Duty to Defend: The Eight-Corners Rule And Extrinsic Evidence (Does the Wording of the Policy Change the Rules?)

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I. Source/s of the Duty to Defend—Do We Care and Why?

What is the source of the duty to defend? Is it the policy language? Does all or part of it exist independent of the policy language? Of course, the real question is whether we should care. We should. It directly affects how the policy is interpreted and could impact efforts by carriers to modify the policy language to eliminate what they consider to be liberal rules on determining defense.

If the duty to defend exists independent of the policy, then what triggers it? At the very least, one would have to have an insurance policy that requires the insurer to defend under specified circumstances. Clearly, some policies , such as excess policies and some D&O policies, do not have a traditional "duty" to defend. So, the true source begins with the policy.

If the policy requires a defense, then what is the source of the rules that govern how we determine whether there is a duty to defend? For example, consider some of the Texas rules for determining the duty to defend:

(1) The determination must focus on facts alleged, not mere theories.

(2) The duty exists regardless of whether the insured is actually guilty or not of the alleged misconduct. In other words, the duty exists even if the allegations are patently false or fraudulent.

(3) The duty exists if just one of multiple counts is potentially covered.

(4) A duty to defend one claim is a duty to defend all (the Three Musketeer Rule).

(5) The allegations must be liberally construed and just the potentiality a claim is covered is sufficient to invoke the duty. If in doubt, you must defend.

(6) The duty is determined by the eight corners of the policy and the underlying allegations. If the policy language says "allegations" control, then how can extrinsic evidence ever be allowed?

It is safe to say that these rules are typically not stated in so many words in the policies. As we will discuss, each seems to find some relationship with the policy through basic rules of construction of the duty to defend language.

II. Basic Examples of Past and Current Policy Language

A. Core CGL Language

1. 1973

The 1973 ISO general liability policy states:

> The company will agree to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
>
> --bodily injury
>
> --property damage
>
> ***to which this insurance applies***, caused by an occurrence. The company shall have the right and duty to defend any suit against the insured ***seeking damages on account of*** such bodily injury or property damage, even if ***any of the allegations of the suit are groundless, false or fraudulent.***..

(Emphasis added.)

2. 1996 and 2012 CGL

The 1996 and 2012 CGL insuring agreements state:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend against any ***"suit"*** ***seeking those damages***. However, we will have no duty to defend the insured against any ***"suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.***

(Emphasis added.) The false or fraudulent language is simply nowhere to be found. But, the policy definition of "suit" appears to at least incorporate a reference to "allegations." It states:

> "Suit" means a civil proceeding in which damages because of "bodily injury", "property damage", "personal injury" or "advertising injury" to which this insurance applies are ***alleged.***

D. MALECKI & A. FLITNER, COMMERCIAL GENERAL LIABILITY (6th ed. 1998) (emphasis added).[1] Does this alter the framework for determining the duty to defend from the 1973 policy language?

[1] The 2012 ISO CGL provides:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against ***any "suit" seeking those damages***. However, we will have no duty to defend the insured against any "suit" ***seeking damages*** for "bodily injury" or "property damage" to which ***this insurance does not apply***.

(CG 00 01 04 13 (emphasis added).) The policy form defines “suit” as follows:

B. Applying The Rules Of Construction To The Duty To Defend Language

1. Complaint Allegations?

According to some commentators, the rules for determining the duty to defend ostensibly are derived, or at least should be derived, from the terms of the policy itself. B. Duhoney, *The Liability Insurer's Duty to Defend*, 33 BAYLOR L. REV. 451, 452 (1981). The courts have generally concluded that the "factual allegations in the pleadings and the policy language determine an insurer's duty to defend." *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 821 (Tex. 1997). Thus, under the complaint allegation rule, the four-corners of the underlying petition or complaint and the four-corners of the policy represent the primary sources for determining the duty to defend. Of course, as we will discuss below, the case-law has been at times muddled as to whether and when evidence extrinsic to or outside the four corners of the underlying complaint or petition may be examined in determining if there is a duty to defend.

From both the 1973 and later CGL forms, it is clear that there must be a suit *seeking* damages to which the insurance applies. Suits seek only through allegations, not proof. Of course, all the policies actually reference the term "allegations": "The company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the ***allegations*** of the suit are groundless, false or fraudulent." (Emphasis added.) While the later forms omit the false or fraudulent language, they also provide a definition of "suit" which reiterates that a "suit" is "a civil proceeding in which damages because of 'bodily injury', 'property damage', 'personal injury' or 'advertising injury' to which this insurance applies are ***alleged***." (Emphasis added.) Contrast this language with the first sentence of the insuring agreement: "We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." A legal obligation to pay as damages typically requires either (a) a judgment after actual trial or (b) a settlement to which the carrier has consented. In either event, it would appear that proven or developed facts as opposed to merely "alleged" facts must bring the case within coverage in terms of indemnity.

Given that the language in all of these versions has been subjected to the complaint allegation rule, it would appear that the parties certainly knew prior to

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"Suit" means a civil proceeding in which *damages because of "bodily injury", "property damage"* or "personal and advertising injury" to which this insurance applies ***are alleged***. "Suit" includes:

> a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or
>
> b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent.

(Emphasis added).This is essentially the same as the 1996 form.

contracting of this interpretation and thus in effect adopted it in agreeing to the policy terms. Therefore, acquiescence in the face of known, decided law can be treated as an incorporation of that law. Also, to the extent the policy leaves a gap regarding an important term, some courts use ”default interpretations” or “interpretive defaults” to fill the gap.

“A default rule determines the *legal* state of affairs absent the parties’ expression to the contrary. As Corbin observes, ‘ [w]hen a court is filling gaps in the terms of an agreement, with respect to matters that the parties did not have in contemplation and as to which they had no intention to be expressed, the judicial process . . . . may be called ‘construction’; it should not be called ‘interpretation.’” Klass, *Interpretation and Construction in Contract Law,* 17 (Jan. 2018), found at http://scholarship.law.georgetown.edu/facpub/1947 and https://ssrn.com/abstract=2913228. “Richard Posner writes: “Gap filling and disambiguation are both . . . ‘interpretive’ in the sense that they are efforts to determine how the parties would have resolved the issue that has arisen had they foreseen it when they negotiated their contract.” *Id.*

One thing is relatively certain, semantic priority of construction results in a part of a contract interpreted by a court becomes part and parcel of the language. *Id.* at 40. “Judicial construction of nontechnical words can give those words new conventional legal meanings going forward. Construction can transform ordinary words into legal formalities.” *Id.* at 40. All persons are charged with knowledge of the law. *Davis v. Allison*, 109 Tex. 440, 211 S.W. 980, 983 (Tex. 1919). As one commentator has noted:

> In many ways, the duty to defend has become a matter of public policy rather than contract: early policy language, by dint of repetition, has hardened into a rule.

Randall, S., *Redefining The Insurer's Duty To Defend*, 3 CONN. INS. L.J. 221, 246-47 (1996-97).

2. Mixed Claims—Some In, Some Out

a. The Mixed Claim or Musketeer Rule

In Texas, the duty to defend applies so long as there are any allegations potentially invoking the coverage of the underlying policy. In other words, in a suit alleging multiple theories of recovery or facts, some of which would be covered under the policy and some that would not be covered, there is still a duty to defend the entire case. In *St. Paul Ins. Co. v. Texas Dept. of Transp.,* 999 S.W.2d 881, 884 (Tex. App.—Austin 1999, pet. denied), the court found that the facts supported alternative claims for either intentional torts or negligence. The court held that because at least one of the claims asserted in the underlying suit was covered, the duty to defend was triggered. *Id.*

As the Fifth Circuit has explained:

> The fact that the Rice's plead negligent, malicious, and knowing actions does not in and of itself transform the negligent actions into malicious or knowing actions, and there is nothing in the factual allegations to suggest that Harken's performance was not negligent. "If an insurer has a duty to defend any portion of a suit, the insurer must defend the entire suit." *Green Tree Corp*., 249 F.3d at 395. Thus, the Appellants must defend Harken against the entire suit including causes of action that would not alone trigger the duty to defend, regardless whether the complaint is pled in the alternative or not because the Rice's factual allegations of negligence are sufficient to trigger the duty to defend. *See St. Paul Ins. Co. v. Texas Dept. of Transp.,* 999 S.W.2d 881, 884 (Tex. App.-Austin 1999, pet. denied) ("[a]lthough the plaintiffs also allege gross negligence and intentional torts, this is not controlling because we must focus on the facts alleged, not the legal theories pleaded . . . ***that coverage may not be available for some causes of action pleaded does not relieve St. Paul of its duty to defend."***).

Harken v. Sphere Drake Ins. PLC, 261 F.3d 466, 474 (5th Cir. 2001).

b. Analyzing Mixed Claims Under Bare Policy Language

Okay, what does the policy language tells about the duty to defend:

- A suit seeking damages within coverage creates a duty to defend:
- A suit that seeks damages outside of coverage triggers no duty to defend?
- What does this say about mixed claims, some in coverage and some out? It could mean a suit exclusively seeking only covered damages creates a duty to defend, but a mixed suit does not.

The second section of the duty to defend language indicates that there is, however, no duty to defend only when the suit seeks matters wholly outside coverage. Of course, no insurance company appears to have been brave enough to make any such argument. The key would appear to be the definition of "suit," which means a "civil proceeding in which damages because of 'bodily injury', 'property damage' or 'personal and advertising injury' to which this insurance applies are alleged." If any such allegations are made, then a suit seeking damages to which the policy applies has been made. Any other interpretation would appear to add "only" and thus rewrite the policy. Thus, the plain language of the policy says there is a defense if any allegations are made in a suit seeking damages to which the policy applies.

3. Liberal Construction

The Texas courts have held that rule of strict or liberal construction applies to the interpretation of the allegations or pleadings in the underlying suit against the insured. The rule of strict construction regarding insurance policies has an understandable

rationale and purpose: (1) the carrier generally has the ability to draft the policy and thus make the scope of coverage more clear; and (2) the insured is generally in an inferior bargaining position vis-a-vis the carrier. So, how is it that these same rules are then applied to the interpretation of the four corners of the suit or allegations against the insured, which neither the insurer nor insured drafted or controlled?

