

TEXAS INSURANCE LAW NEWSBRIEF

MAY 4, 2020

SUPREME COURT OF TEXAS ADOPTS EXTRINSIC EVIDENCE EXCEPTION TO EIGHT-CORNERS RULE - FINDS NO DUTY TO DEFEND WHEN INSURED ENGAGED IN COLLUSIVE FRAUD

Last Friday, the Supreme Court of Texas recognized for the first time, an extrinsic evidence exception to the eight-corners rule in determining the duty to defend under an auto liability policy, finding that when an insured and, a third-party suing the insured collude to make false representations to trigger coverage under the policy, the insurer may use evidence outside the pleadings to establish it has no duty to defend. In *Loya Insurance Company v. Avalos*, 2020 WL 2089752 (Tex. May 1, 2020), the insured's husband was an excluded driver but was driving the insured vehicle when it collided with the third-party claimants' vehicle.

In an effort to secure insurance coverage, the insured and claimants lied to the police and the insurance company telling them the named insured was driving the car, and not her husband at the time of the collision. The claimants later sued the insured and Loya hired an attorney to defend her. But, early in discovery, the insured disclosed the lie to her attorney and identified her husband as the driver. The insurer then canceled her deposition and denied coverage, both defense and indemnity under the policy. The claimants then moved for and were granted summary judgment against the insured and were awarded \$450,343 against her. The claimants then took an assignment from the insured of all claims against her insurer and filed suit against the insurer alleging breach of contract, negligence, bad faith and other extra-contractual causes of action for denying a defense and coverage under the policy. The insurer filed counterclaims for breach of contract, fraud and sought a declaratory judgment arguing it owed no coverage and no duty to defend because the insured's husband, an excluded driver, was driving when the accident occurred.

During the insured's deposition in the subsequent litigation, she admitted her husband was driving. The insurer then moved for summary judgment and attached the insured's deposition excerpts in support. The claimants opposed the motion because the underlying petition alleged the insured was driving and, under the traditional eight-corners rule, the court could not consider extrinsic evidence so the insurer had a duty to defend as a matter of law. At the hearing on the motions, the trial judge remarked that the claimants were "asking this Court to ignore every rule of justice and help [them] perpetuate a fraud." Refusing to do so, the trial court granted summary judgment in favor of the insurer. But the court of appeals reversed holding that "as logically contrary as it may seem," under the eight-corners rule, the insurer had a duty to defend. This appeal to the Supreme Court of Texas followed.

The Supreme Court of Texas discussed the eight-corners rule, noting that it is restricted to considering only the four corners of the policy and the four corners of the petition to determine the duty to defend, even if the allegations in the petition are groundless, false, or fraudulent. The Court then noted that: "Although we have not recognized any exceptions to the rule, other courts have, and we left open the question whether to do so in an appropriate case.... This is such a case." The Court focused on two main issues. First, this case involves "collusive fraud," not mere allegations by a claimant to trigger coverage, but collusive fraud by the claimant and insured for the purpose of invoking an insurer's duty to defend. There was no dispute that the insured's husband, an excluded driver was operating the insured vehicle when the accident occurred. The Court noted: "Given the contractual foundations of the eight-corners rule, we conclude it does not bar courts from considering such extrinsic evidence regarding collusive fraud by the insured in determining the insurer's duty to defend."

Second, the Court addressed the claimant's assertion that the defense should not have been withdrawn without first seeking a declaratory judgment. The Court noted that it has and continues to "encourage insurers to take that course" but the Court has not mandated that they do so. The Court stated that when faced with "undisputed evidence of collusive fraud" insurers should not be required to pursue a declaratory judgment action before withdrawing its defense" for the reason which follow. First, an insurer facing conclusive evidence of collusive fraud could determine there is no justiciable controversy and it would be a waste of time, money and judicial resources to pursue a declaratory judgment action. And, second, if the insurer is wrong it can be held liable for substantial damages, including attorney fees and exposure under the Texas Insurance Code Chapter 541 and DTPA. The Court then reversed the court of appeals and reinstated the trial court's summary judgment in favor of the insurer.

Editor's Note: This case is very significant in that it is the first time the Supreme Court of Texas has recognized an exception to the eight-corners rule. But the court was quick to point out that while an "insurer confronted with undisputed evidence of collusive fraud may choose to withdraw its defense without first seeking a declaratory judgment, though it risks substantial liability if its view of the duty to defend proves wrong." But, here the evidence was clear and the decision was affirmed. As noted in our March 24, 2020, Newsbrief, we get the sense that the Supreme Court of Texas is ready to address the extrinsic evidence exception issue and it did so here for the first time. We will continue to monitor this and other cases for related developments.

WORKERS' COMPENSATION EXCLUSIONS PRECLUDE UM/UIM COVERAGE

Last Wednesday, the United States District Court, Western District of Texas, San Antonio Division, granted summary judgment in favor of the insurer after finding that the insurer met its burden in proving the workers' compensation exclusion applied to preclude UM/UIM benefits sought by the insureds, and the insureds failed to provide evidence that it did not. In *Sanchez v. Great American Insurance Company*, 2020 WL 2086552 (W.D. Tex. April 29, 2020), Thomas Sanchez, Jr. and Daniel Crisp were injured in an auto accident while occupying a vehicle insured by their employer, Goodwill Industries through Great American Insurance Company. The policy included underinsured motorist (UM/UIM) coverage. Sanchez and Crisp requested and received permission from Great American to settle for the other driver's \$30,000 policy limit. Then claiming damages in the amount of \$750,000 and \$2,500,000 respectively, Sanchez and Crisp then presented their UM/UIM claims.

In defending the claims, Great American relied on the worker's compensation exclusions precluding UM/UIM coverage such that it would "directly or indirectly benefit...[a]ny insurer or self-insurer under any workers compensation, disability or similar law" and limiting the insurance coverage in that it would only "pay all covered damages not paid or payable under any...workers compensation, disability benefits or similar law" and requested a sixty-day abatement of the case to allow plaintiffs to seek reimbursement from their workers compensation carrier and provide written proof that the conditions precedent to triggering UM/UIM coverage had been met. Four months later, and not receiving the requested proof, Great American moved for summary judgment arguing that it is not contractually obligated to pay UM/UIM benefits based on the workers' compensation exclusions.

The court observed that Great American argued that it "has never denied coverage but is instead merely waiting on Plaintiffs to provide it with information concerning Texas Mutual's coverage decisions or payments." And, that Great American is not obligated to pay until it first receives proof "that there is no coverage available under the workers' compensation policy, a condition precedent to its obligation to pay."

The court reviewed the voluminous records filed by Plaintiff's in response and, Great American's argument that the "voluminous evidence"...still does not show a final determination from Texas Mutual, instead showing that Texas Mutual maintains secured liens against both Plaintiffs, confirming that payment of UM/UIM benefits would go to Texas Mutual's benefit, in contravention of the Policy's exclusion of payments that would benefit workers' compensation carriers." Accordingly, having met their burden in proving the exclusion applies, and because Plaintiffs failed to meet their subsequent burden, summary judgment was granted to Great American.

Editor's Note: MDJW congratulates Great American Insurance Company on this significant win. William McMichael and Austin Hagee of MDJW had the privilege of representing Great American in this case before the Federal District Court and appreciate the carrier's willingness to let them try to win it by motion.