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SUPREME COURT OF TEXAS REJECTS "POLICY LANGUAGE EXCEPTION" TO "EIGHT-CORNERS RULE" IN DETERMINING DUTY TO DEFEND

As a matter of first impression for Texas courts, last Friday the Supreme Court of Texas rejected a "policy language exception" to the eight-corners rule as presented to them in a certified question from the Fifth Circuit. But in doing so, the Supreme Court of Texas left open questions regarding application of another extrinsic exception to the eight-corners rule. In *Richards v. State Farm Lloyds*, No. 19-0802, 2020 WL 1313782 (Tex. Mar. 20, 2020), a ten-year-old boy died in an all-terrain vehicle (ATV) accident while under his paternal grandparents' supervision. The boy's mother sued the grandparents and they sought a defense from State Farm. State Farm provided a defense subject to a reservation of rights and then filed a declaratory judgment action to address the coverage issues.

Under the eight-corners rule, Texas courts traditionally examine the four corners of the petition and compare the factual allegations to the four corners of the policy in order to determine if the insurer has a duty to defend. Here, the petition failed to state sufficient facts to support application of the policy's "motor-vehicle" and "insured" exclusions. Extrinsic evidence, however, revealed the ATV accident took place on a public recreational trail and not on the grandparent's property which would trigger the "motor-vehicle exclusion." Independently, a family law court order revealed the boy qualified as an "insured" under the policy as a resident relative, thereby triggering the "insured exclusion." State Farm asserted a "policy language exception" to Texas' eight-corners rule arguing that because its policy no longer contained language requiring a defense even if "the allegations of the suit are groundless, false or fraudulent" then extrinsic evidence could be considered and it had no duty to defend. In response, the grandparents argued the eight-corners rule prohibited the district court from considering any extrinsic evidence, including the crash report and family law court order, when determining State Farm's duty to defend the lawsuit.

The federal district court relied on a "policy language exception" that it previously adopted holding the eight-corners rule did not prohibit consideration of the extrinsic evidence because the rule applies only to insurance policies which explicitly require the insurer to defend "all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent." The insured appealed and the Fifth Circuit certified the following question to the Supreme Court of Texas:

> Is the policy-language exception to the eight-corners rule in *B. Hall Contracting Inc. v. Evanston Ins. co.*, 447 F.Supp. 2d 634, 635 (N. D. Tex. 2006) a permissible exception under Texas law?

The Supreme Court of Texas recognized that no other court had applied the "policy language exception" to allow extrinsic evidence in determining the duty to defend. It also recognized the parties could "contract around the eight-corners rule." But, it rejected the argument advanced here by the trial court and State Farm claiming that extrinsic evidence could be considered to deny a duty to defend by simply omitting the policy requirement that State Farm had to defend even if the claims are "groundless, false of fraudulent." Accordingly, the Texas Supreme Court answered the certified question in the negative finding the "policy-language exception" is not a permissible exception under Texas law.

Editor's Note: Significantly, the Supreme Court of Texas discussed in great detail another extrinsic evidence exception to the eight-corners rule applied by the Fifth Circuit and other federal courts in Texas, the *Northfield* exception, which historically allows extrinsic evidence when (1) "it is initially impossible to discern whether coverage is potentially implicated" and (2) "the extrinsic evidence goes solely to a fundamental issue of coverage that does not overlap with the merits of or engage the truth of any facts alleged in the underlying case." *Northfield Ins. co. v. Loving Home Care, Inc.*, 363 F.3d 523,531 (5th Cir. 2004). The Court also noted that there is a split in authority among the Texas courts of appeal on whether the *Northfield* exception applies even though the Supreme Court of Texas has twice acknowledged its widespread use. The high court noted: "The Fifth Circuit did not request this Court's opinion on the *Northfield* exception. Instead, it asked only if the federal district court was correct in *B. Hall* that the eight-corners rule is inapplicable unless the policy includes a groundless-claims clause. We address only the question certified." We get the sense the Supreme Court of Texas is ready to address this issue as well, but it didn't get the opportunity to do so in this case. We will continue to monitor this and other cases for related developments.

