I. BASIC TENETS OF THE "EIGHT CORNERS" RULE AND THE DUTY TO DEFEND

Texas law is well settled that the "eight corners" rule determines an insurer's duty to defend. Historically less concrete, however, is the rule's flexibility and interpretation. Texas state and federal courts have inconsistently applied the rule to an insurer's defense duty, except, occasionally, where the Texas Supreme Court has stepped in to realign the intended breadth of the rule. On June 30, 2006, the Supreme Court again reset the rule's boundaries in *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, in which it rejected the use of extrinsic evidence and re-established the focus of the duty to defend solely on the "eight corners" of the pleading and policy.

In light of the recent *GuideOne* decision, this paper examines historical and recent interpretations of the "eight corners" rule and discusses practical concerns and possible answers for insurers given correct Texas law.

A. "Eight Corners" Rule Defined

Under the "eight corners" (or complaint allegation) rule, an insurer's duty to defend is determined by the allegations in the pleadings and the language of the insurance policy. *See King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex. 2002); *National Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997). Therefore, if a petition does not allege facts within the scope of coverage, an insurer is not legally required to defend a lawsuit against its insured. *See King v. Dallas Fire Ins. Co.*, 85 S.W.3d at 187; *Fidelity & Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex. 1982).

The duty to defend is determined by construing the latest pleading and the focus of the inquiry is on the alleged facts, not the asserted legal theories. *See St. Paul Fire & Marine Ins. Co. v. Green Tree Fin. Corp.-Tex.*, 249 F.3d 389, 392 (5th Cir. 2001); *Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co.*, 99 F.3d 695, 701 (5th Cir. 1996). Texas courts liberally construe a pleading. The duty to defend arises when the alleged facts, if taken as true, would *potentially* state a cause of action falling within the terms of the policy. *See Canutillo Indep. Sch. Dist.*, 99 F.3d at 701 (emphasis in original). If a court cannot readily determine if the allegations against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend, the court must resolve any issue of coverage in the insured's favor. *See Merchants Fast Motor Lines, Inc.*, 939 S.W.2d at 141. Importantly, facts ascertained before suit, developed in the process of litigation, or determined by the ultimate outcome of the lawsuit do not affect the duty to defend. *See Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997). This premise is the crux of the "eight corners" rule as, theoretically, only the four corners of the live pleading and the four corners of the relevant policy – thus, "eight corners" – are considered in analyzing the duty to defend.

II. BENDING THE "EIGHT CORNERS" RULE

A. When Eight Corners Are Not Enough

The Texas Supreme Court has not recognized any exceptions to the "eight corners" rule. But, several Texas appellate courts and federal courts have interpreted the rule more liberally. For instance, the Corpus Christi Court of Appeals created an exception to the "eight corners" rule in *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448 (Tex. App. -- Corpus Christi 1992, writ denied), a decision often cited by Texas federal and appellate courts in allowing extrinsic evidence. In *Wade*, the insurer filed a declaratory judgment action to determine if an exclusion applied to preclude coverage. State Farm's policy covered boat accidents resulting from a specific use of a boat, however, the underlying petition did not specify how the boat was used prior to the accident. *See id.* at 451. In light of the vague pleading, the court held that State Farm was not barred from using evidence and facts outside the underlying petition to show the boat was used for an excluded purpose. *See id.* The court reasoned that extrinsic evidence was allowed because the evidence had no bearing on the truth or falsity of the facts in the underlying petition. *See id.* at 453.

The *Wade* court relied on prior Texas appellate court precedent allowing extrinsic evidence. *See id.*, citing *Gonzales v. American States Ins. Co.*, 638 S.W.2d 184, 187 (Tex. App. -- Corpus Christi 1982, no writ)(holding that facts extrinsic to the petition relating only to coverage and not to liability could be considered in determining the duty to defend as long as the evidence did not contradict any allegation in the pleading); *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712, 715-16 (Tex. Civ. App. -- Texarkana 1967, no writ)(concluding that Texas law draws a distinction between cases in which the merit of the claim is the issue and those in which coverage is in question; in the first instance, the allegation of the petition controls, and in the second, the known or ascertainable facts prevail); *International Serv. Ins. Co. v. Boll*, 392 S.W.2d 158, 161 (Tex. Civ. App. -- Houston [1st Dist.] 1965, writ ref'd n.r.e.)(finding that parties' stipulation regarding identity of boat driver was admissible to show that loss was not covered by policy).