The courts have repeatedly held:

> [I]n considering the allegations in the complainant's petition to determine whether they fall within the provisions of the insurance policy, a liberal interpretation of the meaning of those allegations should be indulged. *Heyden Newport Chemical Corp. v. Southern General Ins.Co*., 387 S.W.2d 22, 26 (Tex.1965); and *Norvell Wilder Supply v. Employers Cas.Co*., 640 S.W.2d 338, 340 (Tex. App.--Beaumont 1982, no writ). Even where the injured person's complaint does not state facts sufficient to clearly bring the case within or without the coverage, the insurer is obligated to defend if there is ***potentially*** a case under the complaint within the coverage of the policy. *Fort Worth Lloyds v. Garza,* 527 S.W.2d 195, 199 (Tex.Civ.App.--Corpus Christi 1975, writ ref'd n.r.e.); and *St. Paul Ins.Co. v. Rahn,* 641 S.W.2d 276, 279 (Tex.App.--Corpus Christi 1982, no writ). Any doubts in that regard will be resolved in the insured's favor. *Heyden, supra*.

Colony Ins. Co. v. HRK, Inc., 728 S.W.2d 848, 850 (Tex. App.—Dallas 1987). The rule of liberal construction can be supported as an outgrowth of the courts' interpretation of the terms of the policy's duty to defend provisions. Because the policy gives little assistance in identifying exactly what will amount to "allegations" sufficient to invoke coverage, it is understandable that the courts would adopt the view that the underlying allegations should be liberally construed.

The rule of liberal construction can also be justified as a necessary result of applying the actual rules applying in the underlying suit as to the meaning and interpretation of the pleadings. Rule 45 of the Texas Rules of Civil Procedure states:

> Pleadings in the district and county courts shall (a) be by petition and answer; (b) consist of a statement in plain and concise language of the plaintiff's cause of action or the defendant's grounds of defense. That an allegation be evidentiary or be of legal conclusion shall not be grounds for an objection when *fair notice to the opponent is given by the allegations as a whole*; and (c) contain any other matter which may be required by any law or rule authorizing or regulating any particular action or defense.

TEX. R. CIV. P. 45. Rule 47 states that "An original pleading which sets forth a claim for relief, whether an original petition, counterclaim, cross-claim, or third party claim, shall contain: (a) a short statement of the cause of action sufficient to give *fair notice of the claim involved* . . . ." (Emphasis added.)

Pursuant to Rule 45 of the Texas Rules of Civil Procedure, "[a]ll pleadings shall be construed so as to do substantial justice." Tex. R. Civ. P. 45. In the absence of a special exception, we liberally construe a pleading in favor of the pleader, *Horizon/CMS Healthcare Corp. v. Auld,* 34 S.W.3d 887, 896-97 (Tex. 2000), and in a manner consistent with the pleader's intent. *Tex. Dep't of Parks & Wildlife v. Miranda*, 133 S.W.3d 217, 226 (Tex. 2004). "[W]hile a pleading must be construed as favorably as possible to the pleader, the inference that a cause of action has been pleaded must be reasonable in light of what is specifically stated in the pleading." *Guevara v. Lackner,* 447 S.W.3d 566, 582 (Tex. App.—Corpus Christi 2014, no pet.) (citing *Boyles v. Kerr*, 855 S.W.2d 593, 601 (Tex. 1993) (op. on reh'g)). Thus, liberal construction "does not require a court to read into a petition what is plainly not there." *Wortham v. Dow Chem. Co.,* 179 S.W.3d 189, 199 (Tex. App.—Houston [14th Dist.] 2005, no pet.).

As a general rule, Texas courts look to the substance of a document rather than to its title or designation to determine the relief sought, if any. *Stroman v. Tautenhahn*, 465 S.W.3d 715, 719 (Tex. App.—Houston [14th Dist.] 2015, pet. dism'd w.o.j.). A valid pleading must include averments of all facts upon which the right to recover depends. *Wilson v. Bloys*, 169 S.W.3d 364, 369 (Tex. App.—Austin 2005, pet. denied). Otherwise, the pleading fails to state a cause of action and no valid judgment can be rendered thereon. Id.; see also TEX. R. CIV. P. 301 (providing that the "judgment of the court shall conform to the pleadings"); *Hartford Fire Ins. Co. v. C. Springs 300, Ltd.,* 287 S.W.3d 771, 779 (Tex. App.—Houston [1st Dist.] 2009, pet. denied) ("A trial court cannot enter judgment on a theory of recovery not sufficiently set forth in the pleadings or otherwise tried by consent.").[2]

In practice, the duty to defend rule of liberal construction is applied much more broadly than the pleading rules of interpretation. So, whether the policy incorporates these rules or merely is interpreted to apply a liberal construction rule could make a difference in the outcome.

Another justification for the use of the liberal construction of pleadings rule in determining the duty to defend is the concept of incorporation. The policy incorporates in effect the allegations in the underlying suit as part of the process for determining the duty to defend. Once incorporated, it should be subject to the same rules of construction as the policy itself. Whether rules of strict construction apply to incorporated collateral

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contracts was raised in *In re Deepwater Horizon,* 470 S.W.3d 452 (Tex. 2015),[3] but the Court chose to resolve the case on other grounds and did not address the strict construction issue. *Id.* at 455-56.

Not all Texas cases have agreed with the rule of strict construction. In *Feed Store, Inc. v. Reliance Ins. Co.,* 774 S.W.2d 73, 74-75 (Tex. App.—Houston [14th Dist.] 1989, writ denied), the court stated:

> [W]e disagree with appellant's argument for strict construction [of the pleadings] against the insurer. Long-settled law in Texas requires resolution of ambiguities in an insurance contract in favor of the insured and against the insurance company. This principle is beyond dispute but quite immaterial to our decision, because both sides agree that the policy is clear and unambiguous. In our view, appellant seeks to transplant the rule of contra preferentum out of the realm of contract interpretation and into the area of construing pleadings . . . Yet the law is, and always has been, otherwise. There is good reason to construe a printed form against its author, and the law encourages an insurance company to think carefully about its draftsmanship. But it takes a great leap to transform this rule into one which construes a third-party's pleadings strictly against the insurance company, a leap we cannot make.

Id. (emphasis supplied in original). *Feedstore* has been ignored by repeated decisions of the Texas intermediate and Supreme Court following the rule of liberal construction.

4. Extrinsic Evidence

The CGL language from the outset makes clear that it is the suit through which covered damages must be sought. "'Suit' means a civil proceeding in which damages because of 'bodily injury', 'property damage', 'personal injury' or 'advertising injury' to which this insurance applies are alleged." "Suit" would appear to be broader than "pleadings," but it is only in the pleadings where *allegations* are made. Or is it?

Some commentators have suggested that under modern defense language, both defense and indemnity are dependent on the existence of coverage, which is dependent on actual facts. Randall, S., *Redefining The Insurer's Duty To Defend*, 3 CONN. INS. L.J. 221, 246-47 (1996-97). If that is really the case, then declaratory actions on the duty to defend are not ripe even as to defense because the theories could clearly shift and the facts change as the case develops and is ultimately tried.

Can it be said that the policy language is ambiguous as to whether extrinsic evidence may be used to determine the duty to defend? If it is ambiguous, given the rules of strict construction, then insured would be able to use extrinsic evidence to create a

[3] The second point of the Fifth Circuit certification order stated: "2. Whether the doctrine of contra proferentem applies to the interpretation of the insurance coverage provision of the Drilling Contract under the *ATOFINA* case, 256 S.W.3d at 668, given the facts of this case?"

duty to defend, but carriers would not necessarily be allowed to do so. As one commentator has observed:

> It is, of course, possible to argue that policy language supports the complaint rule. The fact that some policies refer to the defense of lawsuits "seeking" damages to which the insurance applies, or "asking" for covered damages, permits an inference that the language of the complaint controls an insurer's duty to defend. Such an argument garners support from the insurance law doctrine which protects an insured's reasonable expectations concerning coverage. An insured might reasonably expect, under this policy language, to receive an insurer-provided defense in any action which alleged a covered claim, regardless of the actual facts. The first and second provisions above, which require a defense in lawsuits "seeking" or "asking for" damages for injuries "to which this insurance applies," might suggest a defense obligation measured by the complaint. Alternatively, if the policy language can reasonably be read as requiring reference either to the complaint or the facts, it is ambiguous, and contra proferentum requires construction against the insurer.

Randall, *supra* (emphasis added). The courts generally ignore the fact that the extrinsic evidence issue is in fact a question of policy construction. The counter-argument is explained as follows:

> As a matter of common sense, however, it is clear that the duty to defend is necessarily related to coverage. The point is especially clear in an extreme example: no one would expect an auto insurer to undertake the defense of its insured in a professional malpractice action. Similarly, it would be unusual to construe identical limiting language in the policies differently for defense and coverage obligations. The current majority practice of utilizing allegations to determine the duty to defend, and actual facts to determine the duty to indemnify, in all cases, contravenes the most plausible construction of the policy language and undercuts accepted methods of contract interpretation. The most plausible construction of the provisions is that ***actual coverage*** controls both duties. In other words, it is unreasonable to expect that the allegations, in the face of contrary facts, control an insurer's duty to defend, or to read identical limiting language as referring in one instance to allegations and in another to facts.
>
> Similarly, contra proferentum does not support the complaint rule: in many jurisdictions, there is no ambiguity to construe against the insurer if the alternative construction of the policy language is unreasonable. Because insureds do not really contract for and cannot reasonably expect a near-absolute duty to defend, the most reasonable reading of the policy is that the defense obligation depends on the facts of coverage. Furthermore, using ambiguity doctrine to determine the duty to defend may create an anomaly. In some instances, it will be to an insured's advantage to assess the duty to defend based on allegations; in others, it will be to an insured's

> advantage to assess the duty based on facts. Thus, use of the ambiguity doctrine precludes the possibility of a general rule; the determinant of the defense obligation will change depending on whether assessment according to facts or allegations benefits the insured.

Id. at 248.

