would recognize no exceptions to the eight corners rule, the Fifth Circuit ultimately held that the evidence was inadmissible because it overlapped with the merits of the underlying suit. *Id.* at 535. Thus, notwithstanding the opinion's dicta, the holding is a non-controversial application of the oldest rule in the "eight corners" book: in determining the duty to defend, the courts cannot look outside the pleadings to decide issues relating to the merits of the underlying claim. See *Heyden Newport*, 387 S.W.2d at 24.

The decisions in *Westport* and *Fielder Road* also recognized limited exceptions to the strict eight corners rule. The

opinion in *Westport* stated that prior cases admitted extrinsic evidence only as to certain types of coverage facts, namely "fundamental coverage issues" which "include" the following: "(1) whether a person has been excluded by name or description from any coverage; (2) whether the property in suit has been expressly excluded from any coverage; and (3) whether the policy exists." *Westport Ins. Corp. v. Atchley, Russell Waldrop and Hlavinka*, 267 F.Supp.2d 601, 621 (E.D. Tex. 2003). See also *Fielder Road*, 2004 WL 1119494, slip op. at *2 (outlining three similar exceptions); *Tri-Coastal Contractors, Inc.*, 981 S.W.2d at 863 n.1 (same).¹⁵ Whether these courts intended to limit extrinsic evidence to only these types of coverage facts is not clear.¹⁶ The *Westport* opinion itself is not helpful on this question because it does not describe the nature of the extrinsic evidence. 267 F. Supp.2d at 622. As noted above, the extrinsic facts in both *Fielder Road* and *Tri-Coastal* related to underlying liability, as well as to coverage. As discussed below, there is no good reason to limit extrinsic evidence of coverage to certain types of coverage facts because the policy concerns are the same whether the coverage fact relates to the definition of the insured, the application of a condition, or the application of an exclusion.

3. The evidence must relate to a readily ascertainable fact.

Texas courts often state that extrinsic evidence relating to a "fundamental coverage issue must be capable of being determined by a readily ascertained fact." *Fielder Road*, 2004 WL 1119494, slip op. at *2. See also *Westport*, 267 F.Supp.2d at 621; *Tri-Coastal*, 981 S.W.2d at 863.¹⁷ In most cases that permit consideration of extrinsic evidence, the evidence refers to a simple fact that is objectively determinable by explicit documentary or other direct evidence or from the parties' stipulations. E.g., *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d at 715-16 (ownership of vehicle determined applicability of exclusion); *International Service Ins. Co. v. Boll*, 392 S.W.2d at 161 (name of driver of vehicle); *John Deere Ins. Co. v. Truckin' U.S.A.*, 122 F.3d at 272-73, (whether vehicle was insured was readily determined by looking to the its title certificate); *Western Heritage Ins. Co. v. River Entertainment*, 998 F.2d 311, 313-15 (5th Cir.1993) (considering a stipulation by the parties that the insured was intoxicated at the time of the accident). Nevertheless, the decisions do not always follow this requirement: some of the cases consider extrinsic evidence that is inherently uncertain or subjective. *Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192, 194 (5th Cir. 1998) (admitting extrinsic evidence of pollution discharges,

spills and other events to show whether pollutant release was "sudden and accidental"); *Acceptance Ins. Co. v. Hood*, 895 F. Supp. 131, 134 n. 1 (E.D. Tex. 1995) (considering extrinsic evidence of whether employee was acting within the scope of his employment). As discussed below, we believe this criterion is a justifiable limit on the use of extrinsic evidence.

C. POLICY AND RECOMMENDATION

The acceptable contours of an extrinsic evidence exception should track the rationale for the eight corners doctrine itself, as long as this results in a rule that is relatively easy to apply. As discussed above, the salient rationales for relying on the underlying petition alone include the following: (1) the need for a "bright line" rule so insurers can make timely decisions about the defense of insureds; (2) the uncertainty created by liberal pleading rules favors erring on the side of coverage in cases of doubt; (3) concerns for efficiency and conservation of resources favor avoiding (re)litigation of underlying liability in the coverage action; and (4) issues of fairness and unequal resources favor giving the insured the benefit of the doubt.

