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TEXAS COURTS ARE NOW CONSIDERING EXTRINSIC EVIDENCE WITH RESPECT TO THE DUTY TO DEFEND.

Immediate Impact Appears to be More of the Same: Artful Pleading Still Seems to Work

On February 11, 2022, the Texas Supreme Court issued its long-awaited decision analyzing an insurer's duty to defend under Texas law in *Monroe Guaranty Ins. Co. v. BITCO General Ins. Corp,* 640 S.W.3d 195 (Tex. 2022). In *Monroe Guaranty,* the Court announced: "Today, we expressly approve the practice of considering extrinsic evidence in duty to defend cases." *Id.* at 201. In so doing, the Court then articulated a new rule for deciding when extrinsic evidence can be considered, which is when:

(1) the petition alleges "a claim that could trigger the duty to defend,"

(2) a "gap" in the petition makes it unable for the court to determine whether coverage exists by applying the eight-corners rule,

(3) the facts the extrinsic evidence relate solely to the coverage issue and do not overlap with the liability merits,

(4) those facts do not contradict facts alleged in the petition, and

(5) the extrinsic evidence "conclusively establishes the coverage fact to be proved."

Id. at 202.

In *Monroe Guaranty,* undisputed extrinsic evidence established that an event causing property damage took place prior to the inception of Monroe Guaranty's policy. *Id.* at 197-98. Nonetheless, the *Monroe Guaranty* Court held that the proffered extrinsic evidence of the stipulation of the date that an event occurred could not be considered because it overlapped with the merits. In this regard, the *Monroe Guaranty* Court opined:

> A dispute as to *when* property damage occurs also implicates *whether* property damage occurred on that date, forcing the insured to confess damages at a particular date to invoke coverage, when its position may very well be that no damage was sustained at all.

Id. Accordingly, the *Monroe Guaranty* Court refused to consider the extrinsic evidence that could have exculpated the insurer from providing a defense and held that the insurer owed its insured a duty to defend. *Id.* at 204.

In the 3½ month aftermath of the issuance of the *Monroe Guaranty* opinion, the issue of whether to consider extrinsic evidence in determining the duty to defend has been analyzed by four courts. The immediate takeaway is that on the one hand, for three of the cases, the new rule does not change anything—e.g., artful pleading to manufacture a duty to defend appears to be alive and thriving—however, on the other hand, the use of extrinsic evidence appears to be well suited to deal with situations such as a claim against an insured predating the inception of a claims made policy.

For example, simultaneously with the issuance of its *Monroe Guaranty* opinion, the Texas Supreme Court handed down its decision in *Pharr-San Juan-Alamo Independent School Dist. v. Texas Political Subdivisions Property/Casualty Joint Self-Ins. Fund,* 642 S.W.3d 466 (Tex. 2022), which refused to consider extrinsic evidence and applied the eight-corner rule to conclude that the allegations that an accident involving the negligent use of a golf cart did not allege a claim for coverage under the auto policy. *Id.* at 477. On this point, the *Pharr-San Juan* Court held that none of the *Monroe Guaranty* factors permitted such extrinsic evidence consideration because no gap existed in the pleadings. *Id.* at 477-78.

Shortly after *Monroe Guaranty* was decided, Dallas federal district judge Jayne Boyle was presented with the situation as to whether to consider extrinsic evidence in determining the duty to defend in *Knife River Corp.—South v. Zurich American Ins. Co.,* 2022 WL 686625 (N.D. Tex. 2022). *Knife River* involved a declaratory judgment action over whether an insurer provided coverage to a putative additional insured, Knife River. *Id.* at *2. As it related to the duty to defend, the insurer wanted to introduce extrinsic evidence of a subcontract to demonstrate that Knife River did not qualify as an additional insured under the operative policy. *Id.* at *9.

On these facts, District Judge Boyle analyzed *Monroe Guaranty* and she refused to consider the subcontract as extrinsic evidence to determine the duty to defend because the subcontract involved allocating responsibility for the placement of a sign, which the court ruled overlapped with the merits of whether Knife River was liable. *Id.* at *8. Resorting to a strict 8-corner analysis, the court denied the insurer's motion to dismiss on the basis that it did not owe a duty to defend. *Id.* at *10.

