FOUR CORNERS, WEINGARTEN AND MERGERS & ACQUISITIONS

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CHAPTER 12

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I. THE CURRENT "COMPLAINT ALLEGATION" A/K/A "EIGHT-CORNERS" RULE IN TEXAS

A. A Bit of History

Perhaps no legal principal or string cite related to liability insurance is as well known, oft cited, and *seemingly* fixed in case law than the "8 Corners" a/k/a "complaint allegation" rule governing the insurer's duty to defend its insured. According to Westlaw, the first reported Texas decision to use the term "eight corners rule" as shorthand for the duty to defend principles is *Feed Store v. Reliance Ins. Co.*, 774 S.W.2d 73 (Tex. App.—Houston [14th Dist.] 1989) and the first reported use of the alternative "complaint allegation rule" was in *American Alliance Ins. Co. v. Frito-Lay, Inc.*, 788 S.W.2d 152 (Tex. App.—Dallas 1990). Thus, these oft used "buzz words" for the rule have only been around for just over twenty years.

However, the substance of the rule, close to its current form, appears to have first been adopted in Texas in 1940 in *Maryland Cas. Co. v. Moritz,* 138 S.W.2d 1095 (Tex. Civ. App. 1940, writ ref'd.). At issue was a fatality truck accident in Oak Hill and coverage for same under an auto policy. The insurance policy afforded B/I coverage and provided that the insurer would "defend in his name and behalf any suit against the insured alleging such injury or destruction and seeking damages on account thereof even if such suit is groundless, false or fraudulent."

The insurer contended that it owed no duty to defend under the rather convoluted facts involved. The court, however, noted that even if those facts might mean that the insurer had no ultimate coverage, "the issue involved depends not upon ultimate liability, established after trial on the merits, of the insurer for damages sustained, but upon the provision of the policy wherein the insurer bound itself to defend any suit against the insured alleging damages within the terms of the policy even though such suit may have been groundless, false or fraudulent. In such instance, in testing the liability of the insurer to defend, the proof is not material. Liability depends upon the allegations of the plaintiff's petition." *Id.* at 1097. The court concluded its opinion stating "the only issue before us is whether the allegations above quoted, if taken as true, were sufficient to state a cause of action against Moritz coming within the terms of the policy." *Id.* at 1097-98. As noted from the citation to the case above, the Texas Supreme Court refused the writ of error. Under the writ of error practice in place in the 1940's that meant that the high court agreed with the holding of the court of appeals.

Surprisingly, for the next 25 years after *Moritz*, there are not very many reported duty to defend insurance cases. In 1965, however, the Texas Supreme Court handed down the decision in *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22 (Tex. 1965). There the injured Plaintiff alleged that the driver Pickering was an agent of Newport at the time of the collision and that Newport was therefore liable for his conduct. However, Newport contended in its defense that Pickering was not its agent at all. However Newport did demand defense from Pickering insurer, Southern, pursuant to the provision in its policy extending coverage to anyone legally liable for the conduct of Pickering. Based on Newport's denial that Pickering was its agent, Southern refused to defend Newport. Southern specifically contended that no duty to defend arose unless and until it had been determined that Pickering was, in fact, Newport's agent. The court of appeals agreed with the insurer.

The Texas Supreme Court, however, relying on the fact that it had refused the writ of error in *Moritz* and noting that *Moritz* had also been followed in *Travelers Ins. Co. v. Newsom*, 352 S.W. 2d 888 (Tex. Civ. App.—1962, writ ref. n.r.e.), stated the following:

> We think in determining the duty of a liability insurance company to defend a lawsuit the allegations of the complaint should be considered in the light of the policy provisions without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof.

Id. at 24-25. The court also noted that the defense provision paragraph of the insuring agreement contained the "groundless false or fraudulent" language. *Id.* at 24.

And thus, with that, what later would come to be known by 1990 as the "complaint allegation rule" or "eight corners rule" was born. And at each step in that process, the insurance policy's defense language included the "groundless false or fraudulent language" to describe the duty vis a vis the suit allegations.

B. The Basic Rule

The more modern formulation of the rule has not changed much since *Heyden Newport* and indeed *Heyden* is a frequent member of the proverbial string cite collection of cases following statement of the rule.

The rule as usually stated is as follows:

> **"An insurer's duty to defend is determined by the third-party plaintiff's pleadings, considered in light of the policy provisions, without regard to the truth or**

falsity of those allegations." *Zurich American Ins. Co. v. Nokia Inc.*, 268 S.W.3d 487, 491 (Tex. 2008); *Guide One Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W. 3d 305, 308 (Tex. 2006).

