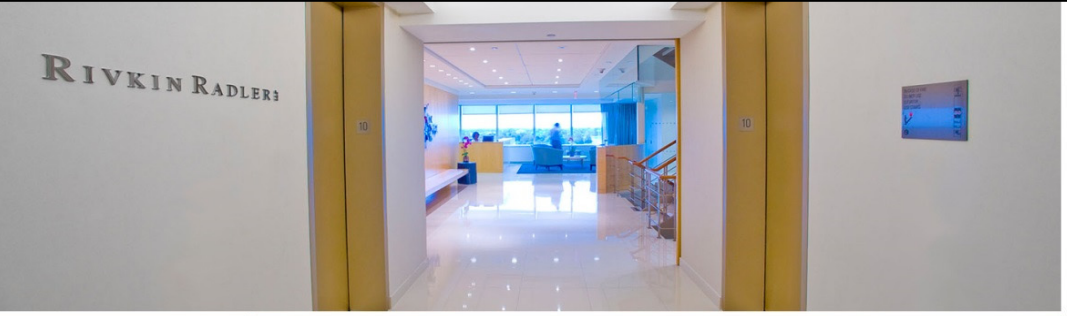

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Texas Supreme Court Refines Eight Corners Rule: Extrinsic Evidence Is Sometimes Allowed

The Fifth Circuit presented the Texas Supreme Court with two certified questions on the duty to defend. May a court consider a stipulated fact important to the issue of insurance coverage but not addressed by the underlying complaint? If so, is the date of an occurrence a type of extrinsic evidence that may be considered?

The Texas Supreme Court answered "yes," with some caveats, and thus adopted an exception to the eight corners rule similar to one that the Fifth Circuit and some Texas appellate courts have been endorsing for years.

Background

In determining whether an insurer has a duty to defend, Texas law applies the eight corners rule. That means the court may consider only two documents: the complaint and the insurance policy. Extrinsic evidence or facts outside the pleadings are usually not considered.

But that sometimes leads to anomalous results. Two years ago, in *Loya Insurance Company v. Avalos*, 610 S.W.3d 878 (Tex. 2020), the Texas Supreme Court recognized a "collusion" exception. Courts may consider extrinsic evidence that the claimant and policyholder colluded in falsely representing facts to give the policyholder a defense it was not otherwise entitled to. In that case, the parties lied about who was driving the vehicle. For more on *Avalos*, see our May 2020 Insurance Update (page 3).

Texas intermediate appellate courts and the Fifth Circuit have also considered extrinsic evidence in assessing the duty to defend where the complaint was silent on a fact that would determine whether coverage applied (ex., vehicle ownership). But courts have differed on when to allow extrinsic evidence or what type of extrinsic evidence to consider.

The Fifth Circuit suggested a standard in *Northfield Insurance Company v. Loving Home Care, Inc.,* 363 F.3d 523 (5th Cir. 2004). It proposed that a court depart from the eight corners rule "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."

Texas intermediate appellate courts were divided on whether to adopt *Northfield*'s narrow exception to the eight corners rule. The Texas Supreme Court has now provided instruction.

Texas Supreme Court's Ruling

The Texas high court has now ruled that courts may consider extrinsic evidence when the claimant's pleading leaves out facts that determine whether coverage exists. But courts may only consider extrinsic evidence that (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved.

The court emphasized, however, that the eight corners rule remains intact and is "the initial inquiry to be used to determine whether a duty to defend exists."

The court also pointed out how its rule differs in three ways from the Fifth Circuit's *Northfield* standard.

First, under *Northfield*, extrinsic evidence may be considered only if it is first impossible to discern from the pleadings and policy whether coverage is *potentially* implicated. The Texas

Supreme Court said the better threshold inquiry is: does the pleading contain the facts necessary to resolve the question of whether the claim is covered? This avoids reading facts into the pleadings.

Second, *Northfield* required that the extrinsic evidence go to a "fundamental" coverage issue: (1) whether the person sued has been excluded by name or description from any coverage, (2) whether the property in suit is included in or has been expressly excluded from any coverage, and (3) whether the policy exists. The Texas Supreme Court eliminates this requirement, finding that the rationale for considering extrinsic evidence is sound whether or not the disputed coverage issue meets *Northfield's* "fundamental" qualifier.