Some posit that the false or fraudulent language strongly *supports* the complaint allegation rule and conflicts with the admission of extrinsic evidence:

> The promise to defend "groundless, false, or fraudulent" suits, contained in many early policies and some modern policies such as the Homeowners policy cited in the preceding paragraph, has suggested to many courts that the duty to defend is virtually absolute and the complaint determines the duty. Even where policies do not contain this language, recent decisions often adopt early judicial recitations of the language as a rule. If a lawsuit is truly groundless, there are no facts by which to assess coverage. In this limited instance, the duty to defend must be determined by the allegations of the complaint. If, however, there is a factual basis for the lawsuit, this provision does not apply. To utilize the "groundless, false or fraudulent" language in a broader context, to create an absolute duty to defend, cannot be justified by policy language or public policy.

Randall, *supra,* at 248-49. In short, “[t]he real reason for the complaint rule, then, appears to be judicial reluctance to let insurers make factual determinations about their contractual obligations without judicial oversight or approval.” Randall, *supra*, at 254.

In *Travelers Ins. Co. v. Newsom*, 352 S.W.2d 888, 890-94 (Tex. Civ. App.--Amarillo 1961, writ ref'd n.r.e), the court rejected its prior decision in *Trinity Universal Ins. Co. v. Bethancourt*, 331 S.W.2d 943, 945-46 (Tex. Civ. App.--Amarillo 1959, no writ), allowing use of extrinsic evidence, was erroneous and refused to follow it, noting it was "against all the great weight of authority . . . in Texas and . . . in other jurisdictions." *Id*. at 890-91. The court emphasized that there was ***no language in the contract*** sufficient to support consideration of ***anything but the allegations***. *Id*. at 893. The court held that if extrinsic facts could not be shown as a *basis for denial* of the duty to defend, then there was no logical reason they could be *used to establish* a duty to defend. *Id*. at 894.

As will be discussed in greater detail below, a small group of “outlier” cases from federal district court in Texas suggest that the deletion in the 1996 and later CGL forms of the reference to the duty to defend applying regardless of whether the allegations were false or fraudulent somehow changes the duty to defend rules. From a constructional standpoint, the policy has always focused on “allegations” regardless of whether true or false. If the actual facts or true facts controlled, the policy would have said that. So, the difference in language should not result in a difference in the duty to defend rules.

Texas has rejected the related California “spandex rule” under which the carrier has a duty to defend if the complaint or ***extrinsic proof*** shows that a case within

coverage, while not actually yet brought, could "potentially" be brought. *Feed Store, Inc. v. Reliance Ins. Co*., 774 S.W.2d 73, 74-75 (Tex. App.—Houston [14th Dist.] 1989, writ denied)(holding that fact case could have supported a claim for damages did not create a duty to defend); *see also Brooks, Tarlton, Gilbert, Douglas, & Kresler v. U.S. Fire Ins. Co.,* 823 F.2d 1358, 1367-68 (5th Cir. 1987)(noting that the question is "not what could . . . [the claimant] successfully have pled, but what did . . . [the claimant] in fact plead."); Glad, King & Gains, *The Spandex Factor in Liability Policies: Stretching the Duty to Defend*, 10 INS. LITIG. RPTR. 258, 260-62 (Oct. 1988)(discussing problems with and criticism of *CNA Cas. Ins. Co. v. Seaboard Surety Co*., 176 Cal. App. 3d 598, 222 Cal. Rptr. 276 (1986)). Given the changes regarding pleadings and the adoption of a fair notice approach, the Spandex rules makes more sense because the real test of "potentiality" is what evidence could be admitted under the allegations actually made.

III. The McBryde Odysseys

Judge McBryde does not appear to like the duty to defend, the eight-corners rule or the liberal construction rule. Judge McBryde issued a series of opinions between 1991 and 1993 holding that extrinsic evidence was admissible on a broad basis. First, in *Blue Ridge Ins. Co. v. Hanover Ins.*, 748 F. Supp. 470, 471 (N.D. Tex. 1990), Jimmy Beech and his son, Scottie, sought coverage as permissive users of a vehicle owned by Southern and operated by Scottie. The underlying suit alleged that Jimmy, an employee of Southern, was given permission to operate the vehicle owned by Southern and that he subsequently gave permission to operate the vehicle to Scottie. The carrier sought to introduce extrinsic evidence showing that Jimmy could not, as a matter of law, have had permission to use and thus allow his son to use the vehicle because the company policy of Southern was to allow only employees to operate the vehicle, and Scottie was definitely not an employee of Southern.

The court held that the complaint allegation rule and thus the policy language upon which it is based does not come into play until the court had determined that the person seeking coverage was actually an insured under the policy. *Id.* at 473. The court amazingly stated:

> The status of "insured" is to be determined by the true facts, not false, fraudulent or otherwise incorrect facts that might be alleged by the personal injury claimant . . . ."

Id. The court did not discuss how it reconciled, if at all, its decision with that of the Texas Supreme Court in *Heyden*, in which the precise coverage question at issue was whether the allegations fell within the "insured" definition of the policy. 387 S.W.2d at 24-25. The court nevertheless concluded that extrinsic evidence could be used to determine the fundamental question of whether someone is an insured, but such evidence could not be used in order to controvert the allegations in the underlying suit. *Id.* With no real analysis, the court concluded that was not being done in the case before it. Ironically, the court held that because the underlying allegations regarding the permission necessary to obtain coverage were factually incorrect and had no likelihood of success, and thus the insured was entitled to no defense. *Id.*

In 1991, Judge McBryde again addressed the issue of the proper use, if any, of extrinsic evidence under Texas law. In *McLaren v. Imperial Cas, & Indem. Co.,* 767 F. Supp. 1364, 1373-74 (N.D. Tex. 1991), Judge McBryde even more broadly stated:

> [T]here appears to be a more general rule that the ***true facts can always be used to establish non-existence of a defense obligation***, no matter what the plaintiff might allege in her damage suit complaint.

(Emphasis added.) The court looked to one Texas decision, *Gonzales, supra*, and an Eighth Circuit decision to reach its conclusions regarding the admissibility of extrinsic evidence. This decision amounts to a frontal attack on the policy language saying the claims must be defended even if false and/or fraudulent.

In 1993, Judge McBryde again addressed extrinsic evidence. In *Ohio Cas. Co. v. Cooper Machinery Corp.*, 817 F. Supp. 45, 48 (N.D. Tex. 1993), Judge McBryde held that a false allegation of fact cannot be used to impose a duty to defend. *Id*. at 48. The underlying pleading falsely asserted that the work in question was not completed in accordance with contractual specifications, thus invoking a products hazard exclusion. Judge McBryde emphasized that a duty to defend *could not be created by a false allegation of a coverage fact in a state court pleading. Id.* ***The court reached the extraordinary conclusion that even if facts were pled establishing coverage, the carrier was still entitled on declaratory judgment to prove the pleaded facts were false and thus bar a duty to defend.*** *Id.*

A law review published in 2004, Smith, R. and Simpson, F., *Extrinsic Facts & the Eight Corners Rule Under Texas Law--The World Is Not As Flat As Some Would Have You Believe,* 46 S. Tex. L. Rev. 463 (2004), examined at length the various key provisions of the evolving CGL defense language. The article appears to be one of the first instances in Texas where the notion was addressed that the absence of the false or fraudulent language in the duty to defend provisions made any sort of difference in how the duty to defend was determined. It is clear that at that time the courts and the insurance industry were struggling with how to deal with cases involving intentional and, in some instances, criminal conduct characterized in the pleadings as “negligence,” thus at least potentially invoking a duty to defend. The false or fraudulent language and related interpretive arguments were part of a larger effort to reign in the easy creation of a “potentiality” for coverage with false or mischaracterized facts. That author explained:

> Unlike wording in former defense clauses, dispositive words in these currently utilized contemporary defense clauses are "seeking damages," "seeking those damages" or "damages payable by this insurance." These contemporary defense clauses are therefore intended to redefine the former duties to defend to narrower limits that are no broader than duties to indemnify. The intent is that neither duties to indemnify nor duties to defend will be triggered unless underlying lawsuits ***are actually covered***, ***not merely allegedly covered***. Contemporary defense clauses, worded as

> above, should restrict defense obligations to those situations where insurers will ultimately owe duties to indemnify in the event of adverse judgments against their insureds.

Id. at 484 (emphasis added).

In 2006, 2011 and again in 2018, Judge McBryde focused on the deletion of the false or fraudulent language to justify the elimination of the complaint allegation or eight corners rule and the use of extrinsic evidence to defeat the duty to defend.

A. *Hall*

In *Hall Contracting Inc. v. Evanston Ins. Co*., 447 F. Supp. 2d 634 (N.D. Tex. 2006), Judge McBryde held that the axiom that the duty to defend is broader than the duty to pay is dependent on the old language stating the duty to defend applies regardless of whether the claims are false or fraudulent. He reasoned that the Supreme Court in *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church,* 197 S.W.3d 305, 308 (Tex. 2006) had found the fact the duty to defend was broader, as a result of the false or fraudulent language, was part of the justification for finding that extrinsic evidence was not admissible to determine the duty to defend. Without the false or fraudulent language, Judge McBryde reasoned: “Because Evanston's policy does not contain that language, the "eight-corners or complaint-allegation rule" is not applicable to this case. The language of the Evanston policy makes the duty to pay and the duty to defend coextensive.” *Id.* at 645. He warned that this did not mean that the duty to defend could be avoided by proving the insured was not liable. *Id.*

In *Hall,* the question was whether the only damages sought were subject to a roofing exclusion included by endorsement. *Id.* at 646. Judge McBryde concluded that even if the eight-corners rule applied, extrinsic evidence was admissible. He found that in *GuideOne* the Supreme Court had noted some courts had adopted an exception allowing the use of extrinsic evidence to determine the duty to defend "when relevant to an independent and discrete coverage issue, not touching on the merits of the underlying third-party claim." *Id.* at 31 (quoting *GuideOne*). Judge McBryde concluded the exception applied, holding:

> [T]he extrinsic evidence here (the facts establishing applicability of the Roofing Endorsement exclusion) does not contradict any allegation in the state court pleadings. Rather, the extrinsic evidence establishing non-coverage is perfectly consistent with the allegations in the state court pleadings.