Another formulation of the rule is as follows: **"Under this rule, courts compare the words of the insurance policy with the allegations of the plaintiff's complaint to determine whether any claim asserted in the pleading is potentially within the policy's coverage."** *National Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997).

What has changed over the last 20-25 years, however, is that with the passage of time, in the vast majority of the reported opinions, the courts no longer see any need to cite any policy language supporting the rule. Instead they seem to treat the rule as one that is so well settled and ingrained in the Texas jurisprudence as to require virtually no explanation of where it came from, why it came to be the rule, or any basis for it in the insurance policy language. Instead, most courts simply state the rule, usually refer to it as "well settled" or "well known" or some such, and then apply it to the case at hand.

C. The "Subset Rules"

Usually, after the court cites one of the two above quoted formulations of the basic, general rule, the court will then at some point also mention one or both oft-cited "subset rules" that the courts employ to reach a decision on the duty to defend when applying the general basic rule still leaves some questions unanswered as to whether the pleadings v. policy comparison is less than crystal clear on whether the pleadings invoke a duty to defend:

Subset Rule No. 1 is frequently stated as follows:

> **If there is "doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in [the] insured's favor."** *Merchants*, 939 S.W.2d at 141.

Or stated differently:

> **"Courts must resolve all doubts regarding the duty to defend in favor of the duty."** *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 26 (Tex. 1965).

Subset Rule No. 1 is almost always a "one way street," *i.e.*, it will always benefit the insured, never the insurer.

Subset Rule No. 2 is frequently stated as follows:

> **"We will not read facts into the petition, nor will we look outside of the petition, or imagine factual scenarios which might trigger coverage."**

Merchants, 939 S.W.2d at 142. Subset Rule No. 2 has been treated as a "two way street" that can be invoked by the insurer or insured. In other words, a court can conclude that there is no duty to defend because the allegations do not sufficiently allege covered facts.

As the mere quotation of the two Subset Rules reveals, the two Subset Rules appear to be somewhat contradictory. On one hand, there is a duty to defend if any claim pleaded is even potentially covered, with all doubts to be resolved in favor of the insured, but yet courts will not necessarily assume the possibility of missing facts if that would result, in the court's eyes, in "imagining factual scenarios" that have not been pleaded. In our experience, courts utilize the two Subset Rules to reach a desired end result by applying one rule in some cases and the other rule in others. Thus, in representing either the insurer or insured in a duty to defend dispute, you should carefully examine the current live pleading of the claimant without regard to whether the allegations are correct or not, and then compare it to the coverage of the policy with Subset Rules No. 1 and 2 in mind.

D. The Possible Extrinsic Evidence Exception

If going through this threshold analysis still leaves the duty to defend unresolved, then the issue will turn on whether extrinsic evidence can be considered to fill in the key missing coverage-important facts.

Given the "well known" and "well settled" general basic rule, not surprisingly Texas courts historically either outright rejected or at most limited consideration of extrinsic evidence as part of the duty to defend calculus in very narrow circumstances where such evidence only goes to a fundamental coverage issue having nothing to do with the merits of the case against the insured. Thus, by way of example, the courts in the following cases considered extrinsic evidence:

- *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448 (Tex. App.—Corpus Christi

1992, writ denied)—extrinsic evidence allowed on whether boat involved in accident was being used for business purposes or not where that issue was completely irrelevant to and outside of any allegations against the insured ;

- *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712 (Tex. Civ. App.—Texarkana 1967, no writ)—extrinsic evidence allowed on car ownership which only affected coverage;
- *Int'l Service Ins. Co. v Boll*, 392 S.W.2d 158 (Tex. Civ. App.—Houston [1st Dist.] 1965, writ ref. n.r.e.)—extrinsic evidence allowed to show that named insured's son, who was expressly excluded from coverage on his father's policy, was the otherwise unidentified driver "son" alleged in the petition.

As a result, the Fifth Circuit has made an Erie-guess, prior to *Guide One* (see below) at least, that "the '8 corners rule' does not prohibit reference to extrinsic evidence when the petition 'does not contain sufficient facts to enable the court to determine if coverage exists.'" *Northfield Ins. Co. v. Loving Home Care Inc.*, 363 F.3d 523, 530-31 (5th Cir. 2004); *Primrose Operating Co. v. National Am. Ins. Co.*, 382 F.3d 546, 552 (5th Cir.2004); *Western Heritage Ins. Co. v. River Entertainment*, 998 F.2d 311, 313 (5th Cir. 1993)).