Third, unlike *Northfield,* the extrinsic evidence must conclusively establish the coverage fact at issue. The coverage fact doesn't have to be the subject of a stipulation. But extrinsic evidence may not be considered if there would remain a genuine issue of material fact as to the coverage fact to be proved.

In summing up its reasons for adopting this exception to the eight corners rule, that court explained that a "contrary rule that ignores conclusively proven facts showing the absence of coverage would create a windfall for the insured, requiring coverage for which the insured neither bargained nor paid."

And that led the court to the second certified question: when applying the exception, may the court consider extrinsic evidence of the date of the occurrence? The answer is "yes," as long as the evidence meets the three requirements described in the court's ruling on the first certified question.

The court said that there is no categorical prohibition against extrinsic evidence of the date of an occurrence. But the stipulation before it did not pass the test because it overlapped with the

merits of the liability. Briefly, the insured was hired to drill an irrigation well and was accused of doing it negligently, resulting in property damage. The complaint was silent on when the negligence or property damage occurred. But the complaint did say that the insured was negligent by getting the drill bit stuck in the bore hole.

The dispute was between two insurers who issued successive policies to the driller. The insurer second on the risk argued that it had no duty to defend because the property damage occurred before its policy took effect. The two insurers stipulated that the drill bit got stuck in the bore hole in November 2014, about ten months before the second insurer's policy incepted. The lower court refused to consider the stipulation because the property damage could have occurred anytime between the formation of the drilling contract and the claimant' suit, thereby triggering both insurers' policies.

The Texas Supreme Court agreed that the stipulation should not have been considered. In cases of continuing damage, the court noted, evidence of the date of property damage overlaps with the merits. A dispute over *when* property damage occurs also implicates *whether* property damage occurred. This may force the insured to confess judgment at a particular date to get coverage even though its position may be that no damage was sustained at all.

The court explained that the insured-driller probably would try to prove in the underlying case that the sticking of the drill bit was not the cause of any damage. But to get coverage in the face of the insurer's refusal, the insured would argue that some of plaintiff's alleged damages occurred after November 2014. This would undermine its liability defense, which is best served by asserting there was no damage either in November or anytime later. Because the stipulation would overlap with the merits of liability, the Texas Supreme Court held that it could not be considered in determining whether the insurer owes a duty to defend.

The Texas Supreme Court has now held that extrinsic evidence may sometimes be used when assessing the duty to defend. But we expect to see more litigation over the type of evidence that may be considered and whether it overlaps with the merits of the insured's liability defense. Indeed, the extrinsic evidence before the court – a fairly straightforward stipulation as to when damage occurred – could not overcome this hurdle.

The case is *Monroe Guar. Ins. Co. v. BITCO Gen. Ins. Corp.,* No. 21-0232 (Tex. Feb. 11, 2022).

Applying Eight Corners Rule, Texas Supreme Court Finds Insurer Has No Duty to Defend Golf Cart Accident Suit

On the same day that it adopted an exception to the eight corners rule, the Texas Supreme Court backed up its statement that the eight corners rule "remains the initial inquiry to be used to determine whether a duty to defend exists" by refusing to consider extrinsic evidence about the type of golf cart involved in an accident. Because a golf cart was not a motor vehicle under an auto policy, the court determined that claimant's petition did not assert a covered claim and that the newly minted *Monroe* exception did not apply.

The Case

A high school student was a passenger in a golf cart being driven by the school's athletic trainer when she fell from the cart and sustained injuries. They were using the golf cart to transport equipment from the school's field house to a football field and remained on campus, driving on sidewalks, the parking area, a campus road, bus-loading area, and the running track. The student claims the athletic trainer was pushing the cart to its limit and made an abrupt turn that caused her to fall.