Id. Judge McBryde recognized that no exception would apply if the extrinsic evidence involved the “merits” of the underlying claim. *Id.* Clearly, if the claim *had involved the underlying merits,* Judge McBryde would have found the absence of the false or fraudulent language allowed the use of extrinsic evidence going to the merits and coverage.

B. *David Lewis*

Judge McBryde again clearly held that the absence of the false or fraudulent language eliminated the application of the eight corners rule in *David Lewis Builders, Inc. v. Mid-Continent Cas. Co.,* 720 F. Supp. 2d 781 (N.D. Tex. 2010). In dicta, Judge McBryde held that while under the eight corners rule the carrier did not have a duty to defend, he added:

> The court would agree that even if the "eight corners" rule did apply to this case, Mid-Continent would not have a defense obligation. However, the court notes that Mid-Continent has overlooked the fact that the wording of the defense obligation in its insurance policy is such that the "eight corners" rule does not apply to the defense obligation imposed by its policy. *See B. Hall Contracting Inc. v. N.D. Tex. Ins. Co*., 447 F. Supp. 2d 634, 644-46 (N.D. Tex. 2006), *rev'd on other grounds*, *B. Hall Contracting Inc. v. Evanston Ins. Co.*, 273 F.App'x 310 (5th Cir. 2008).

Id. n. 3.

C. *GuideOne*

Again, in *GuideOne Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ,* 806 F. Supp. 2d 923 (N.D. Tex. 2011), Judge McBryde revisited *Evanston* and held the eight-corners rule inapplicable, opening the door for the use of extrinsic evidence to determine the duty to defend and the duty to indemnify. In the underlying suit in *GuideOne*, the claimant alleged in the underlying lawsuit that “Church and Salgado were liable for Meyers's conduct at the time of the collision based on a negligent entrustment theory and that Church was liable for the conduct of Salgado and Meyer based on a respondeat superior theory.” *Id.* at 926. The policy at issue was a CGL policy, which excluded liability arising out of ownership, maintenance or use of an automobile by any insured. Nevertheless, coverage for use of an automobile was added by separate endorsement. *Id.* at 927. The policy provided that in addition to the Church the following were also insured:

> any person who was an officer, clergy, or employee of Church, but only with respect to such person's duties as such; any person who was a volunteer for Church, but only while using an auto with Church's express knowledge and authorization, in the course of Church's business, and within the course of such persons' duties for church; and anyone else while using, with Church's permission, a covered auto hired or borrowed by Church, except the owner of the auto or anyone else from whom the auto was borrowed or hired.

Id. at 928. *GuideOne* moved for summary judgment, urging:

> (1) the eight-corners rule does not apply because the Insurance Policy does not define the duty to defend more broadly than the duty to indemnify and

(2) a declaratory judgment should be rendered at this time resolving all insurance coverage disputes between the parties even though the underlying lawsuit has not been resolved.

Id. at 930.

The court framed the coverage issues as follows:

1. Whether the van operated by Rodriguez was a “covered auto” sufficient to make the Church an additional insured?

    a. Whether it was a hired auto as to the Church?

    b. Whether the van was a non-owned auto as to the Church?

    c. Whether the van was being used in connection with the Church’s business at the time of the accident?

2. Whether the Church had a duty to pay as damages as a result of the accident?

3. Whether Meyer and Delgado (two of the three Church members left behind to do clean-up were using the van) were volunteers or employees acting

    a. In the course of the Church’s business, or

    b. With the Church’s permission?

    c. Again, whether the van was a “covered auto”?

First, the court held: “There is no evidence that at the time of the collision Meyer was engaging in any activity on behalf of Church, or that Church entrusted Meyer with the vehicle he was operating at the time of the collision. *Id.* at 934. Second, absent a relationship with the church, neither Meyer nor Salgado could be insureds. These conclusions, dressed in the language of the insured failing to carry its burden of proof, preceded any discussion of the rules for determining the duty to defend.

Echoing *B. Hall,* but failing to cite it, the court noted:

> *The eight-corners rule simply does not apply to the Insurance Policy. The defense-obligation wording of the Insurance Policy is drastically different from the wording found in the liability insurance policies that gave rise to, and perpetuated, the eight-corners rule*. The insurance company and the insured in each of the cases that has applied the rule contracted that the insurance company would "defend any suit brought against [the insured] seeking damages, even if the allegations of the suit are groundless, false or fraudulent." *See, e.g., GuideOne Elite Ins. Co.,* 197 S.W.3d at 307*; Am.*

> *Physicians Ins. Exch. v. Garcia,* 876 S.W.2d 842, 846 (Tex. 1994)*; Argonaut Sw. Ins. Co. v. Maupin*, 500 S.W.2d 633, 634 n.1 (Tex. 1973*)*; *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 24-25 (Tex. 1965). *See also* C.T. Drechsler, Annotation, *Allegations In Third Person's Action Against Insured As Determining Liability Insurer's Duty To Defend,* 50 A.L.R.2d 458, 463-64 § 3 (1956).

Id. at 936 (emphasis added). Judge McBryde clearly treated the false or fraudulent language as the sole textual basis for the eight-corners rule: ”The eight-corners-rule policy language ("even if the allegations of the suit are groundless, false or fraudulent") that is absent from the policy issued by plaintiff is essential to applicability of the rule . . . Because plaintiff's policy does not contain that language, the eight-corners rule is not applicable to this case. The language of plaintiff's policy makes the duties to pay and defend coextensive.” *Id.* Of course, the opinion ignores the fact that the policy states the duty to defend depends upon allegations, which are by definition unproven and thus potentially true or false or legally with or without merit. Thus, the absence of the false or fraudulent language removes a redundancy and thus cannot and does not serve as the basis for the duty to defend.

In *GuideOne,* Judge McBryde actually expanded the rationale given in *B. Hall* for the elimination of the eight-corners rule. He stated:

> Not only does the Insurance Policy not contain the "groundless, false, or fraudulent" policy language that is so essential to the eight-corners rule, ***the language of the policy could not make any clearer that the parties contracted in such a way as to preclude applicability of the rule.*** The basic definition of plaintiff's defense obligation, as set forth in the CGLC and adopted by reference in the Endorsement, reads as follows:
>
> > We will have the right and duty to defend the insured against any "suit" seeking those damages. However we have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.
>
> Mot., Am. App. at GIG 0044 (GIG 0154), GIG 0059 (GIG 0169). To eliminate any possible uncertainty on the subject as to coverage provided by the Endorsement, the Endorsement added the following language:
>
> > However we have no duty to defend "suits" for "bodily injury" or "property damage" not covered by this endorsement.
>
> *Id.* at GAG 0082 (GIG 0192).

Id. (emphasis added). Thus, Judge McBryde allowed the open use of extrinsic evidence without any limitation whatsoever. He concluded: “Therefore, extrinsic evidence is proper for consideration, and should be considered, in determining

whether plaintiff has an obligation to defend anyone in the underlying lawsuit." *Id.* at 936-37. Overlapping evidence and the fact the insured was having to face a two-front war did not have any impact on Judge McBryde's analysis: "There is no reason why the court cannot, or should not, at this time fully and finally resolve those disputes even if such a resolution coincidentally resolves issues raised in the underlying lawsuit."

Judge McBryde also found that the insurer was entitled to injunctive relief under the Anti-Injunction Act, 28 U.S.C. sec. 2283.[4] He noted that the carrier cited "They cited *Royal Insurance Co. of America v. Quinn-L Capital Corp.*, 960 F.2d 1286, 1288-89, 1293-97 (5th Cir. 1992), and *Royal Insurance Co. of America v. Quinn-L Capital Corp.*, 3 F.3d 877, 888-89 (5th Cir. 1993), for the proposition that an injunction barring further prosecution of a state court proceeding is proper following declaratory judgment rulings made by a federal district court in an insurance coverage matter ***when the rulings coincidentally determine issues raised in the state court proceeding the insurer was entitled to injunctive relief regarding."*** So, Judge McBryde concluded that there was not only an overlap between the issues in the coverage case and the state court underlying tort suit, but the issues were in fact identical, thus resulting in injunctive relief to prevent the claimant from even pursuing its state law claims any further after the declaratory ruling. The court reasoned:

> "The re-litigation exception is intended 'to prevent state litigation of an issue that previously was presented to and decided by the federal court.'" *Moore v. State Farm Fire & Cas. Co.,* 556 F.3d 264, 273 (5th Cir. 2009) (citing and quoting from *Chick Kam Choo v. Exxon Corp*., 486 U.S. 140, 147, 108 S. Ct. 1684, 100 L. Ed. 2d 127 (1988)). The factors to be considered in determining whether the exception applies were enumerated by the Fifth Circuit in Moore:
>
> > In determining whether the re-litigation exception applies, the district court employs a four-part test: (1) parties in the later action must be identical to or in privity with the parties in the previous action; (2) judgment in the prior action must have been rendered by a court of competent jurisdiction; (3) the prior action must have concluded with a final judgment on the merits; and (4) the same claim or cause of action must be involved in both suits.
>
> 556 F.3d at 273.
>
> The four-part test expressed in *Moore* is satisfied here as to the issues of the legal obligation of Church Defendants to make payment to Gilmore for

[4] This section provides: "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or ***where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."*** (Emphasis added.)

> damages she sustained in the collision. The issues of liability of the Church Defendants to Gilmore for damages she suffered were actually litigated at the summary judgment stage in the instant action, and are being actually decided at this stage of the litigation by the rulings in this memorandum opinion and order, and the final judgment that will accompany it. Gilmore and the Church Defendants are parties to both actions. The declaratory relief the court is ordering will be part of a judgment rendered by a court of competent jurisdiction. This action will be concluded by a final judgment on the merits. There are identical issues in the two actions as to the legal liability of the Church Defendants to Gilmore for damages she suffered by reason of the March 9, 2006, collision.