According to the court in *Northfield*, if the Texas Supreme Court was to recognize any exception to the strict "8 corners rule," it would be limited to situations **where "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."** *Northfield*, 363 F.3d at 531. This potential exception, as noted, only applies in limited circumstances to determine "fundamental coverage issues" involving facts that can be readily ascertained without engaging the truth or falsity of any of the allegations. *Northfield*, 363 F.3d at 530.

Subsequent Texas Supreme Court decisions since *Northfield* have done little to shed light on whether the Fifth Circuit's Erie guess in *Northfield* was correct, although one could certainly argue that since the Texas Supreme Court has now had multiple occasions, but has refused, to repudiate the Fifth Circuit's prediction, this suggests that there may be such a limited exception.

Dicta in *Guide One Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006) is arguably somewhat favorable the federal court's prediction that to the extent that the Texas Supreme Court were to recognize any exception to the "8 corners rule" at all, it would be limited to situations where the evidence goes solely to a fundamental coverage issue and does not overlap the liability merits or contradict the allegations. *Guide One*, 197 S.W.3d at 308-09. The *Guide One* court hinted that a narrowly drawn exception might be appropriate in some cases. *Id.* at 310. The *Guide One* court flatly rejected extrinsic evidence, however, if it would engage the truth or falsity of any of the allegations. *Id.* at 309, 310.

Subsequent Texas Supreme Court decisions still do not resolve if and when extrinsic evidence is available on the duty to defend:

- *Zurich Am. Ins. Co. v. Nokia*, 268 S.W.3d 487 (Tex. 2008)-rejecting the insurer's extrinsic evidence offered to show that notwithstanding allegations that suggested that the suit was potentially seeking "bodily injury" damages, other documents filed by the plaintiff showed they were not; the court simply noted that to date it had not recognized any exception to the "8 corners rule" but acknowledged *Guide One's* dicta about a narrow possible exception but concluded that it need not decide if such exception existed since the evidence offered by the insurer contradicted the pleadings, which suggested the possibility of "bodily injury."
- *Pine Oak Builders, Inc. v. Great American Lloyds Ins. Co.*, 279 S.W.3d 650 (Tex. 2009)-again recognizing, and quoting, the language from *Guide One* that suggests that the court might recognize a limited exception to the "8 corners rule," *Id.* at 654, but concluding that extrinsic evidence offered by the insured contractor to show that a subcontractor had done the defective work at issue (so as to invoke the "subcontractor exception" to the "insured's work" exclusion of the CGL policy) touched on liability issues and thus could not be considered.
- *D.R. Horton v. Markel*, 300 S.W.3d 740 (Tex. 2009)—failing to address D.R. Horton's argument that extrinsic evidence on a subcontractor's involvement in allegedly defective work should have been considered to determine if D.R. Horton qualified as an additional insured under the subcontractor's policy when the pleadings, as in *Pine Oak*, were completely silent on the involvement of any sub. The court again, however, noted *Guide One's* suggestion of a limited exception to the "8 corners rule," but held the

> issue had been waived in the lower court. *Id.* at 743.

So, in multiple cases since *Northfield's* prediction of a possible limited exception, the Texas Supreme Court has somehow found a way to avoid either approving or rejecting the Fifth Circuit's prediction or otherwise squarely answering the question as to whether there are any exceptions to the "complaint allegation" rule and, if so, what are its parameters. Thus, we are left with the hint in *Guide One*, if one can call it that, coupled with the Court's repeated opportunity but refusal to repudiate that hint to date. Thus, the only conclusion that one can safely draw is that if there is any exception that would allow extrinsic evidence on the duty to defend question, it is a narrow "coverage only facts" exception and the relevant coverage evidence cannot overlap or contradict the pleaded liability facts. And then, whether any particular evidence meets or fails that test seems to be in the "eye of the beholder" with close calls going against consideration.

Even after *Guide One*, including recently, the Fifth Circuit has continued to read *Guide One* as still allowing for a limited exception to the strict "8 corners rule" where extrinsic evidence is admissible on a fundamental coverage-only issue that does not overlap the merits of the liability case. *Ooida Risk Ret. Group v. Williams*, 579 F.3d 469 (5th Cir. 2009)(allowing extrinsic evidence on whether a coverage exclusion applied where petition was silent as to whether deceased plaintiff passenger was operating truck as a tandem driver with the driver so as to qualify as a statutory employee under FMCSA); *VRV Dev. v. Mid-Continent Cas. Co.*, 2010 WL 375499 (N.D. Tex. 2010)(citing *Ooida* and the language in *Guide One*, concluding that extrinsic evidence was admissible to determine if corporation sued but not named in the policy was an "insured" by virtue of having been a corporate successor of the named insured).