In the first artful pleading case considered post-*Monroe Guaranty,* another Dallas federal district judge, Sam A. Lindsay, did not even cite to *Monroe Guaranty* in finding a duty to defend in *Certain Underwriters at Lloyd's London v. Keystone Development, LLC,* 2022 WL 865891 (N.D. Tex. 2022). *Keystone Development* involved a situation where the operative policy insuring a condominium developer contained an exclusion that precluded coverage for projects consisting of over 25 units, however, there were 39 units in the particular development. *Id.* at *2. After receiving the insurer's motion for summary judgment that no duty to defend existed based

on this exclusion, the plaintiff in the underlying construction defect case artfully amended its pleadings to allege that the development consisted of two projects, one with 24 units and the other with 15 units. *Id.* at **2, 4.

District Judge Lindsay refused to apply the pre-*Monroe Guaranty* rule allowing utilization of extrinsic evidence in determining the duty to defend for collusive efforts to manufacture a duty to defend that was announced in the 2020 Texas Supreme Court opinion in *Loya Ins. Co. v. Avalos,* 610 S.W.3d 878 (2020). Although he alluded to "different exceptions to the eight-corners rule," *Keystone Development,* 2022 WL 865891 at *2, District Judge Lindsay did not analyze the new test in determining a duty to defend as announced in *Monroe Guaranty.* Rather, he rejected the applicability of the *Loya* rule allowing the use of extrinsic evidence to defeat a collusive effort to manufacture a duty to defend because there was no evidence to implicate the insured in the "Plaintiff's alleged fraud." *Keystone Development,* 2022 WL 865891 at *2.

Left with a strict eight-corner analysis, the court held that the live pleadings circumvented the exclusion for projects over 24 units and thus, the insurer owed a duty to defend. *Id.* at **2, 6. Additionally, the court ruled that the proffered extrinsic evidence "problematically overlap[ped] with the merits of the facts alleged in the live petition." *Id.* at *6. In this regard, District Judge Lindsay held:

> The extrinsic evidence pointedly questions the number of units and the number of floors or height of each unit and impermissibly engages in the truth or falsity of the facts alleged in the second amended petition.

Id.

The only case decided post-*Monroe Guaranty* that so far has actually considered extrinsic evidence in holding that the duty to defend did not exist, *Drawbridge Energy US Ventures, LLC v. Federal Ins. Co.,* 2022 WL 991989 (S.D. Tex. 2022), involved a claims made policy and extrinsic evidence, i.e., the "Keybridge Letter," showing that the claim was first made against the insured during the prior policy period to the policy at issue. Under this scenario, Houston federal district judge Andrew Hanen held:

> The Court concludes that the Keybridge Letter falls within the *Monroe* exception and may be considered as extrinsic evidence. First, the letter goes solely to the coverage issue of when the claim was first made and does not overlap with he merits of liability. Second, it does not contradict facts alleged in the underlying petition. Third, the letter conclusively goes the heart of the pivotal issue, as it evidences that the claim against the Plaintiffs was first made prior to the inception of the policy period. Thus, the Keystone Letter may be considered in determining whether [the insurer] had a duty to defend [the insured] under the policy. [Citation to *Monroe Guaranty*].

Id. at 5.

So, at this early stage in the post-*Monroe Guaranty* world, it is hard to predict how and when *Monroe Guaranty* will be applied to allow the consideration of extrinsic evidence in determining the duty to defend. For example, extrinsic evidence was not utilized to analyze

allegations of an amended petition worthy of admission into the artful pleading hall of fame in *Keystone Development.* Also, extrinsic evidence was rejected in *Monroe Guaranty, Knife River and Keystone Development* because the extrinsic evidence overlapped with the merits of the case. The lone case which at this point has allowed the use of extrinsic evidence to determine the duty to defend, *Drawbridge Energy,* involved a claim against the insured that predated the inception of a claims made policy. Thus, right out of the box, it appears that *Monroe Guaranty* has not implemented much change in ascertaining whether an insurer owes a duty to defend under Texas law. Nonetheless, there will no doubt be many future disputes over the *Monroe Guaranty* rule as to when and under what circumstances extrinsic evidence can be utilized in determining an insurer's duty to defend.