In certain cases, however, the rationales for giving the insured the benefit of the doubt evaporate well before the underlying claim has reached finality. This occurs, first and foremost, when the facts alleged in the petition clearly preclude coverage. In such cases, Texas courts have had no trouble concluding that the carrier has no duty to defend; they even relieve the insurer of the duty to indemnify in such cases, if the same

facts that preclude defense also preclude coverage entirely. See *Farmers Texas County Mutual Insurance Co. v. Griffin*, 955 S.W.2d 81, 83 (Tex. 1997). But see E. Pryor, 31 Tex. Tech. L. Rev. at 886-890 (criticizing *Griffin's* approach). When there is no uncertainty about the lack of coverage, there is no danger of excessive or duplicative litigation, and the insurer's command of greater resources does not create any danger of overreaching. When there is no meaningful coverage dispute, the rationale favors deciding coverage immediately rather than later.

A second situation also justifies relaxation of the eight corners rule: when a readily ascertainable fact, known to the carrier or the policyholder, but not alleged in the underlying suit and not related to the insured's liability, clearly affects coverage. When an objective extrinsic fact relates solely to coverage, there is no reason to give the insured the "benefit of the

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doubt," or to err on the side of coverage, and courts should consider such evidence in coverage litigation whether it precludes coverage or triggers it. Consideration of extrinsic evidence in these circumstances violates no policy consideration inhering in the eight corners rule and promotes other policies that the legal system values: fairness and efficiency. In such cases, the public interest in avoiding the perpetration of fraud on the courts,¹⁸ reducing waste of resources, and mitigating the impact of artful pleadings that misrepresent the true nature of the suit,¹⁹ overcomes any remaining interest in erring on the side of coverage. As long as courts limit the exception to "readily ascertainable" facts derived from objective evidence, these policy considerations will be well-served. Of course, the extrinsic evidence must preclude any potential for coverage, just as the allegations of the complaint must do under eight corners analysis.²⁰

Our approach agrees with Professor Pryor's recommendation, with one exception. Professor Pryor thinks carriers should be permitted to use "overlapping" extrinsic evidence (which pertains to underlying liability as well as coverage), if they can show the evidence will not prejudice the insured's defense in the underlying suit. See E. Pryor, 31 Tex. Tech L. Rev. at 891, 895-896. This proposal is one we believe the Texas Supreme Court is unlikely to adopt for several reasons. Although this rule would comport with some underlying policy considerations, it is difficult to apply and defeats a bright line approach. Cf. E. Pryor, 31 Tex. Tech. L. Rev. at 895 n. 189 (noting that the

courts should not allow the insurer, at the outset of the claim, to base its initial denial of coverage on overlapping extrinsic evidence because the standard "is not sufficiently bright around the edges" to govern at the outset). In any given coverage suit, it will be difficult to foresee the effects on the liability suit of permitting discovery and jury consideration of liability-related facts. As a practical matter, coverage courts will inevitably disagree with each other on the perceived impacts of certain types of evidence in similar cases. Such inconsistencies in the decisions will only aggravate the difficulties inherent in trying to predict prejudicial impacts. On balance, we believe fairness, simplicity, judicial economy and other factors weigh in favor of limiting the extrinsic evidence exception to coverage-only facts.

The exception we propose also has the advantage of avoiding the difficulties that inhere in the "insufficient pleadings" analysis, which was initiated by *Wade* and has been con-