II. SOME POSSIBLE NEWLY EMERGING PARADIGM SHIFTERS

As set out below, some courts have now called into question whether the rule is as well settled and across the board as this historical summary otherwise suggests. And it is these cases and the possible implications of them for future development of the arguments that is the real focus of this paper.

A. Is The "Complaint Allegation" Rule Based on Largely Obsolete Older Policy Language Such That It No Longer Applies Under Many Modern Policies?

The first question that has now been raised by a couple of cases is whether the "complaint allegation rule" is a rule of well settled general Texas liability insurance law or instead is one rooted in particular older actual policy language such that the absence of such language in more modern policies means that there is no such rule to apply. As noted earlier, courts rarely mention any policy language basis for the rule when they cite it and instead treat it is simply axiomatic to any liability insurance duty to defend analysis.

In this connection, up until relatively recently, but for many decades before, the standard CGL, homeowners and auto policies widely in use throughout the U.S. typically stated in their basic insuring agreement section something to the effect that the insurer would "pay on behalf of the insured all amounts [or "sums"] that the insured becomes legally obligated to pay as damages because of bodily injury or property damage caused by an "accident" [or "occurrence",]" and then stated in the next sentence or section something to the effect that the insurer would also "*defend any suit against the insured seeking such damages, even if the allegations of the suit are groundless, false or fraudulent.*".

Given that historical language, it is not difficult to come up with a formulation of the "complaint allegation" rule that looks a lot like the current formulation of the general rule as quoted above. To wit, the insurer cannot refuse to defend because the allegations against its insured may be false or fraudulent and as long as the suit seeks (i.e. alleges) some damages that would be covered if the allegations were true, then there is a duty to defend to defend the insured against such suits. After all, if liability insurance only afforded defense to an insured against allegations that were in fact true, insurance would be worthless to all but the most unsavory characters.

But is the "complaint allegation rule" rooted in that type of policy language or does it have a more general basis untethered to any specific policy wording? As noted, most courts, once the rule matured into a part of "well settled" Texas insurance law seem to assume the latter. However, the *Guide One* decision itself seems to have planted the seed upon which an argument could be made that the rule only applies where the policy language imposes it.

In *Guide One*, the court, in rejecting the insurer's argument that it had no duty to defend its insured church in a sexual molestation case involving a former church youth minister because the undisputed extrinsic evidence showed that the youth minister did not work for the church during the policy period of the insurer's coverage, explained why such extrinsic evidence was not properly considered on the duty to defend question:

> Moreover, were we to recognize the exception urged here, we would by necessity conflate the insurer's defense and indemnity duties *without regard for the policy's express*

> *terms. Although these duties are created by contract,* they are *rarely* co-extensive. [citations omitted] The policy here obligated GuideOne to indemnify the Church in the event of a meritorious claim for sexual misconduct, *but with respect to the duty to defend, the contract provided that GuideOne should "defend any suit brought against [the insured] seeking damages, even if the allegations of the suit are groundless, false or fraudulent . . . ". The policy thus defined the duty to defend more broadly than the duty to indemnify. This is often the case in this type of liability policy and is, in fact, the circumstances assumed to exist under the eight-corners rule.*

Guide One, 197 S.W.3d at 310 (emphasis added).

On its face, this language from *Guide One*, the most recent leading Texas Supreme Court case on the parameters of the "eight corners" rule, would appear to plant the seeds for a possible new way to approach the "8 'corners" rule:

- It suggests that both the duty to indemnify and the duty to defend are created by the terms of the contract rather than being an independent rule of law;
- It suggests by negative inference from "rarely" that there may be occasions or types of policy language where the duty to defend is in fact co-extensive with the duty to indemnify;
- It suggests that the usual formulation of the "complaint allegation" a/k/a "8 corners" rule flows from the "groundless, false or fraudulent" language in the duty to defend clause of the insurance policy;
- It recognizes that such language is common and is assumed to exist whenever the rule is applied thereby opening the door to the rule disappearing if such language is absent.