Id. at 940. The Court ordered: "The court hereby ORDERS that Gilmore and her attorneys not pursue, and they are hereby ENJOINED from prosecuting, any claim in any court based on any theory that Church or Salgado has any legal obligation to pay any amount to her because of any damage she suffered as a result of the March 9, 2006, collision." *Id.*

The Fifth Circuit rejected Judge McBryde's reasoning regarding the impact of the omission of the false or fraudulent language. *Guideone Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ*, 687 F.3d 676 (5th Cir. 2012). The Court explained the approach taken by Judge McBryde:

> The district court's departure from the typical method of analysis stems from its conclusion that GuideOne's duty to defend and its duty to indemnify were co-extensive in this case. The district court held that the parties intended to narrow the scope of GuideOne's duty to defend to only those claims that the Church and Salgado could prove were covered by the policy. It therefore reasoned that instead of comparing the allegations in Gilmore's petition to the language in the insurance policy, it was required to compare the language in the insurance policy to the evidence presented in support of Gilmore's claims.

Id. at 682. ***The Fifth Circuit held that the eight-corners rule "is a judge-made rule," and the parties can agree to contract around the rule, if they so desire and express.*** *Id.* (emphasis added)(citing *See Pendergest-Holt v. Certain Underwriters at Lloyd's of London,* 600 F.3d 562, 574 (5th Cir. 2010); *see also* 14 Lee R. Russ & Thomas F. Segalla, COUCH ON INSURANCE 200:5 (3d ed. 2009).) The Court found no authority to support the notion that the "false or fraudulent" language controlled application of the duty to defend and the eight corners rule. *Id.* n. 8. "[The Texas Supreme Court] has not written . . . that the eight corners rule applies only to policies containing such language." *Id.*

The Fifth Circuit in *GuideOne* reasoned:

> The duty to defend is not interpreted more broadly than the duty to indemnify by reason of language in the insurance policy that expressly defines the duty to defend more broadly than the duty to indemnify. The contrast instead results from what the language setting forth those duties is compared with: While courts compare the language setting forth the duty to defend with the allegations in the petition, they compare the language setting forth the duty to indemnify with the evidence presented by the parties. *See, e.g., Utica Nat. Ins. Co. of Tex. v. Am. Indem. Co*., 141 S.W.3d 198, 201, 203 (Tex. 2004) (explaining difference in how courts interpret the duty to defend compared with the duty to indemnify); *Northfield Ins. Co. v. Loving Home Care*, 363 F.3d 523, 531 (5th Cir. 2004) (contrasting duty-to-defend inquiry, which focuses on "alleged facts in the petition," with duty-to-indemnify inquiry, which focuses on "the actual facts that underlie the cause of action and result in liability"). ***Consequently, even if an insurance policy employs the same language for the duty to defend and the duty to indemnify, Texas courts define the duty to defend more broadly than the duty to indemnify***.

Id. at 684.[5] The Fifth Circuit additionally noted that the Texas courts assume the duty to defend must be determined at the beginning of the proceeding, “when courts have no evidence to examine. In contrast, the duty to indemnify is determined at a later stage when evidence is established and/or factual determinations have been made at an actual trial. *Id.* n. 7 (citing *See* 14 COUCH ON INSURANCE 200:3 ("The distinction between the duty to defend and the duty to indemnify is based upon the time when the duties are determined."). Because the courts have supplied the overlay rules for determining how courts should examine the allegations, the Fifth Circuit reasoned that there must be policy language reflecting an intention to eliminate that overlay. *Id.* The court added:

> Accordingly, the language gives no reason to depart from Texas's time-honored manner of interpreting insurers' duty to defend. The language of this insurance policy, in fact, roughly tracks the usual understanding of the eight-corners rule that "the duty to defend does not extend to circumstances where there is no duty to indemnify as a matter of law . . . ." See 14 COUCH ON INSURANCE § 200:11; *see also Northfield Ins. Co*., 363 F.3d at 528 ("If the petition only alleges facts excluded by the policy . . . the insurer is not required to defend."). Like the hornbook description of the eight-corners rule, the language in the GuideOne policy does no more than affirm that if "there is no possible factual or legal basis on which the insurer could be obligated to indemnify the insured," GuideOne has no duty to defend the

[5] Therefore, if the parties are going to contract around the eight corners rule, they have to deal with the fact that the eight corners rule is a function of policy language and accepted judicial interpretation. Merely altering some piece of the language used does not result in an alteration of the rules for determining the duty. The simple fact is that the policy, even with “false or fraudulent” deleted, still says the duty to defend depends on ***allegations.*** The policy does not in any way suggestion that a judgment after actual trial, which determines the duty to indemnify, also determines whether something is to be defended or not.

> insured. See 14 COUCH ON INSURANCE § 200:11; *see also Northfield Ins. Co.*, 363 F.3d at 528. In effect, the eight-corners rule is ensconced in the policy.

Id. at 684-85. The court noted it had reached a similar conclusion with a policy involving similar language in *Liberty Mut. Ins. Co. v. Graham*, 473 F.3d 596, 598 (5th Cir. 2006) (applying eight-corners rule when policy provided that "we have no duty to defend suits for bodily injury or property damage not covered by this Coverage Form").

Applying the eight corners rule, the court noted there were clearly allegations that Salgado and Meyer, two of the putative insureds, were acting as agents of the church and were employees of the church acting within the course and scope of employment. The van was clearly non-owned, but used in connection with the church's business. Accordingly, there was a potential case under the petition within the coverage of the policy. *Id.* The court noted that a series of cases decided by the Texas courts had recognized a narrow exception allowing the use of extrinsic evidence to assist in determining the duty to defend "when it is *initially impossible to determine* 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 added). The court concluded that there was an unmistakable overlap between the coverage issues and the liability issues in the underlying case:

> The key question in the coverage dispute relates to the purpose of Meyer's car trip: was Meyer's car trip taken "in connection with [the Church's] business"? The disputed issue of the purpose of Meyer's trip overlaps with the merits of Gilmore's negligent entrustment action against the Church and Salgado. If we conclude that the purpose of Meyer's trip was personal, our finding will support Salgado's argument that he did not entrust his vehicle to Meyer; if we conclude that the purpose of Meyer's trip was Church-related, our finding will support Gilmore's argument that Salgado negligently entrusted his vehicle to Meyer. For this reason, the evidence considered by the district court to determine coverage ***overlaps with the merits of Gilmore's action***. *See Fielder Rd*., 197 S.W.3d at 308-09. Accordingly, this case does not fall under the "very narrow" exception to Texas's eight-corners rule. *See id.*

Id. at 686 (emphasis added). Finally, the Fifth Circuit found that the injunction issued against the plaintiff from pursuing his claims "was improper, [because] the Anti-Injunction Act does not allow the district court to enjoin Gilmore from bringing those claims in another forum."

D. *State Farm v. Richards*

In *State Farm Lloyds v. Richards*, 2018 U.S. Dist. LEXIS 81374 (N.D. Tex. 2018), the insurer raised two policy defenses:

(1) Whether the automobile exclusion applied to an ATV while “off an insured location”?

(2) Whether the injured child was an insured and thus his claims were subject to the exclusion barring coverage for injury to an insured?

Judge McBryde even more fully explained his theory of the modern duty to defend in light of policy language changes:

> The policy . . . provides that "[i]f a claim is made or a suit is brought against an insured for damages because of bodily injury . . . to which this coverage applies, caused by an occurrence, (plaintiff] will pay up to [its] policy limits of liability for the damages for which the insured is legally liable." *Id.* at App. 0046. And, plaintiff will "provide a defense at [its] expense by counsel of [its] choice." *Id.* Thus, for an obligation on the part of plaintiff to arise, there must be a claim made or suit brought because of bodily injury caused by an occurrence as defined in the policy.
>
> In this respect, the policy at issue here is ***unlike those typically at issue*** in Texas cases where the duty to defend is defined more broadly than the duty to indemnify. Those cases, in which an insurance policy provides that the insurer must defend any suit brought against its insured "even if the allegations of the suit are groundless, false or fraudulent***," rely upon the eight-corners or complaint***-allegation rule to determine the duty to defend. *See Northfield Ins. Co. v. Loving Home Care, Inc.,* 363 F.3d 523, 528 (5th Cir. 2004); *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 308 (Tex. 2006). Pursuant to that rule, an insurer's duty to defend is determined by the allegations in the third-party plaintiff's pleadings and the language of the insurance policy at issue. Courts do not go outside the pleadings of the underlying suit except in *narrow circumstances where the court is determining a pure coverage question that may be determined by facts that do not contradict the merits of the underlying claim*. *GuideOne*, 197 S.W.3d at 310. See Doc. 45 at 7-8, n.36 (citing numerous cases).
>
> In this case, the policy does not require plaintiff to defend all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent. Rather, the duty to defend arises only if suit is brought to which the coverage applies. Doc. 46 at App. 0046. ***Thus, the eight-corners rule is not applicable***, *B. Hall Contracting, Inc. v. Evanston Ins. Co*., 447 F. Supp. 2d 634, 645 (N.D. Tex. 2006), *rev'd on other grounds*, 273 F. App'x 310 (5th Cir. 2008), and plaintiff contends that the court can consider evidence outside Meals's pleading to determine whether the Richards's policy provides coverage for Meals's claims. ***Plaintiff does not contest the facts pleaded by Meals; rather, it says that additional facts show that there is no coverage.*** Doc. 45 at 10.

Id. at 6-7 (emphasis added). Given the obvious reversal of this position by the Fifth Circuit in *GuideOne,* one wonders why Judge McBryde has again undertaken to act in this fashion.

State Farm pressed the *B. Hall* rule in moving for summary judgment: "The duty to defend analysis is different when the insurance policy (like Mr. and Mrs. Richards' policy in this case) does not include language that obligates the insurer to defend a damage such . . . 'even in the allegations of the suit are groundless, false, or fraudulent.' . . . ." On appeal to the Fifth Circuit, State Farm is now "moon-walking" away from *B. Hall,* describing it as an "interesting" but immaterial oddity. (Response Brief for Appellee State Farm at 22.)

