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Insurance Coverage Decisions: Issued Today - Impact Tomorrow

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# Happy Valentine's Day: Texas Supreme Court Still Loves the "Eight Corners" Rule

I'd be lying if I said I wasn't smitten with Friday's Supreme Court of Texas decision in *Pine Oak Builders v. Great American Lloyds Insurance Company*. On one hand, this construction defect decision was rather pedestrian. But so what. Just imagine how chuffed I was to see that the task before the Texas high court was the interpretation of three of its own recent decisions – all of which appeared in previous issues of the "Mealey's Top 10 Coverage Cases of the Year" article: *Don's Building Supply v. OneBeacon* (2008); *Lamar Homes v. Mid-Continent Casualty* (2007) and *GuideOne Elite Insurance Co. v. Fielder Road Baptist Church* (2006).

Typical for a construction defect coverage case, it was necessary for the *Pine Oak* Court to determine if "property damage" was caused by an "occurrence" and when any property damage took place. The court made very short work of the "occurrence" and trigger issues. And why not, as both of these issues were so recently addressed in great detail in *Lamar Homes* and *Don's Building*, respectively. These issues were each disposed of in two, short, non-sweat-breaking paragraphs.

The more substantive issue before the *Pine Oak* Court was whether evidence, extrinsic to the eight corners of the policy and complaint, could be used to establish an insurer's duty to defend. Incidentally, all throughout the country courts addressing duty to defend refer to a "four corners" rule, meaning that the duty to defend is based solely on whether the allegations contained in the underlying complaint (i.e., within the four corners of the document) may potentially be covered under the policy. But in Texas this identical same rule is called "eight corners." Why the difference? Because everything is bigger in Texas.

Texas has been a state that limits the duty to defend determination to solely the allegations contained in the complaint. However, having recently completed a 50 state survey of this very issue, I can report that this is the minority view (very much so in fact). The clear majority of states tie the duty to defend to the allegations contained in the complaint *and* other available information. The rules concerning how such other information effects the duty to defend vary between states. That's where the rub comes in.

At issue before *Pine Oak Builders v. Great American Lloyds Insurance Company:* Does Texas remain a member of the camp that limits the duty to defend to solely the allegations contained in the complaint? The court's answer – very much so.

Pine Oak Builders had been sued in separate actions by five homeowners that alleged construction defects. Four of the underlying suits expressly alleged defective work by one or more of Pine Oak's subcontractors. The fifth action (Glass) contained no allegations of defective work by a subcontractor.

The Supreme Court concluded that, because of the possible application of the "subcontractor exception" to the "your work" exclusion, a defense was owed for the four suits that expressly alleged defective work by subcontractors. But what about the Glass action, which contained no allegations of defective work by a subcontractor?

While the Glass action contained no allegations of defective work by a subcontractor, Pine Oak submitted evidence in the coverage action that the defective work alleged in the Glass action was in fact performed by subcontractors. Based on this extrinsic evidence, Pine Oak argued that Great American had a duty to defend the Glass action. *Pine Oak* at 3.

The Texas Supreme Court disagreed. Its decision included a revisit of its 2006 decision in *GuideOne Elite Insurance Co. v. Fielder Road Baptist Church. In GuideOne,* the Texas top court acknowledged that some courts have drawn a very narrow exception to the eight corners rule -- permitting the use of extrinsic evidence only when relevant to an independent and discrete coverage issue, not touching on the merits of the underlying claim. However, the Texas Supreme Court in *GuideOne*, without recognizing this exception to the eight-corners rule, held that any such exception would not extend to evidence that was relevant to both insurance coverage and the factual merits of the case as alleged by the underlying plaintiff. *Pine Oak* at 3-4. Likewise, the extrinsic fact that Pine Oak sought to introduce in the coverage action – its use of subcontractors -- contradicted the facts alleged in the Glass action.

In reaching its decision that no defense was owed to Pine Oak for the Glass action, because faulty workmanship by a subcontractor that might fall under the subcontractor exception to the "your work" exclusion was not mentioned anywhere in the complaint (no matter how hard Pine Oak tried to interpret the allegations otherwise), the Texas Supreme Court set forth one of the strongest pronouncements in support of the "four corners" rule (or "eight corners," whatever) that I've ever seen:

> [The Glass complaint] alleges that Pine Oak alone is liable for its own actionable conduct. "We will not read facts into the pleadings. . . . Nor will we look outside the pleadings, or imagine factual scenarios which might trigger coverage." Instead, "an insurer is entitled to rely solely on the factual allegations contained in the petition in conjunction with the terms of the policy to determine whether it has a duty to defend."
>
> Pine Oak views *GuideOne Elite* as distinguishable because in that case the insurer was attempting to introduce extrinsic evidence to *limit* its duty to defend, whereas here Pine Oak, the insured, offered extrinsic evidence to *trigger* the duty to defend. <u>This distinction is not legally significant</u>.
>
> In deciding the duty to defend, the court should not consider extrinsic evidence from either the insurer or the insured that

> contradicts the allegations of the underlying petition. The duty to defend depends on the language of the policy setting out the contractual agreement between insurer and insured. A defense of third-party claims provided by the insurer is a valuable benefit granted to the insured by the policy, separate from the duty to indemnify. But the insurer's duty to defend is limited to those claims actually asserted in an underlying suit. *** The policy imposes no duty to defend a claim that might have been alleged but was not, or a claim that more closely tracks the true factual circumstances surrounding the third-party claimant's injuries but which, for whatever reason, has not been asserted. To hold otherwise would impose a duty on the insurer that is not found in the language of the policy.

*Pine Oak* at 4-5 (citations omitted; italics in original; underline added)

The *Pine Oak* Court's most significant point is that an insurer, attempting to introduce extrinsic evidence to preclude its duty to defend, versus an insured offering extrinsic evidence in an attempt to trigger the duty to defend, is a distinction that is "not legally significant." Some courts that have adopted an exception to the "four corners" rule do recognize this distinction – giving insureds latitude to introduce extrinsic evidence to trigger the duty to defend, but not to insurers seeking to introduce extrinsic evidence to limit their duty to defend.

A copy of the Supreme Court of Texas's February 13th decision in *Pine Oak Builders v. Great American Lloyds Insurance Company* can be accessed here:

http://www.supreme.courts.state.tx.us/historical/2009/feb/060867.htm

Please let me know if you have any questions or comments.

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