For the first time, the Supreme Court of Texas recognizes exception to eight-corners rule

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To determine whether an insurer has a duty to defend, Texas applies the eight-corners rule.[1] Under the eight-corners rule, only the insurance policy and the pleadings are relevant—indeed, "the allegations . . . should be considered . . . without reference to the[ir] truth or falsity . . . and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof."[2] Thus, if a petition alleges a potentially-covered cause of action, an insurer must provide a defense, even if the allegations in the petition can be shown to be "groundless, false, or fraudulent."[3]

On May 1, 2020, however, the Supreme Court of Texas recognized the first-ever exception to the eight-corners rule.[4] Under the exception, courts may now pierce the pleadings and consider extrinsic evidence to determine whether the insured has colluded to obtain insurance coverage for an otherwise uncovered claim.

I. After its insured lies to procure coverage, the trial court upholds an insurer's withdrawal of defense.

Loya Insurance Company ("Loya") sold an auto-insurance policy to Karla Flores Guevara, which excluded coverage for accidents occurring when Guevara's husband, Rodolfo Flores, was driving.[5] After Rodolfo hit another car, the parties agreed to tell the responding police officer and Loya that Karla—not Rodolfo—was driving.[6] The other car's occupants then sued Karla for negligence, and she testified in discovery that she was driving the car.[7] But after Karla admitted to her attorney that she was not behind the wheel at the time of the accident, Loya denied coverage and withdrew defense of the claim, even though the petition affirmatively claimed Karla was driving at the time of the accident.[8]

After Loya withdrew defense coverage, judgment was entered against Karla for US$450,343.34.[9] She assigned her rights against Loya to the plaintiffs, who sued Loya, alleging it had breached its duty to defend.[10] Loya won summary judgment—based on its assertion that it had no duty to defend—because Karla had

1 *Loya Ins. Co. v. Avalos*, No. 18-0837, 2020 WL 2089752, at *2 (Tex. May 1, 2020).
2 *Id.* (quoting *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965)).
3 *Id.*
4 In the past, other courts have recognized exceptions to the eight-corners rule, but extrinsic evidence was only "relevant to an independent and discrete coverage issue, not touching on the merits of the underlying third-party claim." *See GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 308 n.2 (Tex. 2006) (collecting cases where other courts had recognized exceptions, without deciding whether such exceptions were permissible).
5 *Loya Ins. Co.*, 2020 WL 2089752, at *1.
6 *Id.*
7 *Id.*
8 *Id.*
9 *Id.*
10 *Id.*

admitted that she had misled others into believing she was driving, that it was actually Rodolfo who was driving, and that Rodolfo was not covered by Loya.[11]

II. The Court of Appeals acknowledges the rule is "logically contrary," but holds that the eight-corners rule requires a defense, even when an insured acknowledges she has colluded to falsely procure coverage.

On appeal, the San Antonio Court of Appeals reversed the trial court's grant of summary judgment, holding that the trial court should not have considered Karla's deposition testimony where she admitted she colluded to tell the insurer that she was driving, because it "directly contradict[ed] the [plaintiff's] allegations that [Karla] was driving" at the time of the accident.[12] The court of appeals noted that its holding seemed "logically contrary," but held that the eight-corners rule required Loya defend the suit due to the allegations in the pleading—despite its own insured's admissions that she tried to falsely procure coverage.[13]

III. For the first time, the Supreme Court of Texas recognizes an exception to the eight-corners rule.

The Supreme Court of Texas reversed the court of appeals, holding that "[c]ourts may consider extrinsic evidence regarding collusion to make false representations of facts for the purpose of invoking an insurer's duty to defend."[14] The Court reaffirmed that "[g]enerally, only the four corners of the policy and the four corners of the petition against the insured are relevant in deciding whether the duty applies," and that "[u]nder the eight-corners rule, a court should not consider extrinsic evidence from either the insurer or the insured that contradicts the allegations of the underlying petition."[15]

However, a trial court can consider extrinsic evidence "when there is conclusive evidence that groundless, false, or fraudulent claims against the insured have been manipulated by the insured's own hands in order to secure a defense and coverage where they would not otherwise exist."[16] This type of extrinsic evidence, the Court explained, outweighs the "contractual foundations of the eight-corners rule . . . ."[17]

IV. Best practices for an insurer confronted with false allegations in a petition

Traditionally, an insurer faced with a demonstrably false petition was forced to defend the suit unless and until it obtained a declaratory judgment that the claim was not covered.[18] The Court made clear though, that in circumstances like those present in *Loya*, an insurer cannot be held hostage by its insured's collusive fraud to procure coverage and that in those circumstances, an insurer need not obtain a declaratory judgment before withdrawing its defense.

The Court did note, though, that insurers must be careful not to overuse this remedy: an insurer that wrongfully withdraws a defense when there is not "undisputed evidence of collusive fraud" would still breach its duty to defend, which would result in liability "for substantial damages and attorneys' fees," including violations of Chapters 541 and 542 of the Texas Insurance Code and potential DTPA violations.[19] Thus, the Court "encourage[d] insurers" to continue to "seek a favorable declaratory judgment before withdrawing a defense in most cases where there is a real controversy regarding the duty to defend."[20]

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11 *Id.* at *2.
12 *Avalos v. Loya Ins. Co.*, 592 S.W.3d 138, 145 (Tex. App.—San Antonio 2018), *rev'd*, No. 18-0837, 2020 WL 2089752 (Tex. May 1, 2020).
13 *Id.* at 145–46.
14 *Loya Ins. Co.*, 2020 WL 2089752, at *2.
15 *Id.* (internal quotation marks omitted).
16 *Id.*
17 *Id.* at *3.
18 *See, e.g., Firemen's Ins. Co. of Newark, N.J. v. Burch*, 442 S.W.2d 331, 332 (Tex. 1968).
19 *Id.* at *4–*5.
20 *Id.* at *5.

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