It should be noted that the court in *Richards* states the *GuideOne* potential exception in terms broader than those recognized by the Texas Supreme Court in *Zurich Am. Ins. Co. v. Nokia, Inc.,* 268 S.W.3d 487, 490 (Tex. 2008). In *Nokia,* the court stated that if it ever did adopt an exception, it would do so only in the narrow circumstance in which [A] it is *impossible to discern* whether coverage is potentially implicated *and* [B] when the extrinsic evidence goes solely to a *fundamental issue of coverage* [C] which *does not overlap* with the merits of or *engage the truth or falsity* of any facts alleged in the underlying case. *Id.* at 497. Judge McBryde does not discuss whether it was impossible to discern whether coverage was potentially implicated it was It was certainly not impossible to determine if coverage was implicated. State Farm was trying to apply the automobile exclusion, which presupposes coverage. Indeed, an exclusion can defeat the duty to defend "[i]f the [underlying] petition ***only alleges facts excluded*** by the policy. *Fidelity & Guaranty Underwriters v. McManus*, 633 S.W.2d 787, 788 (Tex. 1982)(emphasis added).

Judge McBryde's opinion does not acknowledge the very limited scope of only limited exception suggested as potentially applying by the Fifth Circuit in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004). In *Northfield,* the Fifth Circuit acknowledged (without deciding) if an exception prospectively might be recognized, it would operate as follows:

> [I]n the unlikely situation that the Texas Supreme Court were to recognize an exception to the strict eight corners rule, we conclude any exception 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.

Northfield Ins. Co., 363 F.3d at 531 (emphasis added). *See also GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church,* 197 S.W.3d 305, 308 – 09 (Tex. 2006) (adopting the reasoning of *Northfield Ins. Co*.).[6] In *Avalos v. Loya Ins. Co.,* 2018 Tex. App. LEXIS 5629

[6] In *Allstate County. Mut. Ins. Co. v. Wootton*, 494 S.W.3d 825 (Tex. App.—Houston [14th Dist.} 2016), the court interpreted *Nokia* to foresee only the potential of a "narrow" exception. The court strictly followed the requirement that the exception had no application unless it was "impossible to discern" the potentiality of coverage. Thus, the court refused to consider evidence proffered by the carrier showing that the accident occurred while the insured was acting in the scope of employer for another.

(Tex. App.—San Antonio 2018), the court held that the "impossibility to discern" requirement meant that the exception applied only in cases "where it was relevant to an ***independent and discrete coverage issue***, but did not ***touch*** on the merits of the underlying claim. *Pine Oak Builders, Inc.,* 279 S.W.3d at 655; *GuideOne Elite Ins.,* 197 S.W.3d at 310."

The exception has been very narrowly construed and applied. For example, whether the coverage issue or facts touch on the merits of the underlying claim has been applied in a way that does not require a direct relationship between the issues. For example, in *Greystone Multi-Family Builders, Inc. v. Gemini Ins. Co.,* 2018 U.S. Dist. LEXIS 56770 (S.D. Tex., Feb. 26, 2018), the exclusion at issue was a "particular part" exclusion requiring that damage occur while the work was ongoing. The pleadings in the underlying suit did not clearly allege when the damage occurred. The court's analysis of the degree of overlap required to avoid the use of extrinsic evidence is instructive:

> Gemini asserts that engaging in discovery to determine when the damage occurred does not implicate the truth or falsity of the facts alleged since the counterclaim itself does not state when the damage occurred . . . However, in this case, discovery relating to when the damages occurred ***necessarily implicates whether the alleged defects were caused, as alleged in the underlying amended complaint, by Greystone.*** Thus, the discovery relating to timing would necessarily overlap with the merits. The narrow exception to the eight-corners rule does not apply.

Id. at *16 (emphasis added).

As to the first coverage defense, State Farm presented extrinsic evidence in the form of (a) admissions and (b) a department of transportation accident report to show that the accident occurred off-premises. As noted, State Farm did not contest that the negligence clearly was plead to have occurred on location or insured premises. *Id.* at 7. The policy mentioned only when the ATV was *not* an excluded motor vehicle, while off the insured location. It did not say whether the negligence and/or harm had to be off-location. The pleadings were silent as to the location of the accident. Thus, on the face of the pleadings, the exclusion did not apply, even under State Farm's interpretation of the motor vehicle exclusion.

As to the second coverage defense, State Farm presented an order modifying the parent-child relationship. This defense as well involved the assertion of an exclusion. Again, absent pleadings that fall squarely and unequivocally within an exclusion, the exclusion will not defeat the duty to defend. The court held that the order allowed the insured to have possession of the child in question and that they were grandparents. The district court held this was sufficient to establish that the child had two resident households and thus was an insured. So, a child as to whom grandparents have limited temporary custodial rights forgo any insurance coverage should they act negligently in the handling and care of the child? That is what the court held, using this extrinsic evidence. Thus, the court created an extrinsic exception to make an exclusion applicable that was not completely invoked and satisfied by the pleadings.

The insured and the policyholders in *Richards* both argued that the extrinsic evidence was used to contradict facts alleged in the underlying suit. The court rejected these arguments out of hand and proceeded to also hold that there was no duty to indemnify. All of these rulings are on appeal to the Fifth Circuit. Oral argument was held February 5, 2019.[7]

On appeal, the policyholder/claimant position is that the eight-corners rule applies and there is no recognized exception allowing the use of extrinsic evidence, noting the Texas Supreme Court's repeated refusal to adopt *any* exception to the eight corners rule. Alternatively, the policyholder/claimants urge that the only possible exception even hinted at the by Supreme Court would not apply here. Without ever adopting the putative exception, the Texas Supreme Court has made clear if there is any such exception, it indeed would be this restrictive:

> [The insurer] relies on extrinsic evidence that is r*elevant both to coverage and the merits* and thus does not fit the [purported] exception to the rule. Hence, [the insurer] argues that we should broaden the exception to include this type of 'mixed' or 'overlapping' extrinsic evidence. But very little support exists for this position, and the Fifth Circuit Court of Appeals has previously rejected a similar use of overlapping facts for this purpose. . . . We likewise reject the use of overlapping evidence as an exception to the eight-corners rule because it poses a significant risk of undermining the insured's ability to defend itself in the underlying litigation.

GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 309 (Tex. 2006) (emphasis added). The policyholder/claimant argument asserts that the extrinsic evidence does impact and overlap with the merits. Claimant's' State Court Petition is not silent with respect to factual averments that possibly implicate the coverage under the Policy. Instead, Ms. Meals repeatedly averred the insureds' actionable conduct that gave rise to Jayden's death all occurred on the Richards' property. At a minimum, this gave rise to the potentiality that the claim was covered. Under the eight-corners rule, the pleadings had to be liberally construed in factor of finding a duty to defend.

Whether the insureds engaged in actionable conduct, and the nature of that conduct, are the matters averred in the State Court Petition in *Richards*. The claimant did not allege it was negligent (in the abstract) for an adult to allow an underage child to operate an ATV, or even that it is negligent for an adult to allow a child to operate an ATV within certain parameters. The claimant alleged the insureds, in particular, were negligent when they allowed the child in question to *begin operating* an ATV on the insureds' property and allowed that activity to continue in the manner that led to child's death. The nature of State Farm's coverage challenge was its resistance to the claimant's attempt to prove the circumstances of the insureds' decision to allow the child to operate the ATV, while on their property, constituted actionable negligence.

[7] The oral argument can be listened to at this link: https://www.courtlistener.com/audio/61397/state-farm-lloyds-v-janet-richards/.

As to insured status, the underlying suit alleged that the child resided with his mother and maternal grandmother at a specific location different from the insured premises. The policyholder/claimants argue that the extrinsic evidence offered by State Farm and relied on by the court contradict these allegations. Indeed, if the basis of liability was away from the insured location, then clearly this young boy could not have been an insured in relation to this event.

As to the constructional argument regarding the absence of the false or fraudulent language, the policyholder/claimant position is that the District Court quite simply stands alone in construing the Texas Supreme Court's decision in *GuideOne* to permit a policy language-based exception to the eight corners rule. In the twelve years since the District Court issued its *B. Hall Contracting Inc*. decision, that decision has been cited in only six published cases, including the proceedings below, and no court has adopted or endorsed the novel exception to the eight corners rule—courts at most have acknowledged, without endorsing, the proposition expressed in B. Hall Contracting Inc. More importantly, the Fifth Circuit flatly rejected the *B. Hall* analysis in its own *GuideOne* decision.

The policyholder and claimants in *Richards* point out that the Texas Supreme Court previously had an occasion to adopt the reasoning from *B. Hall Contracting Inc*., but rejected the opportunity to do so. In *Zurich American Ins. Co. v. Nokia, Inc*., 268 S.W.3d 487 (Tex. 2008), a party asserted *B. Hall Contracting Inc.* should stand for the proposition that when a policy lacks language obligating the insurer to defend "even if the allegations of the suit are groundless, false, or fraudulent," that omission should open the door to extrinsic evidence. *See* Federal Insurance Company's Brief on the Merits, 2007 WL 2408029, No. 06-1030, * 4, n.6 (Tex. Aug. 6. 2007) ("At least one court has questioned whether a court must presume the truth of the underlying allegations in determining the duty to defend where the form 'groundless, false or fraudulent' language is missing.") (citing *B. Hall*). The Texas Supreme Court nevertheless passed upon this opportunity to abandon categorical application of the eight corners rule, to all insurance policies, because in *Nokia*, the Texas Supreme Court yet again affirmed: "In determining a duty to defend, we follow the eight-corners rule . . .: "an insurer's duty to defend is determined by the third-party plaintiff's pleadings, considered in light of the policy provisions, without regard to the truth or falsity of those allegations." 268 S.W.3d at 491. At least implicitly, it is urged that this signals there is no basis to treat differently policies that omit language affirmatively obligating an insurer to defend "even if the allegations are groundless, false, or fraudulent."

