TRAUB LIEBERMAN

INSURANCE LAW BLOG

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# Texas Supreme Court Rejects "Policy-Language Exception" to "Eight-Corners" Rule

BY: Jason Taylor

On March 20, 2020, the Texas Supreme Court delivered its opinion addressing a question of Texas law certified from the United States Court of Appeals for the Fifth Circuit regarding application of the "eight-corners" rule to an insurer's duty to defend. Under the rule, an insurer's duty to defend is determined by the claims alleged in the petition and the coverage provided in the policy. The "four corners" of the petition and the "four corners" of the policy together comprise the "eight corners" that give the rule its name. Generally speaking, courts applying the eight-corners rule determine the insurer's duty to defend solely by the third-party plaintiff's pleadings, considered in light of the policy provisions, without regard to the truth or falsity of those allegations.

According to one federal district court applying Texas law, the eight-corners rule does not apply unless the policy includes language requiring the insurer to defend "all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent." *State Farm Lloyds v. Richards*, 2018 WL 2225084, at *3 (N.D. Tex. May 15, 2018). The Fifth Circuit asked whether the district court's "policy-language exception" to the eight-corners rule is "a permissible exception under Texas law." *Richards*, 784 F. App'x 247, 253 (5th Cir. 2019), certified question accepted (Sept. 13, 2019). As explained below, the Texas Supreme Court answered that it is not.

The underlying dispute concerned whether State Farm must defend its insureds, Janet and Melvin Richards, against personal injury claims brought by Amanda Meals. Ten-year-old Jayden Meals died in an ATV accident while under the supervision of his grandparents. Jayden's mother, Amanda, sued the grandparents (the Richards) alleging negligent failure to supervise and instruct Jayden. Plaintiff's petition alleged Jayden was under the defendant-grandparents' "supervision" and alleged the accident occurred "[o]n or near the Defendants' residence." The Richards asked their insurer, State Farm, to defend (and if necessary, indemnify) them. State Farm refused and sought a declaration in federal court that it had no duty to defend or indemnify. In doing so, State Farm argued two exclusions barred coverage and relied on extrinsic evidence.

The first exclusion, the "motor-vehicle exclusion," excluded coverage for bodily injury arising from the use of an ATV *while off an insured location*. Although the complaint was silent as to the location of the accident, State Farm attached a vehicle crash report showing that the accident occurred away from the Richards' premises, as well as the Richards' admissions that the accident occurred off an insured location. The other exclusion—the "insured exclusion"—excluded coverage for bodily injury to any insured, which includes "you" and "your" relatives *if residents of your household*. State Farm attached the Richards' admission that they were the boy's grandparents, as well as an order appointing them as joint-managing conservators in order to show that the boy was a "resident of [the Richards'] household." Again, the complaint was silent as to the boy's residency.

The parties filed cross summary-judgment motions. The Richards argued that under Texas's eight-corners rule, State Farm could not rely on extrinsic evidence to prove up a policy exclusion, and State Farm owed a duty to defend because the complaint was silent as to critical facts establishing application of either exclusion. The district court held that the eight-corners rule does not apply if a policy does not include language requiring the insurer to defend "all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent." According to the district court, because they did not include the "groundless, false or fraudulent" language, the policy did not define the duty to defend as broadly as those policies typically at issue in cases applying the eight-corners rule. The district court allowed consideration of State Farm's extrinsic evidence in finding no duty to defend.

The Fifth Circuit was not so sure. The Fifth Circuit panel observed that neither the Fifth Circuit nor any Texas court had previously taken the view of the eight-corners rule articulated by the district court. The panel further noted that the Fifth Circuit has consistently applied a different exception to the eight-corners rule, derived from *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004). The exception recognized in *Northfield* allows extrinsic evidence bearing on the duty to defend when (1) "it is initially impossible to discern whether coverage is potentially implicated" and (2) "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." *Richards*, 784 F. App'x at 251 (citing *Northfield Ins. Co.*, 363 F.3d at 531). Several Texas courts of appeal have adopted the Fifth Circuit's approach or something similar. Others have declined to follow the Fifth Circuit's approach. The Texas Supreme Court, however, has not had occasion to address the so-called "*Northfield* exception," although has twice acknowledged its widespread use. *See Zurich Am. Ins. Co. v. Nokia, Inc*., 268 S.W.3d 487, 497 (Tex. 2008); *GuideOne*, 197 S.W.3d at 308–09.

As courts often do, the Texas Supreme Court limited its decision to the narrow, specific question before it. The Fifth Circuit *did not* request the Texas Supreme Court's opinion on the *Northfield* exception, nor did the district court make its ruling on that basis. Instead, the Fifth Circuit asked only if the federal district court was correct in that the eight-corners rule is inapplicable unless the policy includes a "groundless-claims" clause. In construing this narrow question, the court reasoned that if an insurance policy contained language inconsistent with the eight-corners rule, the policy language would control. The question in *Richards*, however, was not whether parties *can* contract around the eight-corners rule. According to the Texas Supreme Court, they can. Rather the question in this case was whether these parties *have* contracted around it by declining to expressly agree that State Farm must defend claims "even if groundless, false or fraudulent." To this specific question, the answer was no.

The Texas Supreme Court found that the presence or absence of a groundless-claims clause has rarely, if ever, been important to Texas courts' analysis of the contractual duty to defend. Similarly, Texas courts routinely apply the eight-corners rule without looking for a groundless-claims clause. Given the consistency of Texas appellate decisions on this topic, the Texas Supreme Court reasoned that those who write insurance contracts know courts applying Texas law will employ the eight-corners rule, subject possibly to exceptions such as that found in the Fifth Circuit's *Northfield* decision. Therefore, "[w]e can safely presume their agreements are drafted in light of this understanding" and State Farm did not contract away the eight-corners rule altogether merely by omitting from its policy an express agreement to defend claims that are "groundless, false or fraudulent."

While the court ruled that the exception argued by State Farm did not apply, the court's holding is narrow. Interestingly, the Texas Supreme Court did not reject possible exceptions to the eight-corners rule under *Northfield* or similar decisions. In fact, the court seemed to recognize that these may be legitimate exceptions to the eight-corners rule. Instead of answering that question more broadly, however, the court refused to do so. As such, we are left with the patchwork of federal court decisions, dicta, and implicit recognition of possible exceptions to the eight-corners rule as guiding principles until such time that the Texas Supreme Court more conclusively addressed.