fusing courts ever since, as recently as the *Northfield* case. In *Northfield*, the Fifth Circuit panel attempted to distinguish two prior Fifth Circuit decisions that permitted the use of extrinsic evidence. See *Northfield*, 363 F.3d at 531, n.3. For example, the court attempted to distinguish *Western Heritage Insurance Co. v. River Entertainment*, 998 F.2d 311, 313-15 (5th Cir.1993), which had considered extrinsic evidence in holding that a liquor liability exclusion in a general liability policy precluded coverage although the underlying petition did not mention alcohol or intoxication. The *Northfield* court stated that the facts alleged in *Western Heritage* as to the restaurant's failure to prevent the patron from driving away or failure to call him a cab, 998 F.2d at 314, were clearly not sufficient to determine whether policy coverage for negligence was potentially implicated. Such alleged facts did not explain how the restaurant came to have any sort of duty regarding the patron. *Northfield*, 363 F.3d at 531, n. 3. However, in our view, the pleadings in *Western Heritage* were sufficient to trigger coverage for the restaurant's negligence; they were not, however, sufficient to determine whether the liquor liability exclusion applied. As we discussed above in connection with *Wade*, in cases of "pleading insufficiency" where the allegations do not clearly allege facts excluded by the policy, the insurer has a duty to defend.

Even so, the insurer in such a case would have no duty to defend if there was an ascertainable extrinsic fact, unrelated to underlying liability, that showed the exclusion applied. The court in *Western*

Heritage was unwilling, apparently, to find coverage when the parties had stipulated that the driver was intoxicated, despite the allegations of impairment in the underlying petition, which were carefully crafted. See *Western Heritage*, 998 F.2d at 313 (noting that the amended complaint had deleted all references to intoxication). The rule we propose would not change the result. The underlying suit in *Western Heritage* was one for simple negligence, the injured plaintiff having deleted causes of action for negligence in continuing to serve an intoxicated patron. *Id.* In their efforts to plead into coverage, the plaintiffs had, ironically, made intoxication irrelevant to liability. The reason for the impairment of the driver did not, therefore, influence underlying liability and the parties' stipulation about intoxication would have been admissible as a coverage-only fact. The proposed exception would avoid the specious "insufficient pleadings" language with a workable, simple and direct standard that would change the result in few, if any, cases.

★
...coverage courts
will inevitably disagree
with each other on
the perceived impacts
of certain types
of evidence in
similar cases.
★

Further, there is no reason to limit extrinsic evidence to certain types of coverage-only facts. As discussed above, several cases appear to limit extrinsic evidence to "fundamental" coverage facts such as whether the person or property involved in the relevant accident is insured.²¹ In fact, the Fifth Circuit panel that decided *Northfield* would have narrowed this condition further to preclude extrinsic evidence relating to applicability of any exclusion even if it does not relate to underlying liability. 363 F.3d at 535. These distinctions make little sense in terms of the underlying rationales. There is no reason to limit extrinsic evidence in this way because the policy concerns relating to efficiency, fairness and conservation of resources are the same whether the coverage fact relates to the definition of the insured, the application of a condition, or the application of an exclusion.

Finally, a narrow exception for the eight corners rule would not necessitate a corresponding expansion of the insurer's duty to investigate. Generally, speaking, Texas law does not impose on the carrier any duty to investigate the underlying suit in assessing its duty to defend. See, e.g., *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 821 (Tex. 1997) ("under the 'complaint allegation' rule an insurer is entitled to rely solely on the factual allegations contained in the petition in connection with the terms of the policy to determine whether it has a duty to defend."). The limited exception we advocate would not change the basis for this rule: because our exception works in favor of both insured and insurer, depending on the evidence, there is no inherent reason to impose any additional burden of investigation on the insurer.

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3. The leading case is *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 452-53 (Tex. App.-Corpus Christi 1992, writ denied). The Texas decisions that have actually agreed to consider extrinsic evidence in deciding the duty to defend are discussed throughout this article.

4. 363 F.3d 523, 531 (5th Cir. 2004).

5. 267 F.Supp.2d 601, 621 (E.D. Tex. 2003).

6. 2004 WL 1119494 (Tex. App.-Fort Worth May 20, 2004, no pet.)

7. Professor Pryor thoroughly discussed the important decisions on the use of extrinsic evidence, among many other significant duty to defend issues, and Texas practitioners would be well-served by reviewing the article. Professor Pryor has also discussed similar issues in a multi-jurisdictional survey of the duty to defend. See E. Pryor, *The Tort Liability Regime and the Duty to Defend*, 58 Md. L. Rev. 1, 31 (1999).