IV. Other Courts Addressing The Omission of False Or Fraudulent Language

The only authority cited by *GuideOne* in support of Judge McBryde's interpretation of the impact of the absence of the false or fraudulent language was authority from Ohio. In *Preferred Risk Ins. Co. v. Gill*, 30 Ohio St.3d 108, 507 N.E.2d 1118 (Ohio 1987), the Ohio Supreme Court held that the absence of false or fraudulent language affected the outcome in that particular case, which involved issues of criminal conduct alleged as negligent conduct:

> This is not a case where the insurer has promised in the insurance policy to defend any suit against the insured alleging injury within coverage, even if such suit is groundless, false or fraudulent. The policy at bar contains no such representation. On this basis, the instant cause is distinguishable from *Willoughby Hills v.. Cincinnati Ins. Co*. (1984), 9 Ohio St. 3d 177, 9 OBR 463, 459 N.E. 2d 555, which held that the insurer has a duty to defend where the allegations of the underlying complaint state a claim potentially or arguably within coverage. *Id*. at syllabus. In *Willoughby Hills*, the insurance policy provided that the company would undertake the defense of any suit alleging injury or property damage within coverage, "'even if any of the allegations of the suit are groundless, false or fraudulent . . . .'" *Id.* at 177, 9 OBR at 463, 459 N.E. 2d at 556.

Id. at 1123. Explaining the impact of the absence of the "false or fraudulent" language, the court observed:

> Where the insurer represents to its insured that it will undertake the defense of any claim asserting injury within coverage, *even where the claim is false or fraudulent,* the duty to defend may arise ***solely from the allegations*** of the underlying complaint, ***regardless of the true facts*** as they are known to the insurer. However, since the appellee herein has promised *only to defend* claims for bodily injury or property damage "to which this coverage applies," the true facts are determinative of the duty to defend. *Where the true facts are such that the insured's conduct was outside the coverage of the policy, the claim is not one "to which this coverage applies,"* and the insurer has no obligation to defend the insured.
>
> We hold, therefore, where the insurer does not agree to defend groundless, false or fraudulent claims, an insurer's duty to defend does not depend solely on the allegations of the underlying tort complaint. Absent such an agreement, the insurer has no duty to defend or indemnify its insured where the insurer demonstrates in good faith in the declaratory judgment action that the act of the insured was intentional and therefore outside the policy coverage.

Id. at 1124 (emphasis added).

Preferred has been limited to its facts by the Ohio Supreme Court. *See Cincinnati Ins. Co. v. Colelli & Assoc., Inc.,* 95 Ohio St.3d 325 (Ohio 2002). Those facts involve claims of criminal conduct falsely alleged as mere negligence. Following *Colelli*, other Ohio courts have held that there need not be the magic "groundless, false or fraudulent" language for the eight-corners rule to apply. *Younglove Construction, LLC v. PSD Development, LLC*, 724 F.Supp. 847, 851, n. 3 (N.D. Ohio 2010) ("The Ohio Supreme Court has recently clarified that the [complaint allegation] rule applies to all insurance policies, even in the absence of such ['groundless, false or fraudulent'] language"); *see also GNFH, Inc. v. West American Ins. Co.,* 127 Ohio.App.3d 127, 134-135, 873 N.E.2d 345, 351 (2007) (same). The court in *GNFH* noted not only that *Preferred* had been limited

to its facts, but also noted that the decision in *Colelli* limiting *Preferred* was a classic example of the type of battle created by extensive use, discovery and litigation over extrinsic facts. The *GNFH* court recognized that *Colelli* involved an eight year struggle, and also noted that "many insured parties would have neither the resources nor the stamina to engage in this type of protracted battle over coverage."

V. *Buss* and Mixed Claims—Extra-Contractual Sources for Duty to Defend Rules

The source of the mixed claim or Musketeer rule has been found by some courts to be based on public policy and common law, not on the language of the contract itself regarding the duty to defend. California has used the non-contractual source as a justification for the attachment of extra-contractual remedies such as a right of reimbursement of defense costs.

In *Buss v. Superior Court,* 16 Cal. 4th 35; 65 Cal. Rptr. 2d 366, 939 P.2d 766 (1997), the California Supreme Court explained the duty to defend as follows:

> The insurer's duty to indemnify runs to claims that are actually covered, in light of the facts proved . . . By definition, it entails the payment of money in order to resolve liability . . . It arises only after liability is established. By contrast, the insurer's duty to defend runs to claims that are merely potentially covered, in light of facts alleged or otherwise disclosed. It entails the rendering of a service, viz., the mounting and funding of a defense in order to avoid or at least minimize liability . . . .

Id. at 773. The court further explained:

> Obviously, the insurer's duty to defend is broader than its duty to indemnify . . . .But, just as obviously, it is not unlimited. . . . It extends beyond claims that are actually covered to those that are merely potentially so--but no further . . . . Thus, in an action wherein all the claims are at least potentially covered, the insurer has a duty to defend . . . This obligation is express in the policy's language. It rests on the fact that the insurer has been paid premiums by the insured for a defense. *"The rule is grounded in basic principles of contract law." (SL Industries v. American Motorists (1992) 128 N.J. 188, 215 [607 A.2d 1266, 1280] [applying New Jersey law, but speaking generally].)* ***The duty to defend is contractual***. . . . "An insurer contracts to pay the entire cost of defending . . . claim[s]" that are at least potentially covered.
>
> Conversely, in an action wherein *none of the claims is even potentially covered*, the insurer does not have a duty to defend. . . . This freedom is implied in the policy's language. It rests on the fact that the insurer has not been paid premiums by the insured for a defense. This "rule" too "is grounded in basic principles of contract law." . . . As stated, the duty to

> defend is contractual. "The insurer has not contracted to pay defense costs" for claims that are not even potentially covered.

Id. at 774.

With respect to mixed claims, some potentially covered and some not, the *Buss* court explained that the policy only makes clear that the carrier has a duty to defend potentially covered claims, but it has no duty to defend uncovered claims. The court noted the authorities in California and elsewhere required a defense of the *entire* case, not just the covered portions, but the decisions did not explain why. The court then did so, holding that the mixed claim rule was not required by the plain meaning of the insurance contract:

> We cannot justify the insurer's duty to defend the entire "mixed" action ***contractually***, as an obligation arising out of the policy, and have never even attempted to do so. To purport to make such a justification would be to hold what we cannot--that the duty to defend exists, as it were, in the air, without regard to whether or not the claims are at least potentially covered . . . As stated, the duty to defend goes to any action seeking damages for any covered claim. If it went to an action simpliciter, it could perhaps be taken to reach the action in its entirety. But it does not. Rather, it goes to an action seeking damages for a covered claim. It must therefore be read to embrace the action to the extent that it seeks such damages. So read, it accords with the general rule, set out above, that the insurer has a duty to defend as to the claims that are at least potentially covered, but not as to those that are not. (See 14 Couch on Insurance, supra, § 51:47, p. 482; Annot., supra, 41 A.L.R.2d at p. 435.) Even if the policy's language were unclear, the hypothetical insured could not have an objectively reasonable expectation otherwise.

Id. at 775 (emphasis added). Instead of a contractual obligation, the court found the mixed claim rule was in fact required by the common law. The court explained:

> [W]e can, and do, justify the insurer's duty to defend the entire "mixed" action prophylactically, as an obligation imposed by law in support of the policy. To defend meaningfully, the insurer must defend immediately. (*Montrose Chemical Corp. v. Superior Court, supra*, 6 Cal. 4th at p. 295.) To defend immediately, it must defend entirely. It cannot parse the claims, dividing those that are at least potentially covered from those that are not. To do so would be *time consuming*. It might also be *futile*: The "plasticity of modern pleading" (*Gray v. Zurich Insurance Co., supra*, 65 Cal. 2d at p. 276) allows the transformation of claims that are at least potentially covered into claims that are not, and vice versa. The fact remains: As to the claims that are at least potentially covered, the insurer gives, and the insured gets, just what they bargained for, namely, the mounting and funding of a defense. But as to the claims that are not, the insurer may give, and the insured may get, *more than they agreed*, depending on whether defense of these claims necessitates any additional costs.

Id. Accord State Farm Fire & Cas. Co. v. Schwan, 371 Mont. 192; 308 P.3d 48, 51-52 (2013). The explanation is weak. If the policy is unclear what happens with mixed claims, the doubt must be resolved in favor of the insured. That is a contractual solution to the problem. The interpretation is also consistent with and bolstered by the fact that defending some claims and not all is unworkable. Did the policy really intend that the insured hire his own lawyer or that he or she pay a lawyer picked by the carrier to defend uncovered claims? An extra-contractual solution was used in *Buss* to justify the creation of a right of reimbursement not included in the policy terms as to the defense of uncovered claims. Not only is necessity the mother of invention, it is also the excuse for rewriting the policy. The court held:

> California law clearly allows insurers to be reimbursed for attorney's fees" and other expenses "paid in defending insureds against claims for which there was no obligation to defend." The reason is this. Under the policy, the insurer does not have a duty to defend the insured as to the claims that are not even potentially covered. With regard to defense costs for these claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement . . . The insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual.

Id. at 776. ***Of course, the absence of a contractual right of reimbursement also makes clear that mixed claims were to be defended in their entirety with no right of reimbursement.***

It is interesting to note that the Texas courts expressly refused to adopt a right of reimbursement regarding defense costs. *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 975 S.W.2d 782, 784 (Tex. App.—Corpus Christi 1998) (refusing to allow insurer to recoup defense costs where not expressly provided for in policy), *aff'd*, 52 S.W.3d 128 (Tex. 2000).The Supreme Court has twice rejected adoption of a right of reimbursement for indemnity claims settled by the carrier subject to a reservation of the right to seek reimbursement. *Excess Underwriters at Lloyds v. Frank's Casing Crew & Rental Tools, Inc*., 246 S.W.3d 42, 48–52 (Tex. 2008); *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128 (Tex. 2000). The Court rejected the adoption of the theory, emphasizing that it would not rewrite the policy to include a right of reimbursement that was not already there.