EXTRA-CONTRACTUAL CLAIMS TO BE ABATED AFTER SEVERANCE IN UM/UIM DECLARATORY JUDGMENT ACTION

Last Tuesday, the Houston First Court of Appeals conditionally granted mandamus relief to an insurer asserting the trial court improperly refused to abate severed extra-contractual claims in a declaratory judgment action seeking uninsured/underinsured motorist (UIM) benefits. In *IN RE STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY*, Relator, No. 01-19-00821-CV, 2020 WL 1264184, at *8 (Tex. App.—Houston [1st Dist.] Mar. 17, 2020, no pet. h.), the insured claimed she was injured as a result of an automobile accident with an uninsured driver. The parties disagreed over whether a settlement offer was made. The insured filed a declaratory judgment action seeking UIM benefits and, alleging breach of the duty of good faith and fair dealing, violations of Texas Insurance Code Chapters 541 and 542, and violations of the Texas Deceptive Trade Practices-Consumer Protection Act.

State Farm moved for severance and abatement of the extra-contractual claims arguing severance was required because: 1) the insured had not established she was legally entitled to recover UIM benefits; and 2) to protect State Farm from unnecessary discovery and trial preparation in defense of claims that would not be ripe until the jury determined UIM benefits were owed. The trial court granted State Farm's motion to sever the extra-contractual claims but refused to abate them. State Farm moved for reconsideration of the denial of abatement, which the trial court denied. State Farm then sought mandamus relief of the trial court's final decision in the court of appeals.

The insured attempted to distinguish cases relied in by State Farm asserting her Insurance Code claims were not dependent on her entitlement to UIM benefits and arguing the cases relied upon by State Farm involved actions taken *after* a proper response to the claim. She alleged State Farm failed to *properly respond*, which State Farm disputed. The court observed that the "supreme court has recognized that 'the Insurance Code offers procedural protections against misconduct likely to lead to an improper denial of benefits *and little else.*'" Further, the insured conceded her statutory claims were "not premised on an independent-injury theory… In this case, Garza was covered under the policy, so the independent-injury rule does not apply."

Accordingly, the appellate court agreed with State Farm's position, conditionally granted mandamus relief and directed the trial court to vacate that portion of its decision denying abatement, and to abate the severed claims until such time as the contractual claims are resolved in the underlying declaratory action.

COVID-19 LAWSUITS ADDRESSING BUSINESS INTERRUPTION COVERAGE BEGIN

Although not involving Texas law, last week, the first drop in what will be a giant bucket of business interruption cases related to COVID-19 began. In *Cajun Conti LLC et al. v. Certain Underwriters at Lloyd's, London et al.*, No. 2020-02558, complaint filed (La. Dist. Ct., Orleans Parish Mar. 16, 2020), a DJ action was brought in Louisiana state court by Oceana Grill Restaurant seeking coverage under their "all risks" property policy for coronavirus-caused losses after public-gathering restrictions were issued by the Louisiana governor and New Orleans mayor. While a decision has not yet been issued, we find the facts and legal posture of this case particularly interesting to the current climate of insurance law in the midst of the global virus crisis.

Oceana Grill argues in their complaint that because their policy includes business interruption losses in the event of closure by order of Civil Authority, and because it had to close under order of the mayor and governor, the coverage should apply. The complaint also seeks a declaration of coverage for physical loss for future Civil Authority shutdowns of restaurants, physical loss from coronavirus contamination (and potential decontamination), and business income coverage in the event that the coronavirus has contaminated the insured premises.

The complaint appears to argue that the mere presence of the coronavirus constitutes physical loss or property damage to the affected premises. It seems to argue if Oceana Grill is shut down, because other restaurants in the area have suffered physical losses on account of the presence of the coronavirus, then it is entitled to Civil Authority coverage for the interruption in their business and the resulting losses. On the other hand, if the coronavirus were present in their restaurant, then the restaurant claims they would be owed coverage for business interruption. Finally, the complaint also points out that Lloyd's policy does *not* contain a "virus" exclusion.

Editor's Note: While this is merely the beginning, it appears the two driving factors in similar cases will be the claimant's ability to prove some physical loss to the affected premises and if the policy in question includes an applicable "virus" exclusion. We believe this case is first of tens of thousands, if not hundreds of thousands, of coverage lawsuits which will make identical coverage arguments in an effort to offset the economic losses created by virus closings across the country.