8. In adopting the rule, the court followed its "outright" refusal of writ in *Maryland Casualty Co. v. Moritz*, a case that also adopted the "eight corners" rule in the context of rejecting proof of facts relating to the insured's underlying liability. See *Maryland Casualty Co. v. Moritz*, 138 S.W.2d 1095, (Tex.Civ.App.-Austin 1940, writ ref'd).

9. The duty to indemnify, unlike the duty to defend, depends on the proven, adjudicated facts in the underlying suit. See *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 821 (Tex. 1997).

10. See also *Ohio Casualty Insurance Co. v. Cooper Machinery Corp.*, 817 F. Supp. 45, 48 (N.D. Tex. 1993) (McBryde, J., stating, in dicta, that the insurer is entitled to contest, in a declaratory judgment action, facts alleged in the underlying suit that relate to coverage); *McLaren v. Imperial Cas. and Indem. Co.*, 767 F. Supp. 1364, 1374 (N.D. Tex. 1991), *aff'd*, 961 F.2d 213 (5th Cir. 1992), *cert. denied*, 113 S. Ct. 1269 (1993) (McBryde, J., stating similar dicta); *Blue Ridge Ins. Co. v. Hanover Ins. Co.*, 748 F. Supp. 470, 473 (N.D. Tex. 1991) (same).

11. Because of the procedural posture of the case, however, the *Wade* court did not consider any particular extrinsic evidence. The trial court had granted the insured's special exceptions asserting that State Farm's petition for declaratory judgment "failed to set forth a cause of action for which relief may be granted." *Wade*, 827 S.W.2d at 450. The court of appeals merely reversed the dismissal and remanded for further proceedings. *Id.* at 453. The concurring justices would have held that the trial court was limited to examining the petition in deciding the duty to defend, but concurred that the dismissal of the entire declaratory judgment suit was erroneous. *Id.* at 454-455 (concurring opinion by Dorsey, J., joined by Hinojosa, J.).

12. This explains why the company denied the vehicle owner was its agent when that admission would preclude indemnity coverage for the company.

13. See, e.g., *Fiedler Road*, 2004 WL 1119494, slip op. at *2 (refusing to consider evidence relating to dates of employment of insured's employee who allegedly assaulted the underlying plaintiff); *Tri-Coastal Contractors, Inc.*, 981 S.W.2d at 863 n.1 (refusing to consider evidence relating to an employee's receipt of workers compensation benefits for purposes of an exclusion for workers compensation obligations in an employers liability policy); *Gonzales v. American States Ins. Co. of Texas*, 628 S.W.2d 184 (Tex. App.-Corpus Christi 1982, no writ) (refusing to consider evidence that showed the insured did not own a piece of equipment that injured the underlying plaintiff because it related to "liability rather than coverage."). Cf. E. Pryor, 31 Tex. Tech L. Rev. at 882 (pointing out that the evidence in *Gonzales* bore on both liability and coverage).

14. E.g., *Fiedler Rd. Baptist Church v. Guideone Elite Ins. Co.*, 2004 WL 1119494, slip op. at *2 (Tex. App.-Fort Worth May 20, 2004, no pet.) (refusing to consider extrinsic evidence that related to dates of employment of sexual assault perpetrator because it bore on the liability of the insured church that employed him); *Tri-Coastal Contractors, Inc. v. Hartford Underwriters Ins. Co.*, 981 S.W.2d 861, 863 n.1 (Tex.App.-Houston [1st Dist.] 1998, pet. denied) (refusing to consider extrinsic evidence relating to whether the insured collected workers compensation insurance because it went to the

merits of the underlying claim); *Gonzales v. American States Ins. Co. of Texas*, 628 S.W.2d 184 (Tex. App.—Corpus Christi 1982, no writ) (refusing to consider evidence that showed the insured did not own a piece of equipment that injured the underlying plaintiff because it related to “liability rather than coverage.”); *Gulf Chemical & Metallurgical Cor. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 371-72 (5th Cir. 1993) (refusing to consider insurer’s evidence that insured sued for shipping dangerous chemicals never shipped them until after the policy expired because the evidence bore on the insured’s liability vis-a-vis the other defendants); *Westport*, 267 F.Supp.2d at 621-22.