In *Pendergest-Holt v. Certain Underwriters*, 600 F.3d 562 (5th Cir. 2010), a case that arose out of Alan Stanford's alleged "Ponzi scheme" under directors and officers policies, the policies disclaimed any duty to defend but provided that defense costs would be paid, notwithstanding a "money laundering" exclusion, by the carriers "until such time that it is determined" that the alleged excluded money laundering "did, in fact, occur." *Pendergest-Holt v. Certain Underwriters*, 600 F.3d 562 (5th Cir. 2010). The carriers asserted that based on discovery, affidavits and other evidence generated in the pending actions, they had "determined" that the claims all involved "money laundering" and thus they had no duty to advance defense costs. The insureds asserted that the "8 corners" rule applied making such evidence irrelevant. The insureds further asserted that the "determination" that "money laundering" had "in fact" occurred required a determination by the court in the underlying cases first, and did not allow the carriers to make that determination unilaterally. The district court agreed with the insureds and held that the "8 corners rule" applied even where there was no duty to defend. *Pendergest-Holt v. Certain Underwriters*, 681 F.Supp.2d 816 (S.D. Tex. 2010).

The 5th Circuit, however, disagreed. The court first noted that the "8 corners rule" has never been applied by any Texas state court where there was no actual duty to defend. 600 F.3d. at 574. It held that the policy language only requiring advancement of defense costs until "it had been determined" that the excluded act had occurred required courts to look beyond the mere allegations. *Id.* This language clearly called for consideration of extrinsic evidence. *Id.* Giving a "tip of the hat" to the *Guide One* court's suggestion that the "eight corners" rule was grounded in contractual language of the policy, the court held that it was not deciding "whether the eight corners rule applies to the duty to advance costs as a general matter, for Texas prefers freedom of contract" and that the parties were free to "contract out" of "judge-made doctrines, like the eight corners rule". *Id.*

The court, however, held that the "determination" required by the policy was not simply the insurers' own unilateral, internal "determination"; it instead required a judicial determination by a court. *Id.* It did not, however, require that such "determination" only occur in the underlying suit and contemplated that such a determination could be made in advance of the trial in the underlying suit by the court in the coverage action. *Id.* Accordingly, the court remanded the case back to the district court to make the require "determination" and noted that "all admissible evidence is welcome." *Id.* On remand, therefore, there was a full trial on whether the claims against the insured officers and directors arose out of "money laundering" and the court found that the exclusion applied as to some but not others so that the carriers had to advance defense costs as to some but not all. *Pendergest-Holt v. Certain Underwriters*, 2010 WL 4026068 (S.D. Tex., Oct. 13, 2010).

In *Guide One v. Missionary Church of Disciples of Jesus Christ*, 806 F.Supp.2d 923 (N. D. Tex. 2011), Judge McBryde similarly concluded that the Texas Supreme Court's Guide One opinion meant that the "complaint allegation" rule does not apply under a liability policy that does not contain the magic "groundless ,false or fraudulent" language in the duty to defend provision.

The material facts were as follows. The plaintiff *alleged* in the underlying lawsuit that he sustained injuries in a car accident involving a vehicle driven by Meyer and allegedly "owned and/or controlled by the [Church] and/or [Salgado]." Salgado was the preacher of the church. Meyer was a church member. Plaintiff also alleged that Salgado and Meyer were employees of the Church at all relevant times. Accordingly, Plaintiff alleged that the Church and Salgado were liable for negligent entrustment and that the Church was also liable under respondeat superior principles.

The actual facts from depositions and discovery taken in the underlying suit, however, showed that Salgado was more akin to a volunteer preacher for the church who drew no salary, paid himself out of church collections for his living expenses at his discretion and that he did not consider himself an employee at all. The day before the accident, Salgado and the three other church members, including Meyer, drove to San Antonio en route to the Rio Grande Valley where one of the members was going to visit his dad. One of the members paid for the gas, not the church. They stopped in San Antonio to visit friends but found that the friends had moved away but left their house in a bad condition. Accordingly, the church group decided to clean it up as volunteers, not church members. Salgado had previously left his own vehicle that was titled in his name at the house in San Antonio because he no longer wanted it and the insurance was expired. He did not intend anyone to drive it and locked the key up at the San Antonio house. After arriving in San Antonio, Salgado got a call that he was needed in Houston at another church, so he left San Antonio, leaving the other members of the Church in San Antonio at the house, expecting that he would be gone a day or two. While he was gone, however, the other church members decided to use the old vehicle owned by Salgado that Salgado had left at the San Antonio house to go get something to eat and had the collision during that trip.

The Guide One policy issued to the Church applied to "covered autos" defined as autos that the Church "leased, hired, rented or borrowed" from any of its employees or partners, and to other non-owned, non-leased, non-hired autos that were used "in connection with [the Church's] business", including autos owned by employees "while used in [the Church's] business or [the Church's] personal affairs."