The student sued the school district and the athletic trainer. The school district sought a defense from its automobile liability insurer. The insurer denied coverage because the golf cart was not a covered auto. "Auto" was defined as "a land motor vehicle . . . designed for travel on public roads but does not include mobile equipment." "Mobile equipment" meant certain types of "land vehicles," including "[b]ulldozers, farm machinery, forklifts and other vehicles designed for use principally off public roads." The insurer maintained that a golf cart is not designed for travel on public roads and thus is mobile equipment.

The insurer then filed a declaratory judgment action.

The student's petition was short on details about either the accident or the golf cart. Discovery revealed that the golf cart was an older electric model commonly seen on golf courses but was modified with a wooden bed to hold coolers and other equipment. It was used only on campus property.

Both the insurer and school district moved for summary judgment. The school district's exhibits included deposition testimony about the golf cart, information from the golf cart manufacturer's website, and a newspaper article about the prevalence of golf carts on public streets. The trial court ruled for the school district, but the intermediate appellate court reversed.

An issue arose over whether plaintiff's extrinsic evidence could be considered in deciding the motion. The appellate court determined that it could consider extrinsic evidence because the evidence was relevant only to the insurance coverage dispute and not the merits of the student's claim against the school district. Based on that evidence, it found that the term "golf cart" has an expanded meaning in today's lexicon and may include vehicles designed for travel on public roads. Summary judgment was inappropriate, however, because material factual questions remained about whether the accident involved such a golf cart.

The school district appealed.

Texas Supreme Court's Decision

The Texas Supreme Court agreed that the trial court had erred, but for different reasons than the appellate court.

During the appeal, the school district argued that the intermediate appellate court erred by considering extrinsic evidence – the very same evidence that the school district itself submitted with its summary judgment motion – because the petition referred to only a "golf cart" and that term could refer to vehicles designed for travel on public roads. According to the school district, the insurer had a duty to defend no matter what the extrinsic evidence might reveal about the golf cart actually involved in the accident.

The Texas high court agreed that extrinsic evidence should not have been considered and that the eight corners rule applied. But that still did not help the school district. Looking at the common, ordinary meaning of "golf cart," as well as Texas's statutes, the court found that the term "golf cart" referred to a vehicle designed primarily for use on a golf course, not for travel on public roads. The court acknowledged that the statutes allow golf carts to be operated on public roads sometimes. But that's the exception and does not show that the term "golf cart" includes vehicles *designed* to be operated on such roads.

Applying the eight-corners rule, the Texas Supreme Court held that the insurer had no duty to defend the school district because the allegation that the student was "thrown from a golf cart" was not akin to an allegation that she was thrown from a "vehicle designed for travel on public roads."

The court explained why its *Monroe* exception, handed down earlier in the day, did not apply. It agreed with the appellate court that the fact issue – whether the vehicle was designed

for travel on public roads – related solely to the coverage issue and did not overlap with the merits of the student's claim. The school district was liable whether or not the golf cart was designed for travel on public roads. But the remaining *Monroe* factors did not apply.

That's because there was no "gap" in the petition that prevented the court from determining whether coverage exists. A golf cart is designed for travel on a golf course and not on public roads. Mere disagreements about the common, ordinary meaning of an undefined term, the court noted, does not create the type of "gap" *Monroe* requires. And with no gap, any extrinsic evidence that the student was thrown from something other than a golf cart would contradict the facts alleged in her petition.

In contrast, had the petition alleged that the student was thrown from a "vehicle" with no indication of the type of vehicle or whether it was designed for travel on public roads, a gap would exist that would prevent the court from determining the duty to defend based solely on the petition's allegations and the policy's provisions. In such case, extrinsic evidence proving that the vehicle was or was not designed for use on public roads would not contradict the general allegation that the accident involved a vehicle.

But by pleading that the vehicle was a "golf cart," the court explained, the petition provided all the information necessary to determine the duty to defend. Thus, the court held that the *Monroe* exception does not apply, and the eight-corners rule governed the duty to defend in this case.

In case you are wondering, sources such as dictionaries, statutes, and court opinions are permissible for the court to consider under the eight corners rule because it aids the court in understanding the meanings and usages of words.