Several Texas federal courts have agreed with *Wade*, holding that, if the pleading is vague with respect to a fact affecting the duty to defend, a court may consider extrinsic evidence. *See Western Heritage Ins. Co. v. River Entertainment*, 998 F.2d 311, 313 (5th Cir. 1993)(stating that extrinsic evidence is proper when the petition contains insufficient facts to determine coverage); *Westport Ins. Corp. v. Atchley, Russell, Waldrop & Hlavinka, L.L.P.*, 267 F.Supp.2d 601, 621 (E.D. Tex. 2003)(concluding that extrinsic evidence is allowed in very limited circumstances – when fundamental coverage issues can be resolved by readily determined facts that do not engage the truth or falsity of the underlying petition or overlap with the merits of the underlying lawsuit). Not every court, however, has agreed.

III. RECENT TRENDS IN INTERPRETING "EIGHT CORNERS"

A. When "No" Means "No"

To date, the Texas Supreme Court has consistently maintained a rigid analysis of the "eights corners" rule. *See Westport Ins. Corp.,* 267 F.Supp.2d at 621; *see also Tri-Coastal Constr., Inc. v. Hartford Underwriters Ins. Co.*, 981 S.W.2d 861, 863-64 (Tex. App. -- Houston [1st Dist.] 1988, pet. denied)(declining to follow *Wade* and refusing to consider extrinsic evidence although the petition contained insufficient facts to determine if an exclusion applied). Other courts, including at times the Fifth Circuit, have followed suit. *See, e.g., Northfield Ins. Co.,* 363 F.3d 523 (5th Cir. 2004)(finding that extrinsic evidence was not allowed to show intentional and criminal conduct barred from coverage by policy exclusions); *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833 (Tex. App. -- Dallas 2004, pet. filed)(refusing to allow extrinsic evidence to show damage occurred outside of policy period).

Strict interpretation of the "eight corners" rule has encouraged vague and incomplete pleading in an effort to trigger a carrier's defense obligation and potential indemnity. This practice, increasingly common in construction defect and other types of "long tail" claims, often imposes a duty to defend on multiple carriers because no specific dates of damage are alleged. *See Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co.*, 99 F.3d 695, 701 (5th Cir. 1996). Some courts have held that, in the absence of pleaded dates, even insurers whose policies clearly would not provide coverage because of the applicable statute of limitations are required to provide a defense. *See Summit Custom Homes v. Great Am. Lloyds Ins. Co.*, 2006 Tex. App. LEXIS 6143 (Tex. App. -- Dallas, July 18, 2006, no pet.)(although underlying plaintiffs pleaded discovery rule, in effect stating they only discovered construction defects within the applicable statute of limitations, the court applied the "eight corners" rule and held the insurer failed to establish as a matter of law that the damages did not manifest within the insurer's early policy period); *Gehan Homes, Ltd.*, 146 S.W.3d at 846 (construing the pleadings liberally in favor of the insured, and concluding that the insurers could not establish, as a matter of law, that no claims were alleged during their policy period).

B. When "No" Means "Maybe"

In *Westport*, the court identified three scenarios in which extrinsic evidence can be considered: (1) to determine whether the named defendant in the underlying lawsuit is specifically excluded from coverage by name or description; (2) to determine whether the litigated property is covered, and (3) to determine whether the policy exists. *See Westport Ins. Corp. v. Atchley, Russell, Waldorp & Hlavinka, L.L.P.*, 267 F.Supp.2d 601, 621. The Fifth Circuit also has surmised that, if the Texas Supreme Court were to recognize an exception to the "eight corners" rule, it would likely do so under very narrow circumstances, such as when the extrinsic evidence goes solely to a fundamental coverage issue that does not overlap with the merits of, or engage the truth or falsity of, any facts in the underlying lawsuit. *See Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004)(refusing to allow extrinsic evidence as to insured's alleged intentional conduct when underlying suit alleged only negligence); *but cf. Primrose Operating Co. v. National Am. Ins. Co.*, 382 F.3d 546 (5th Cir. 2004)(allowing extrinsic evidence to evaluate if "sudden and accidental" exception to pollution

exclusion applied), *Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192 (5th Cir. 1998)("sudden and accidental discharge" exception to pollution exclusion not applicable where pleadings and extrinsic evidence confirmed the insured's pollution was ongoing and routine); *see also John Deere Ins. Co. v. Truckin' USA*, 122 F.3d 270 (5th Cir. 1997)(affirming district court judgment allowing extrinsic evidence that showed truck involved in accident was not a covered auto).

