

## In The News

# Texas Justices Wary Of Exception To Insurance Defense Rule

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Law360 (January 8, 2020, 6:12 PM EST) -- The Texas Supreme Court appeared hesitant Wednesday to recognize an exception to a long-standing insurance rule that would allow a State Farm unit to defeat its duty to defend policyholders facing litigation over a fatal ATV crash by relying on documents outside the policy and underlying suit.

During a 40-minute hearing in Austin, counsel for State Farm Lloyds urged the Texas high court to acknowledge a limited exception to the Lone Star State's "eight corners rule," which generally establishes that, when deciding whether an insurer has a duty to defend its policyholder, a court may refer only to the relevant policy terms and the factual allegations in the suit against the insured. The case came before the state justices via a certified question from the Fifth Circuit.

State Farm is seeking to preserve U.S. District Judge John McBryde's 2018 decision allowing the insurer to introduce outside documents, commonly known as "extrinsic evidence," to deny its duty to defend policyholders Melvin and Janet Richards in an underlying suit blaming them for a 2017 ATV crash that killed their grandson. Judge McBryde said the documents proved that two exclusions in the Richardses' homeowners policy relieved State Farm of any obligation to defend them.

State Farm's attorney, Theodore Christian Schultz of Lindow Stephens Treat LLP, told the Texas justices that the district judge properly found that the eight-corners rule shouldn't foreclose the introduction of extrinsic evidence in this situation because the Richardses' policy lacked common language stating the insurer will defend "all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent."

Without that language, Schultz contended, the insurer's duty to defend isn't broader than its duty to indemnify — that is, to cover damages that a policyholder pays on claims that are actually proven to be covered by the policy terms.

"I think if there had been a groundless suit provision, that would have extended the duty to defend beyond the duty to indemnify," Schultz said.

However, several justices questioned Schultz over whether the lack of this groundless suit provision is sufficient grounds to deviate from the eight-corners rule, which traces its origins to an intermediate Texas appellate court's 1940 ruling in *Maryland Casualty Co. v. Moritz*.

"Why would the omission of this clause upend what is the settled expectation of carriers and insureds about the breadth of the duty to defend?" Justice Jane Bland asked.

"Because the basis of the eight-corners rule was in this clause, based on *Moritz* and the cases that came after it," Schultz replied. "If you remove that clause, you have a different contract with different rights and obligations."

The case dates back to the summer of 2017, when the Richardses' grandson, 10-year-old Jayden Meals, died in an ATV accident near the couple's Weatherford, Texas, home. Shortly thereafter, the boy's mother, Amanda Meals, sued the Richardses in Texas state court, alleging they negligently failed to instruct Jayden on how to use the vehicle or require him to wear appropriate safety gear.

The Richardses asked State Farm to pay their legal fees under their homeowners policy, which required the insurer to defend them in any suit "for damages because of bodily injury to which this coverage applies," according to court documents. State Farm agreed to defend the Richardses while reserving its rights to challenge its coverage obligations in court, then filed the current suit in Texas federal court in September 2017.

In its March 2018 motion for summary judgment, State Farm presented a variety of outside documents to bolster its position that a pair of policy exclusions foreclosed coverage for the Richardses.

Over the Richardses' objections, Judge McBryde agreed to set aside the eight-corners rule and consider State Farm's extrinsic evidence. He granted the insurer's motion for summary judgment in May 2018, ruling that State Farm has no duty to defend the Richardses or indemnify them for any judgment that Meals may obtain against them.

The Richardses and Meals then appealed to the Fifth Circuit. After hearing oral arguments, a panel of the appellate court issued an order on Sept. 9 asking the Texas Supreme Court to weigh in on the case to decide whether the state recognizes a policy language-based exception to the eight-corners rule.

During Wednesday's oral arguments, Meals' attorney, Nolan Cornelius Knight of Munsch Hardt Kopf & Harr, P.C., asserted that the Texas Supreme Court and the state's midlevel appeals courts have consistently refused to carve out any exceptions to the eight-corners rule since its inception. The absence of the "groundless, false or fraudulent" language in the Richardses' policy shouldn't give State Farm an avenue to flout the rule, Knight argued.

"As an initial matter, based on this court's jurisprudence, we think stare decisis takes care of this," he said. "The settled expectations of the insurance community, insured community and, dare I say, even the court is that this language does not matter."

Responding to a question from one of the justices, Knight said that State Farm could, if it so desired, draft a policy permitting it to introduce extrinsic evidence to contest its defense duty.

"Why not just say it and seek the Texas Insurance Department's approval, rather than saying the omission of a clause no one ever thought was important gets you there?" he asked.

Schultz countered that the Texas Supreme Court should decline to continue enforcing the common-law eight-corners rule without exception, saying the high court has long "relied upon the freedom of contract."

"What is happening here is, an extracontractual rule is now being applied saying State Farm cannot bring in evidence as to whether exclusions apply," he said. "There is nothing in the contract that provides a basis for doing so."

Justice Paul Green asked Schultz why the court shouldn't persist in adhering to the eight-corners rule because it is "simple and straightforward and easy to apply as a matter of policy."

"If the basic reason is, 'we will apply the simplest rule in a particular case,' I would argue this is not what the common law holds," Schultz said.

Justice Jeffrey Boyd queried Schultz as to whether a ruling in State Farm's favor would make it pointless for insurers to initially defend their policyholders while reserving their rights to potentially challenge their coverage obligations in court.

"No, I don't believe the entire concept of reservation of rights would be gone," Schultz said. "We would still have to initially defend the case and reserve our rights to seek a declaratory judgment. When the declaratory judgment came out, that would allow us to go forward."

At the conclusion of arguments, the Texas high court took the case under submission.

Meals is represented by Nolan Cornelius Knight and Michael Wallace Huddleston of Munsch Hardt Kopf & Harr, P.C.

The Richardses are represented by Russell Wayne King of King Law Office PC.

State Farm is represented by Theodore Christian Schultz, Mark A. Lindow and Jana Marie Richard of Lindow Stephens Treat LLP.

The case is State Farm Lloyds v. Janet Richards et al., case number 19-0802, in the Texas Supreme Court.

The full article can also be viewed by clicking [here](#).

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