The case is *Pharr-San Juan-Alamo Indep. Sch. Dist. v. Tex. Pol. Subdivisions Property/ Cas. Joint Self Ins. Fund*, No. 20-0033 (Tex. Feb. 11, 2022).

Connecticut Supreme Court Holds That Nolo Plea Does Not Trigger Criminal Acts Exclusion

On a certified question from a federal district court, the Connecticut Supreme Court ruled that a plea of nolo contendere (no contest) could not be used to trigger a criminal acts exclusion in a homeowner's policy because it was inadmissible as proof of criminal acts.

The Case

The insured was arrested for assaulting a man with a baseball bat. He pleaded nolo contendere to the assault charge. The victim filed a separate civil action against the insured asserting assault, negligent assault, intentional infliction of emotional distress, and negligent infliction of emotional distress. The two negligence counts asserted that the insured swung the baseball bat wildly and without warning.

The insured was defended in the civil suit by his mother's homeowners insurer under a reservation of rights. The insurer then sought a judgment declaring that it had no duty to defend based on the policy's criminal acts exclusion. That exclusion applied whether or not the insured is actually charged with or convicted of a crime. The insurer argued that the plea of nolo contendere precludes any argument that the insured did not commit a crime.

The Decision

The Connecticut Supreme Court disagreed. As a general rule, a plea of nolo contendere in a criminal case is inadmissible in a civil action to establish either an admission of guilt or the fact of criminal conduct. A plea of nolo contendere allows a defendant to accept a punishment lighter

than if found guilty and yet still maintain his or her innocence. Allowing the use of nolo contendere pleas as proof of underlying criminal conduct in subsequent civil litigation, the court explained, would undermine the very essence of the nolo contendere plea itself.

So the court's holding was based first on Connecticut's rules of evidence – that a plea of nolo contendere cannot be used as proof of criminal conduct. The court acknowledged that despite this evidentiary limitation, a nolo plea does not always shelter criminal defendants from the collateral consequences arising from the resulting criminal conviction. But it did not need to consider that because the policy's exclusion did not turn on the existence of a criminal conviction. The provision instead is triggered by the intentional or criminal acts of an insured. The nolo plea was inadmissible as proof of a criminal act.

The court next rejected the insurer's argument that the inadmissibility of the nolo plea should apply only to the civil action by the victim, not the declaratory judgment action, because otherwise, the nolo plea would allow the insured to benefit from his own illegal conduct. The court saw no reason to apply the restriction to the victim of a crime in a tort case but not a corporation in a declaratory judgment action arising out of the same facts. The court also found that the nolo plea would not rule out the insurer's ability to enforce the criminal acts exclusion based on other evidence. But the plea of nolo contendere, by itself, cannot be used to establish the applicability of the criminal acts exclusion.

Two dissenting judges, however, believed that the nolo plea was relevant and admissible in the declaratory judgment action, although not dispositive of the coverage issue.

The case is *Allstate Ins. Co. v. Tenn,* No. SC 20586 (Feb. 23, 2022).

Eleventh Circuit Rejects Insured's Excuse for Not Promptly Notifying Insurer of Fire Loss, Finding 11-Month Delay Unreasonable as a Matter of Law

Applying Georgia law, the Eleventh Circuit ruled that an insured who waited 11 months before notifying his homeowners insurer of a fire loss breached the notice conditions of the policy. The court found that the insured's excuse for the delay – that he did not know if the property was insured or the name of the insurer – unreasonable under the circumstances.

The Case

In 2014, Richard Currie and his wife bought a homeowners' policy from Auto-Owners Insurance Company for their property in Stockbridge, Georgia. The policy required Currie to give Auto-Owners "or [its] agency immediate notice . . . if a covered loss occurs." The Curries regularly paid their insurance premium with their mortgage payment to Wells Fargo after each annual renewal.

In June 2017, three months after Currie and his wife separated, Currie submitted a claim to Auto-Owners for damage a tree caused to the back deck and above-ground pool. Currie exchanged emails with an adjuster and negotiated three insurance checks. In August 2018, Currie renewed the homeowner policy.