IV. *GUIDEONE*

A. What This Means for Insurers in Texas

On June 30, 2006, the Texas Supreme Court reaffirmed a strict interpretation of the "eight corners" rule and refused to allow the use of extrinsic evidence. *See GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 2006 Tex. LEXIS 608 (Tex. June 30, 2006). In *GuideOne*, the insured received limited coverage for sexual misconduct under a commercial general liability policy as follows:

> "We agree to cover your legal liability for damages because of bodily injury, excluding any sickness or disease, to any person arising out of sexual misconduct which occurs during the policy period. We shall have the right and duty to investigate any claim…and to defend any suit brought against you seeking damages, even if the allegations of the suit are groundless, false or fraudulent, and we may make any settlement we deem expedient."

GuideOne's policy was effective from March 31, 1993 to March 31, 1994. The underlying plaintiff sued Fielder Road Baptist Church (the "Church") and a minister for the minister's alleged sexual misconduct while employed by the Church from 1992 to 1994, alleging "[a]t all times material herein from 1992 to 1994, Evans was employed as an associate youth minister and was under Fielder Road's direct supervision and control when he sexually exploited and abused Plaintiff." The Church demanded that GuideOne defend it in the lawsuit and indemnify it for any settlement or judgment.

GuideOne agreed to defend the Church, subject to a reservation of rights, but filed a declaratory judgment lawsuit seeking a determination of its duty to defend. In the suit, the trial court allowed GuideOne to conduct discovery regarding the minister's employment history at the Church. The discovery revealed that the minister ceased working for the Church in December 1992, before the inception of GuideOne's policy. Based upon evidence that the minister left his employment with the Church before the inception of the policy, GuideOne argued an exception to the "eight corners" rule should apply, and the evidence precluded GuideOne's obligation to defend the Church and minister because it addressed coverage and not the merits of the underlying lawsuit. GuideOne also argued, alternatively, that the evidence was required to supplement the plaintiff's vague and insufficient allegations, or that, if the evidence was determinative to both coverage and liability, it should nonetheless be allowed. The Church objected, arguing that GuideOne's duty to defend should be determined by the pleadings and the policy without considering extrinsic evidence.

The Texas Supreme Court noted that courts allowing extrinsic evidence did so under limited circumstances involving pure coverage questions. *See id., citing International Services Ins. Co. v. Boll,* 392 S.W.2d 160 (Tex. Civ. App. – Houston 1965, writ ref'd n.r.e.)(extrinsic evidence dealt with a pure coverage issue – the identity of the driver who was named under the policy as an excluded driver). The Supreme Court, however, strictly applied the "eight corners" rule to conform with the policy's insuring agreement that GuideOne would defend the Church against allegations of sexual misconduct potentially within coverage, even if the plaintiff's allegations were false or fraudulent. *See id., citing Heyden Newport Chem. Co. v. Southern Gen. Ins. Co.,* 387 S.W.2d 22, 25 (Tex. 1965). The Court stated that GuideOne relied on extrinsic evidence that is relevant to both coverage and the merits of the underlying lawsuit, and did not fit previously recognized exceptions to the rule.

The Supreme Court also rejected GuideOne's argument that the Court should broaden the exception to the "eight corners" rule to allow the type of "mixed" or "overlapping" extrinsic evidence GuideOne advocated because the Fifth Circuit Court of Appeals has rejected a similar use of facts for this purpose, and the use of the evidence posed a significant risk of undermining the insured's ability to defend itself in the underlying litigation. *See id.; see also Gulf Chemical & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 367 (5th Cir. 1993). Accordingly, the plaintiff's allegations that the minister sexually assaulted her during the policy period and while he was a minister with the Church were sufficient to trigger GuideOne's duty to defend. Moreover, GuideOne, in its policy, agreed to defend the Church against allegations of sexual misconduct potentially within coverage, even if the plaintiff's allegations were false or fraudulent, and applying the "eight corners" rule conforms with the parties' contract. Therefore, GuideOne's argument did not present a basis for allowing an exception to the rule.

V. "EIGHT CORNERS" OF THE FUTURE

The *GuideOne* decision dealt another blow to the use of extrinsic evidence, although a carrier may still be able to skirt the "eight corners" rule in limited circumstances. Notably, the *GuideOne* court did not hold that extrinsic evidence can *never* be used, but simply held that such evidence cannot be used to contradict pleaded facts or if the evidence might affect the insured's liability. Situations may still exist when an insurer can use extrinsic evidence – such as when a petition is completely silent on issues that may impact coverage but not the underlying claims against the insured. As it appears that much of the plaintiffs' bar has learned the art of creating ambiguous and vague pleadings to trigger a defense obligation, this is certainly an area that will be explored by insurers in future coverage litigation.