On the duty to defend question, Judge McBryde held that the "eight-corners" rule did not apply. *Id.* at 935. His rationale, picking up on the language quoted above from the *Guide One v. Fielder Road* opinion was that "The defense-obligation wording of the insurance policy is drastically different from the wording found in the liability insurance policies that gave rise to, and perpetuated, the eight-corners rule." *Id.* at. 935. He noted that in each of the major Texas Supreme Court opinions that had applied the rule (*Guide One*, *Am. Physicians v. Garcia*, *Argonaut v. Maupin*, and *Heyden Newport*), the defense language of the policy included the "groundless, false or fraudulent" language. *Id.* He then concluded that such language is "essential to applicability of the rule" quoting the language quoted above from *Guide One v. Fielder Road. Id.* at 935-36.

Judge McBryde then quoted the language contained in the policy at issue:

> We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.

Id. at 936. He also noted that the endorsement under which the coverage was sought stated that "However, we have no duty to defend 'suits' for 'bodily injury' or 'property damage' not covered by this endorsement." *Id.* He also noted that the court in *Pendergest-Holt* had recognized that insureds and insurers were free to "contract around" the "eight-corners" rule if they chose to. *Id.* at 936. Accordingly, Judge McBryde concluded that all of the testimony and other discovery from the underlying suit was properly considered on the duty to defend issue in the dec suit and that Guide One had no coverage for or duty to defend anyone. *Id.* There was no need to even analyze whether or under what circumstances there might be a possible exception to the "eight corners" rule as the rule itself was inapplicable given the policy language involved.

If *Pendergest-Holt* and Judge McBryde's decision are correct, then this has potentially significant implications. For example, the standard ISO form CGL policy has for several years contained a basic insuring agreement reading generally like this:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.

CG 00 01 12 07 (ISO form). Similar worded defense language appears in several other types of standard ISO form policies currently in use. Notice that there is no "groundless, false or fraudulent" language and that

the language purports to state that there is no duty to defend if the suit does not seek damages that will be covered.

Therefore, it is at least *arguable* that many of the current standard ISO form policies could be construed as the parties, to use the *Pendergest-Holt* court's phrase, "contracting around" the traditional "eight corners"/"complaint allegation" limitations. If so, that would mean that the duty to defend is virtually co-extensive with the duty to indemnify and there is no bar against the use of extrinsic evidence to decide the duty to defend issue.

What would be the implications of such a new paradigm should courts start adopting this reasoning? There are several readily apparent:

1. First, there is the same issue that the *Pendergest-Holt* court had to confront—how and where is the coverage determination upon which both indemnity and defense would depend be made? The *Pendergest-Holt* court as noted allowed that determination to be made in the coverage action rather than deferring to the underlying liability case. If there is, in fact, no coverage for the actual facts involved, then such a rule obviously would usually benefit the carrier as the carrier could get off of the duty to defend before waiting on the trial or settlement of the underlying suit. If on the other hand, the courts were to conclude that the coverage determination can only be made on the facts actually adjudicated and determined in the underlying case, then as long as the allegations are susceptible of a construction that supports a ruling of no duty to defend under the traditional "eight corners" analysis, then the carrier will want to stick with the traditional rule if it hopes to avoid the defense costs that would otherwise be incurred by having to wait on the underlying suit to resolve.
2. If, as suggested by *Pendergest-Holt* and Judge McBryde's *Guide One* opinion, both the coverage and duty to defend issue can be resolved up front in the coverage action when the parties have "contracted out" of the "eight corners" rule, does that determination operate as res judicata or collateral estoppel on any material fact issues so determined so as to bar relitigation of the same issues in the underlying case to the extent that the issues do overlap? The *Pendergest-Holt* court was apparently concerned about that implication as well and even noted the "awkwardness" in "putting the civil 'cart' before the criminal 'horse' "in that case *Id.* at 575. To deal with it, the court held that since Judge Hittner was presiding over the underlying criminal case, the coverage issues should be decided by a different judge in order to avoid even the appearance of partiality and then added that even if the coverage case found that the executives had engaged in money laundering so as to invoke the exclusion and allow the carriers to stop advancing defense costs thereafter, such a determination would not be final and would have to be re-examined later should the executives be found not guilty of money laundering in the underlying criminal case. *Id.*

   By contrast, Judge McBryde was less concerned. In his *Guide One* decision, after holding that the "eight corners" rule did not apply and that the extrinsic evidence from the underlying case negated both the duty to defend and the duty to indemnify, he concluded that under his resolution of the coverage issues, neither the insured church nor Salgado could be factually "legally liable to pay" damages to the plaintiffs for the accident in question and thus the declaratory judgment action was the best court to resolve everything. 806 F.Supp.2d at 937-38, and he thus entered declaratory judgment of no coverage as well as no legal liability on the part of the Defendants and enjoined the underlying Plaintiffs, who were also parties to the declaratory action, from proceeding further in the underlying state court suit. *Id.* at 940.