In October 2018, Wells Fargo foreclosed on the mortgage and the Curries' divorce became final. Currie remained on the property as a squatter. In November 2018, a fire occurred on the property, and left it uninhabitable. The fire department issued a report that classified the cause of the fire as undetermined and could not rule out human action or misuse of electrical appliances. Currie returned to the property to retrieve three items without protecting the house from the elements or from intruders. Later, Currie could not recall the name of his insurer and called Wells Fargo. A Wells Fargo representative told Currie that the property was uninsured.

In October 2019, after receiving notice that Auto-Owners had cancelled the homeowners' policy for nonpayment of premiums, Currie filed a claim. Following an investigation of the claim, Auto-Owners denied coverage because, due to Currie's delay in reporting the loss, it was unable "to fully investigate the cause of the fire" or "to determine the extent of the damages due to the delay in reporting after the loss."

Currie sued Auto-Owners in Georgia state court, alleging breach of contract and bad faith. Auto-Owners removed the action to federal court and moved for summary judgment. The district court granted Auto-Owner's motion, ruling that Currie breached a condition precedent to coverage by failing to provide immediate notice of the loss, which it held was unreasonable as a matter of law. Currie appealed.

The Decision

The Eleventh Circuit affirmed the district court's ruling. Applying Georgia law, the court held that the district court did not err in ruling that Currie's 11-month delay in reporting his loss was unreasonable as a matter of law. The court observed that a reasonable person in Currie's circumstances would have thought a policy existed. The court noted that Currie had been a policyholder since 2014, he obtained payment from Auto-Owners on a claim he filed about a year earlier, and he renewed his policy three months before the fire.

The court rejected Currie's reliance on the statement of an unnamed Wells Fargo representative at an unspecified time after the fire that there was no insurance on the property. The court noted that Wells Fargo did not issue the policy and Currie could not reasonably rely on Wells Fargo to know the status of an insurance policy he purchased. The court determined that the law requires more than "misplaced confidence . . . to avoid the terms of a valid contract."

The court also held that Currie's bad faith claims were properly dismissed. It found that Auto-Owners performed a fair investigation because it hired an expert to examine the scene and after amassing records from the fire department, agreed that the cause of fire could not be determined.

For these reasons, the court affirmed the district court's award of summary judgment to Auto-Owners.

The case is *Currie v. Auto-Owners Ins. Co.*, 21-13174 (Feb. 10, 2022, 11th Cir. 2022)(unpublished).

Washington Federal Court Rules That "Fines and Penalties" Exclusion Applies to Settlement of AG's Malware-Based Suit

In an intra-insurer dispute, a federal court in Washington ruled that an equitable subrogation action by a settling insurer against other insurers could proceed because the settling insurer established that it paid a settlement for a claim barred by its policies' "fines and penalties" exclusion.

The Case

In early 2015, Premera Blue Cross disclosed that in May 2014, unauthorized parties had gained access to its computer systems, installing malware that resulted in the compromise of confidential information belonging to millions of people. This event led to many lawsuits against Premera, including claims brought by 30 state attorneys general.

Premera sought indemnification from Atlantic Specialty Insurance Company ("ASIC") under primary commercial general liability and umbrella liability policies. ASIC sued Premera in federal court in Washington for a declaration that ASIC did not have to defend or indemnify Premera for

the claims asserted in the underlying AG lawsuits. The AG suit settled before the court could determine ASIC's right and obligations under the policies. ASIC contributed approximately $2.7 million toward the AG settlement, while reserving its rights to subrogate against two other carriers, Lexington Insurance Company and BCS Insurance Company.

ASIC sued Lexington and BCS in Washington federal court for a declaration that it was entitled to equitable subrogation and contribution in the amount of $2.7 million. In it motion for judgment on the pleadings, ASIC argued that its policies excluded coverage for "fines and penalties," and thus Premera's liability for the settlements was not covered.

The Decision

The court granted ASIC's motion in part and denied it in part. The court found that the ASIC policies' "fines and penalties" exclusion precluded coverage for any portion of the AG settlement allocated to fines and penalties. The court reasoned that, absent a definition in the policies, the terms "fines and penalties" should be enforced based on its plain meaning. The court noted that the black-letter definition of "penalty" is "a sum of money exacted as punishment for a wrong to the state" and the black-letter definition of "fine" is "a pecuniary criminal punishment or civil penalty payable to the public treasury."