IV. Professional Liability/Claims-Made

Texas has a fairly well-developed series of decisions refusing to extend any exception based on the impossibility of discerning if a potentially covered claims was in the context of professional liability coverage written on a claims-made basis. *Everest Nat'l Ins. Co. v. Gessner Eng'g, LLC,* 325 F. Supp. 3d 760 (S.D. Tex. 2018)(addressing (a) whether notice of the claim was given during the policy period; (b) whether the insured should have known a claim was likely to be made prior to the policy period). The *Gessner* court reasoned:

> In a case in the Eastern District of Texas, which this Court finds both similar and well-reasoned, the court twice held that no exception to the eight-corners rule applied to the duty to defend analysis under a claims-made policy. *See Corinth Investors Holdings, LLC v. Evanston Ins. Co*., 2014 U.S. Dist. LEXIS 118008, 2014 WL 4222168 (E.D. Tex. Aug. 25, 2014) (Clark, J.); *Corinth Investors Holdings, LLC v. Evanston Ins. Co*., 2015 U.S. Dist. LEXIS 36273, 2015 WL 1321616 (E.D. Tex. Mar. 24, 2015) (Mazzant, J.). In those opinions, the district court held that it was not impossible to discern whether coverage was potentially implicated because the lawsuit was filed and served on the insured within the policy period. *See Corinth*, 2015 U.S. Dist. LEXIS 36273, 2015 WL 1321616 at *4; *Corinth*, 2014 U.S. Dist. LEXIS 118008, 2014 WL 4222168 at *10. The Eastern District court noted that it had "to find only that the claim is potentially within the insurance policy's scope of coverage to establish a duty to defend." *Corinth*, 2015 U.S. Dist. LEXIS 36273, 2015 WL 1321616 at *4.
>
> The Court declines to apply an exception to the eight-corners rule in this case because, as explained above, it is not impossible to discern whether coverage under the Policy is potentially implicated by the allegations in Cause No. 35961.

Id. at 766-67.

VI. Extrinsic Exceptions

A. Florida: Coverage Topic Not One Normally Plead—Pleading Rules?

Recent cases suggest a narrowing of the circumstances where extrinsic evidence can be used. In *Advanced Systems, Inc. v. Gotham Ins. Co.,* 2019 Fla. App. LEXIS 5933; 44 Fla. L. Weekly D 996 (Fla. Ct. App.—3d Dist. April 17, 2019), the court acknowledged that a narrow exception existed for the admission of extrinsic evidence where the complaint omits a reference to an uncontroverted fact that, if pled, would have clearly placed the claim outside the scope of coverage.[8] In such cases, the extrinsic evidence must be "uncontroverted" or it must be "manifestly obvious to all" that it precludes coverage. Thus, the court concluded that evidence of the make-up, through evidence in the form of an MSDS sheet, of a chemical alleged to have caused damage was certainly not uncontroverted and thus did not fall within the exception. The purpose of the extrinsic evidence had been to establish that the chemical in question was a "pollutant." Thus, the general rule in Florida applied that an insurer "must defend even if the allegations in the

[8] This exception was noted by way of a footnote in *Higgins v. State Farm Fire & Cas. Co*., 894 So. 2d 5, 10 n.2 (Fla. 2004): "We note, however, that there are some natural exceptions to this where an insurer's claim that there is no duty to defend is based on factual issues that ***would not normally be alleged*** in the underlying complaint. One example would be when the insurer claims that the insured did not provide sufficient notice of the claim and therefore breached an assistance and cooperation clause. In such circumstances, we believe the courts may entertain a declaratory action seeking a determination of a factual issue upon which the insurer's duty to defend depends." (Emphasis added.)

complaint are factually incorrect or meritless . . . [and] even if it is uncertain whether coverage exists under the policy." *Id.* at *6-*7. The court admitted that the exception is an ***equitable remedy*** to alleviate the perceived unfairness of a silent pleading in the face of undisputed and uncontroverted facts showing the claim will never be covered.

This decision and that in *Higgins* adopting the exception seem to completely ignore the policy language in creating even a narrow exception to the eight-corners rule. If the carrier had desired an outlet clause, it could have included it in the policy language. A narrow exception allowed to defeat a duty to defend would appear to be uncalled for under the terms of the policy.

B. Pleading of Limited Damages—Extrinsic Would Have Aided Policyholder

The Wisconsin Supreme Court in *Water Well Solutions Service Group Inc. v. Consolidated Insurance Co.,* 369 Wis. 2d 607 **; 881 N.W.2d 285 (2016), held the “your product” exclusion defeated the duty to defend where the only damages alleged involved injury to the product itself. The court firmly rejected the adoption of an extrinsic evidence exception.

The *Water Well* court recognized that the duty to defend rules were created by case-law, not necessarily strict policy terms. Under this approach, the court was permitted to consider prudential issues such as the problematic nature of declaratory actions and the conflict often existing in contesting factual issues with possible overlap. The court reasoned:

> Longstanding case law requires a court considering an insurer's duty to defend its insured to compare the four corners of the underlying complaint to the terms of the entire insurance policy. . . . The four-corners rule prohibits a court from considering extrinsic evidence when determining whether an insurer breached its duty to defend . . . We have, however, consistently explained that a court must liberally construe the allegations contained in the underlying complaint, assume all reasonable inferences from the allegations made in the complaint, and resolve any ambiguity in the policy terms in favor of the insured . . . .

Id. at 291-92. As to extrinsic evidence, the court noted:

> *We now unequivocally hold that there is no exception to the four-corners rule in duty to defend cases in Wisconsin* . . . We have applied the four-corners rule, without exceptions, in duty to defend cases for so long because it generally favors Wisconsin insureds . . . The rule ensures that courts are able to efficiently determine an insurer's duty to defend, which results in less distraction from the merits of the underlying suit. Also, the four-corners rule supports the policy that an insurer's duty to defend is broader than its duty to indemnify. That is because "[i]t is the nature of the claim alleged against the insured which is controlling even though the suit

> may be groundless, false or fraudulent." . . . Adherence to "[t]he four-corners rule 'ensure[s] that insurers do not frustrate the expectations of their insureds by [prematurely] resolving the coverage issue in their own favor[.]'" . . . Without the four-corners rule, insurers would be incentivized to outright refuse to defend their insureds and hope that the facts later revealed that no coverage existed . . . ***The end result of strict adherence to the four-corners rule is that "the insurer may have no duty to defend a claim that ultimately proves meritorious against the insured because there is no coverage for that claim. Conversely, the insurer may have a clear duty to defend a claim that is utterly specious because, if it were meritorious, it would be covered."***

Id. at 294-95 (emphasis added).

VII. Extrinsic Evidence—The One Direction Rule

As noted above, some jurisdictions allow either party to use extrinsic evidence. Some allow extrinsic evidence only to assist the insured in establishing a duty to defend. Still others place a duty on the carrier in the face of ambiguous or vague pleadings to investigate and seek out extrinsic evidence that would show a duty to defend.

In *Woo v. Fireman's Fund Ins. Co.,* 161 Wash.2d 43, 164 P.3d 454 (Wash. 2007)(en banc), the court noted that extrinsic evidence was only allowed under recognized exceptions and then only to assist the insured in establishing a duty to defend. The court observed:

> There are two exceptions to the rule that the duty to defend must be determined only from the complaint, and both the exceptions favor the insured." . . . First, if it is not clear from the face of the complaint that the policy provides coverage, but coverage could exist, the insurer must investigate and give the insured the benefit of the doubt that the insurer has a duty to defend. *Id*. Notice pleading rules, which require only a short and plain statement of the claim showing that the pleader is entitled to relief, impose a significant burden on the insurer to determine if there are any facts in the pleadings that could conceivably give rise to a duty to defend . . . Second, if the allegations in the complaint . . .conflict with facts known to or readily ascertainable by the insurer . . . or if . . . the allegations are ambiguous or inadequate, . . . facts outside the complaint may be considered . . .The insurer may not rely on facts extrinsic to the complaint to deny the duty to defend-it may do so only to trigger the duty.

Id. at 459 (citations omitted).

Several jurisdictions allow use of extrinsic evidence to determine the duty to defend in both directions. The Texas cases using limited exceptions have done so. The same is true, for example, in Florida. *See Advanced Systems, Inc. v.*

Gotham Ins. Co., 2019 Fla. App. LEXIS 5933; 44 Fla. L. Weekly D 996 (Fla. Ct. App.—3d Dist. April 17, 2019), discussed *supra.*

VIII. Restatement of the Law of Liability Insurance

The adopted version of the duty to defend section of the Restatement provides:

> § 13. Conditions Under Which the Insurer Must Defend
>
> (1) An insurer that has issued an insurance policy that includes a duty to defend must defend any legal action brought against an insured that is based in whole or in part on any allegations that, if proved, would be covered by the policy, without regard to the merits of those allegations.
>
> (2) For the purpose of determining whether an insurer must defend, the legal action is deemed to be based on:
>
> (a) Any allegation contained in the complaint or comparable document stating the legal action; and
>
> (b) Any additional allegation known to the insurer, not contained in the complaint or comparable document stating the legal action, that a reasonable insurer would regard as an actual or potential basis for all or part of the action.
>
> (3) An insurer that has the duty to defend under subsections (1) and (2) must defend until its duty to defend is terminated under § 18 by declaratory judgment or otherwise, unless facts not at issue in the legal action for which coverage is sought and as to which there is no genuine dispute establish that:
>
> (a) The defendant in the action is not an Insured under the insurance policy pursuant to which the duty to defend is asserted;
>
> (b) The vehicle or other property involved in the accident is not covered property under a liability insurance policy pursuant to which the duty to defend is asserted and the defendant is not otherwise entitled to a defense;
>
> (c) The claim was reported late under a claims-made-and-reported policy such that the insurer's performance is excused under the rule stated in § 35(2);
>
> (d) The action is subject to a prior-and-pending-litigation exclusion or a related-claim exclusion in a claims-made policy;

> (e) There is no duty to defend because the insurance policy has been properly cancelled; or
>
> (f) There is no duty to defend under a similar, narrowly defined exception to the complaint-allegation rule recognized by the courts in the applicable jurisdiction.

RESTATEMENT OF THE LAW OF LIABILITY INSURANCE, Revised Proposed Final Draft No. 2. Ironically, the Commentary accompanying this section is silent as to the source of the duty. Indeed, the Comments simply state that the complaint allegation rule has become "hornbook law."

The Restatement is certainly inconsistent with Texas law. Texas intermediate courts allowing extrinsic evidence have allowed it "both ways" and not "one direction." Moreover, serious questions exist as to whether any exception will even be recognized by the Texas Supreme Court. Even the federal cases adopting a limited exception where the coverage facts do not overlap with liability facts have been more expansive in terms of actual defensive theories. The Restatement limits the extrinsic exception to a narrow set of situations involving issues truly outside any pleadings.