B. Does The "Complaint Allegation" Rule Apply to the Threshold Issue of Whether Someone is an Insured on the Policy in the First Instance?

If the rule is viewed as one grounded in contract law rather than a general rule of insurance law or a common law rule of decision, then the "complaint allegation" rule arguably only applies as between the parties to the contract and not as between the insurer and others who are not either parties or intended third-party beneficiaries to the contract. However, very few courts thus far have engaged in that type of contractual privity analysis even when the coverage issue involved is whether someone is an insured on the policy in the first instance. Instead, as with other applications of the rule, the courts generally, at least historically, have simply assumed that the "complaint allegation" rule applied and then compared the allegations to the provisions in the policy governing who is an "insured" there under and reached a decision either without

extrinsic evidence or with the addition of extrinsic evidence *if they can justify invoking one of the extrinsic evidence exceptions to the general rule.*

A recent case, however, now calls this general approach into question as well. In this connection, in *Weingarten Realty Management v. Liberty Mut. Ins. Co.*, 343 S.W.3d 859 (Tex. App.—Houston [14th Dist.] 2011, pet. denied), the court seems to have carved out an additional exception to the rule's general bar against the use of extrinsic evidence where there is a threshold question as to whether the party seeking a defense is in fact an insured at all under the policy. If they are not, i.e. they are a "complete stranger" to the policy, then extrinsic evidence, even evidence that contradicts material and liability-relevant allegations of the pleadings may be considered and defense can be denied. And the basis for that appears to be that only persons or parties shown to have some contractual rights under the policy as written get to enjoy the benefits of the "complaint allegation" rule.

In *Weingarten*, the underlying lawsuit was a premises liability criminal assault case involving a violent attack upon the manager of a store that was a tenant in a shopping center. The shopping center was owned by Weingarten Realty Investors ("Weingarten Investors"); in other words the landlord was Weingarten Investors. However, the Plaintiff erroneous alleged in her pleadings, and never corrected it, that a related sister company, Weingarten Realty Management ("Weingarten Management") was the landlord/owner when, in fact, it only managed the property. Specifically, the Plaintiff alleged, according to the dissenting opinion of Justice Frost, that Weingarten Management was the lessor of the premises, controlled the premises, knew of high crime in the area, failed to provide for safety and failed to provide adequate lighting or security.

The tenant's lease with Weingarten Investors required that the tenant name the landlord, Weingarten Investors, as an additional insured on its Liberty Mutual policy. Accordingly, the Liberty policy contained an endorsement naming "all lessors of the premises leased to [the tenant] as additional insureds under the policy." Accordingly, Weingarten Investors was an "additional insured" but Weingarten Management was not. Weingarten Management initially defended the case itself pursuant to a self-insured retention on its own policy with Scottsdale and then upon exhaustion of the SIR Scottsdale took over its defense. Shortly before trial, Weingarten Management tendered its defense to Liberty under the additional insured provision of the Liberty policy. Liberty refused. The case went to trial, the jury found no liability, and Weingarten Management and Scottsdale then sued Liberty for $242,000 in incurred defense costs.

Weingarten Management and Scottsdale argued that under the "eight corners" rule, the undisputed extrinsic evidence that Weingarten Management was not the lessor and that Weingarten Investors was could not be considered because it directly contradicted the material allegations and thus Liberty owed a defense. The trial court, however, ruled in favor of Liberty.

After noting that the Texas Supreme Court had never expressly adopted any extrinsic evidence exception to the "eight corners" rule but had noted in Guide One that other courts had recognized a "very narrow" possible exception when the extrinsic evidence goes only to an issue of coverage not touching on the underlying merits, the court noted that it had previously rejected extrinsic evidence that touched on both liability and coverage in *D.R. Horton v. Markel Int'l. Ins. Co.*, 300 S.W.3d 773 (Tex. App.—Houston [14th Dist.] 2006), *rev'd in part on other grounds*, 300 S.W.3d 740 (Tex. 2009). The court then noted, however, that the rationale of the "eight corners rule" is to require insurers to defend the insured even against claims that lack merit since as to an insured, a meritless claim still requires a defense. *Weingarten*, 343 S.W.3d at 864-65. The court then says:

> "But the protection the eight corners rule provides exists for the benefit only of the insured. It is the insured who is entitled to trust that his insurer will defend him against all covered claims, meritorious or not. A stranger to the policy neither needs nor should expect this benefit."