Measured against these definitions, the court determined that Premera's payment in settlement of the AG lawsuits constituted a "sum of money exacted as punishment for a wrong to the state." The AG lawsuits accused Premera of violating state and federal law, sought civil penalties and statutory damages, and in one case, a consent judgment ordered Premera to pay the judgment amount to the Attorney General's Office. It was immaterial that Lexington and BCS never admitted to any wrongdoing, but the court declined at the motion to dismiss stage to grant ASIC's request for a declaration on the $2.7 million payment. The court reasoned that BCS raised

an issue of material fact over whether its policies did not cover at least one of the AG settlement payments.

The case is *Atl. Specialty Ins. Co. v. Lexington Ins. Co.*, 21-cv-0616 (Feb. 7, 2022 W.D. Wash).

Illinois Court Finds No Coverage for Trademark Infringement Claim By Pizza Restaurants

An Illinois federal court held that a trade dress exception to a policy exclusion for trademark infringement did not apply to a dispute between pizza restaurants with the same name because the underlying claim did not include the hallmarks of a trade dress claim.

The Case

Ledo Pizza System, Inc. and Ledo Pizza Carryouts, Inc., sued Ledo's, Inc., in Illinois federal court. Both Ledo Pizza System, Inc. and Ledo Pizza Carryout and Ledo's Inc. were all pizza restaurants. Ledo Carryouts owned the trademark and service mark "LEDO PIZZA®," and licensed Ledo System to use the trademark and related intellectual property in the sale of franchised restaurants operating under the various names beginning with "Ledo."

The complaint alleged trademark infringement and unfair competition under the Lanham Act. The complaint alleged that Ledo's Inc. used a LEDO PIZZA® service mark and trademark likely to cause confusion among consumers that Ledo's, Inc. was allowed to advertise and deliver plaintiffs' products. The complaint further alleged that the operation of a pizza restaurant under the name "Ledo's Pizza" while selling food products almost identical to plaintiffs was likely to confuse consumers and lead them to believe that the companies were affiliated.

Ledo's, Inc. tendered the defense of the lawsuit to its commercial liability and umbrella carrier, AMCO Insurance Company. AMCO declined to defend Ledo's, Inc., citing exclusions for

knowingly violating the rights of another and "infringement of copyright, patent, trademark, trade secret or other intellectual property rights." But the second exclusion contained an exception for infringement based on copyright, trade dress, or slogan.

Ledo's Inc. sued AMCO in Illinois federal court for a declaration that it had no duty to defend or indemnify Ledo's, Inc. against the underlying suit. AMCO moved for summary judgment.

The Decision

The district court granted summary judgment to AMCO, finding it had no duty to defend or indemnify Ledo's Inc. in connection with the action.

In analyzing trade dress claims under the Lanham Act, courts focus on whether there is any alleged confusion that might stem from "the size, shape, color, etc.—the 'look and feel'" of the allegedly infringing product. The court found that the underlying complaint, even liberally construed, could not be read to claim that the presentation of the pizza (or any other item) Ledo's, Inc. sold might mislead consumers based on the "look and feel" of the competing products. The court emphasized that the plaintiffs did not allege any facts that might suggest that Ledo's, Inc. "modeled its overall appearance after that used in connection with their marks." Plaintiffs did not allege that Ledo's, Inc. wrongfully appropriated the look and feel of plaintiffs' business such that customers may be confused as to the source of the pizza. To the contrary, the court noted, plaintiffs only argued that Ledo's, Inc.'s *name*, used with similar food products, was likely to cause confusion with plaintiffs' trademark.

Because the complaint did not state a trade dress claim, the court held that AMCO did not have a duty to defend Ledo's, Inc. in the lawsuit.

The case is *Amco Ins. Co. v. Ledo's, Inc.*, No. 21 C 2972 (N.D. Ill. Feb. 4, 2022).

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