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TEXAS TWO-STEP: TEXAS SUPREME COURT ISSUES TWO BLOCKBUSTER DUTY TO DEFEND OPINIONS

Court Announces New Rule on Considering Extrinsic Evidence; but holds that it does not Apply in the Two Cases

On February 11, 2022, the Texas Supreme Court issued two cases that will forever impact analyzing an insurer's duty to defend under Texas law in *Monroe Guaranty Ins. Co. v. BITCO General Ins. Corp.* and *Pharr-San Juan-Alamo Independent School Dist.* In *Monroe Guaranty,* the Court announced: "Today, we expressly approve the practice of considering extrinsic evidence in duty to defend cases." In so doing, the Court then articulated a new rule for deciding when extrinsic evidence can be considered to , 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 to solely concern 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."

The pertinent facts in *Monroe Guaranty* are straightforward. Bitco provided coverage in year 1 and it was replaced by Monroe Guaranty for year 2. The insured was sued for property damage that based on the allegations in the pleadings, could have occurred in either year 1 or 2. Undisputed extrinsic evidence, however, established that an event causing the property damage took place in year 1. Bitco defended the insured and Monroe Guaranty denied a defense. Bitco settled the case against the insured and then sued Monroe Guaranty to recover its share of the defense expenses.

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The *Monroe Guaranty* Court gave homage to the federal court "*Northfield"* exception to the strict eight-corner rule against considering extrinsic evidence, however, it changed it slightly, but significantly. Under the Court's decision, the threshold inquiry is: "does the pleading contain the facts necessary to resolve the question of whether the claim is covered?," which is slightly different than the federal court *Northfield* inquiry of whether it is initially impossible to discern from the pleadings and policy "whether coverage is *potentially* implicated."

Next, the *Monroe Guaranty* Court nixed the federal court standard of whether the coverage issue goes to a "fundamental" coverage issue (like whether a party or property were excluded from coverage or whether a policy existed). Dropping the "fundamental" qualifier altogether, the *Monroe Guaranty* Court reasoned "[r]ather than task courts with determining which coverage issues are—or are not—fundamental, we think the better approach is to eliminate this requirement altogether." The *Monroe Guaranty* Court then added the requirement that, unlike the federal court *Northfield* rule, the "proffered extrinsic evidence must conclusively establish the coverage fact at issue

With the rule announced, the *Monroe Guaranty* Court applied it to deciding whether, under the parameters, extrinsic evidence can be considered to ascertain the date of an occurrence. Here, the *Monroe Guaranty* Court held that:

> [W]e see no sound reason to limit consideration of extrinsic evidence in that manner. Because we do not categorically limit the types of potentially coverage-determinative facts that may be proven by extrinsic evidence, evidence of the date of an occurrence may be considered if it meets the other requirements described above.

Interestingly, the *Monroe Guaranty* Court held that the proffered extrinsic evidence of the stipulation of the date that an event occurred which caused the property damage 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.

Thus, after announcing the new rule, the *Monroe Guaranty* Court held that since the extrinsic evidence showing that the property damage did not occur during Monroe's policy period also would require the insured to admit that the claimant suffered property damage in the first place, Monroe is not entitled to eliminate its duty to defend by relying on the stipulation to say that it did not occur during its policy period.

Simultaneously with the issuance of its *Monroe Guaranty* opinion, the Texas Supreme Court handed down its decision in *Pharr-San Juan* involving the issue of how to determine whether a generic golf cart refers to a land motor vehicle "designed for travel on public roads." In *Pharr-San Juan,* a passenger was thrown from the golf cart and injured due to the alleged negligence of the golf cart driver who was an employee of the school district. On the one hand, vehicles designed for use on public roads were covered under the school district's auto coverage.

On the other hand, vehicles not designed for use on public roads were considered mobile equipment and therefore covered under the school district's general liability coverage.

In the underlying negligence case, the trial court found negligence against the school district and awarded the plaintiff the maximum $100,000 permitted under the Texas tort Claims Act. As it relates to the duty to defend, the *Pharr-San Juan* Court applied the eight-corner rule and concluded that the allegations of the accident involved the negligent use of a golf cart did not allege a claim for coverage under the auto policy. In so doing, the *Pharr-San Juan* Court referred to dictionary, statutory definitions and caselaw from other jurisdictions. While the *Pharr-San Juan* Court conceded that Texas statutes allow golf carts to be operated on a public road, that does not mean that golf carts are designed to be operated on such roads.

Next, the *Pharr-San Juan* Court addressed whether to consider extrinsic evidence in determining the duty to defend and ruled that none of the *Monroe Guaranty* factors exist to permit such extrinsic evidence consideration. In this regard, the *Pharr-San Juan* Court first noted that, unlike *Monroe Guaranty,* the fact issue of whether the plaintiff was thrown from a vehicle "designed for travel on public roads," did not overlap with the liability merits because the school district would be liable regardless of whether or not the golf cart was designed for use on public roads, however, none of the other *Monroe Guaranty* factors applied. In explaining why no gap existed in the pleadings as to whether a golf cart is designed for use on public roads, the *Pharr-San Juan* Court noted that if the pleadings only referenced a "vehicle," as opposed to the golf cart, a gap would exist.

After determining that the school district's auto insurer did not owe a duty to defend, the *Pharr-San Juan* Court turned to the auto insurer's duty to indemnify, which was not based on the allegations in the pleadings; but rather on the actual facts. On this point, the *Pharr-San Juan* Court considered the extrinsic evidence and ruled that the golf cart at issue was not designed for use on public roads and thus, not covered under the school district's auto policy. In other words, if the *Pharr-San Juan* Court had considered the extrinsic evidence in determining the duty to defend, it would have yielded the same result—no duty.

Having lived through the evolution and uncertainty of the eight corner/extrinsic evidence rule analysis, these are profound and long-coming decisions. We have been dealing with a situation in which the result in a particular case depended on how your judge or court of appeals came down on how to apply the federal court *Northfield* exception, if it applied at all. Similar to many removal/remand situations today, it is not unusual for the same set of facts leading to opposite results on whether a defense is owed—even in the same federal district.

Nonetheless, while *Monroe Guaranty* sets a hard and fast five-prong analysis on whether extrinsic evidence can be considered, I don't see it reducing disputes over the use of extrinsic evidence to determine a duty to defend anytime soon—it just sets a new set of rules over which to litigate. I envision fights over all five prongs of the *Monroe Guaranty* test, including whether the extrinsic evidence overlaps with the merits of liability like *Monroe Guaranty;* or whether a gap exists in the pleadings like *Pharr-San Juan.*