Id. at 865. The court then concluded that enforcing the eight corners rule under these circumstances does not further the policy underlying the eight corners doctrine. Id. Accordingly, the court held that a new exception applies "*only when an insurer establishes by extrinsic evidence that a party seeking a defense is a stranger to the policy and could not be entitled to a defense under any set of facts." Id (emphasis added).*

Interestingly, in so holding, the court cited to a 1990 district court opinion by Judge McBryde, *Blue Ridge v. Hanover Ins. Co.*, 748 F. Supp. 470 (N.D. Tex. 1990) where the court concluded that it was not bound by false allegations that the driver involved was driving the vehicle with the permission of his employer. In that case, Judge McBryde had noted that the "eight corners" rule did not require treating false allegations made by the plaintiff as true unless the person seeking a defense was first shown to be an insured. 343 S.W.3d at 866 (citing *Blue Ridge*, 748 F.Supp. at 472-73.) And the *Weingarten* court stated that it agreed with *Blue Ridge* that the status of "insured" is to "be determined by the true facts, not false, fraudulent, or otherwise incorrect facts that might be alleged." *Id.* (citing *Blue Ridge*).

With regard to the fact that the exception adopted by the court here allowed consideration of extrinsic evidence that actually contradicts the allegations, the court dismissed such observation by stating that while the plaintiff's allegations that Weingarten Management was the lessor may be viewed by the Plaintiff "as important to the merits of their case", "Liberty's *interest in contradicting it* is confined to disputing Weingarten Management's status as an insured." *Id.* at 869(emphasis added).

The court majority concluded that barring consideration of extrinsic evidence under the circumstances here "would impose on insurers the duty to defend parties who—by accident or otherwise—plead themselves into an insurance policy to which they were previously a stranger. *If a contract does not exist,* a duty to defend should not be allowed to spring into existence based on artful or inartful pleading." *Id.* at 869 (emphasis added).

Justice Frost dissented on the ground that the majority was recognizing an extrinsic evidence exception that contradicted the pleadings and the underlying merits and thus was not sanctioned by any of the existing case law, even those cases that had recognized a possible exception. *However, as noted from the citation to the case at the outset of this discussion the Texas Supreme Court denied the petition for review late last year.*

Weingarten is obviously a potentially (but not yet necessarily) significant new development in the "eight corners" rule paradigm depending on whether it is followed in subsequent cases and, if so, how far its reach extends. There are several possible implications/area for further case law development:

1. First, if followed by other courts, then it will establish, consistent with the suggestions in the Texas Supreme court's *Guide One* decision, the rule of *Pendergest-Holt* and Judge McBryde's *Guide One* decision that the "eight corners" rule is ultimately premised on the contract between the insured and insurer.
2. The court's statement of its new exception as only applying when the extrinsic evidence shows that there is "no set of facts" under which the "complete stranger" to the policy could be entitled to coverage suggests the possibility that if "insured" status would normally be satisfied but for some factual exception that applies in the particular case, then the result may be different and the general "eight corners" rule may apply. For example, many additional insured endorsements name the specific entity intended to be covered but then go on to provide that they are only covered for certain types of factual scenarios connected with the work or operations of the named insured. Weingarten does not address those types of situations. Arguably in such a case, the alleged additional insured would not really be a complete stranger to the policy but would instead be a party named in the policy but who is only covered there under as an insured under certain circumstances. That *may* be a distinction that matters.
3. On the other hand, as noted, the language that the court uses at other places in the opinion also seems to lay down a broader rule that the "eight corners" rule simply does not apply to threshold "who is an insured?" issues. So, it could be that if later courts start to follow *Weingarten* they will abandon the "eight corners" rule altogether until it is first established that the party seeking a defense is, in fact, covered on the policy as an "insured".
4. Is the court's extrinsic evidence permission a two-way street available not just to an insurer seeking to establish lack of insured status but also to the additional insured seeking to establish its status as such? In other words, can a party seeking insured status for purposes of a defense now argue under *Weingarten* that even if the Plaintiff's allegations are in some way deficient or even negate the facts necessary to qualify that party as an "insured", the court should nevertheless look at the actual facts established via the extrinsic evidence in order to show that the party seeking the coverage is a party to the contract and then, and only then apply the eight corners rule? (This was one of the arguments made by DR Horton in the *DR Horton v. Markel* case cited by the *Weingarten* court).