15. Cases illustrating admissibility of such evidence follow:

(1) whether a person has been excluded by name or description from any coverage. *See Int’l Serv. Ins. Co. v. Boll*, 392 S.W.2d 158, 161 (Tex. Civ. App.—Houston 1965, writ ref’d n.r.e.) (holding extrinsic evidence allowed to show person involved in accident was excluded from policy);

(2) whether the property in suit has been excluded from any coverage. *E.g. State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 452-53 (Tex. App.—Corpus Christi 1992, writ denied) (admitting extrinsic evidence to show that an exclusion for a boat carrying passengers in a boat-owners policy applied to an accident resulting in the drowning of the underlying plaintiff); *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712, 715-16 (Tex.Civ.App.—Texarkana 1967, no pet.) (holding extrinsic evidence allowed to show automobile involved in accident was excluded from coverage); *John Deere Insurance Co. v. Truckin’ U.S.A.*, 122 F.3d 270, 272-73 (5th Cir.1997) (considering extrinsic evidence to show whether the vehicle involved in an accident was a “covered auto” under an auto policy);

(3) whether the policy exists (no cases located); and

(4) a fourth category, not mentioned in *Westport*, might entail the question of whether a policy condition, such as the policy period condition, applies. *See Harken Exploration Co. v. Sphere Drake Ins. PLC*, 261 F.3d 466, 476 (5th Cir. 2001) (considering extrinsic evidence relating to application of the policy period condition, but holding the evidence indicated the condition did not apply to preclude coverage).

16. In fact, the Fifth Circuit panel that decided *Northfield* would narrow this condition further to preclude extrinsic evidence relating to applicability of any exclusion even if it does not relate to underlying liability. 363 F.3d at 535.

17. The phrase “readily determined fact” comes from *King v. Dallas Fire*, 85 S.W.3d 187, 189 (Tex. 2002), in which the court held that whether an assault was an occurrence within a CGL policy was to be viewed from perspective of the insured employer. The *King* court distinguished *Fidelity & Guaranty Insurance Underwriters, Inc. v. McMamus*, 633 S.W.2d 787 (Tex.1982), which had held that an exclusion for injuries caused by the “ownership, maintenance, operation, use, loading or unloading of a recre-

ational motor vehicle away from the residence” barred the insurer’s duty to defend a negligent entrustment claim, on the ground that, in *McMamus*, it was not necessary to consider the insured’s relationship to the event, because the exclusion was premised on a “readily determined” fact. *King*, 85 S.W.3d at 189.

18. *E.g. State Farm Fire and Cas. Co. v. Gandy*, 925 S.W.2d 696, 705 (Tex. 1996) (avoidance of “fraud on the court” by requiring actual trial).

19. *See, e.g. Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997) (a court must focus on the factual allegations rather than the legal theories asserted in reviewing the underlying petition).

20. *See, e.g. Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1159-60 (Cal. 1993) (noting that the “critical distinction” between admissible and inadmissible extrinsic evidence is whether it “presents undisputed facts which conclusively eliminate the potential for liability”); *Winnau Underwriters Ins. Co. v. Unigard Sec. Ins. Co.*, 80 Cal. Rptr. 2d 688, 689 (Cal. Ct. App. 1998) (declining to consider extrinsic documentary evidence because it did not rise to the level of “undisputed facts” necessary to satisfy the *Montrose Chemical* standard).

21. *See, e.g. Westport*, 267 F.Supp.2d at 621; *Fiehler Road*, 2004 WL 1119494, slip op. at *2; *Tri-Coastal Contractors, Inc.*, 981 S.W.2d at 863 n.1.

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