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TABLE OF CONTENTS

I. INTRODUCTION

DURING this Survey period, Texas courts addressed various issues related to insurance law, including the application and scope of the "eight-corners" rule in determining the duty to defend, the availability of extracontractual remedies in the workers' compensation context, and the right of an insured to choose independent counsel in light of a conflict of interest. Additionally, the Fifth Circuit certified two questions to the Texas Supreme Court regarding the application of the "contractual liability" exclusion in a commercial general liability policy. Finally, both state and federal courts continued to struggle with the relative rights of co-insurers through contribution and subrogation, as this area of law continued to evolve during this Survey period.

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II. WORKERS' COMPENSATION INSURANCE

A. EXTRACONTRACTUAL REMEDIES IN WORKERS' COMPENSATION CASES

In 1988, the Texas Supreme Court extended the common law duty of good faith and fair dealing to workers' compensation insurers.[1] During this Survey period, however, the Texas Supreme Court overruled its prior decision and held that when the Texas legislature substantially amended the Workers' Compensation Act in 1989, the legislature sufficiently addressed the deficiencies that led the Texas Supreme Court to create the common law remedy.[2] In *Texas Mutual Insurance Company v. Ruttiger*, the Texas Supreme Court found that because the legislature created detailed procedures and remedies in the amended Workers' Compensation Act (the Act), there was no longer any need for a judicially imposed cause of action.[3] Rather, the Act now provides the exclusive remedy in *all* workers' compensation claims and the sole recourse to challenge most insurer misconduct.[4] Therefore, the supreme court ruled that an injured employee may not sue a workers' compensation carrier for common-law bad faith or for unfair settlement and investigation practices under the Texas Insurance Code.[5]

A practical understanding of the implications of *Ruttiger* requires examination of two preceding landmark decisions. Specifically, in *Aetna Casualty & Surety Co. v. Marshall*, the Texas Supreme Court held that the exclusive-remedy nature of the workers' compensation system did not bar claims under the former Unfair Claim Settlement Practices Act—Article 21.21 of the Texas Insurance Code.[6] Similarly, in *Aranda v. Insurance Co. of North America*, the Texas Supreme Court held that a workers' compensation insurer may be liable for breach of the common law duty of good faith and fair dealing.[7] These decisions were based largely on perceived procedural flaws in the workers' compensation scheme, which created an unequal balance of power between insurers and employees.[8] However, after more than twenty years of litigation and statutory amendments, the Texas Supreme Court was given the opportunity to reexamine the utility of these statutory and common law causes of action.

The factual background of *Ruttiger* provided the Texas Supreme Court with an interesting vehicle in which to make workers' compensation re-

1. Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210, 212 (Tex. 1988), *overruled by* Tex. Mut. Ins. Co. v. Ruttiger, 381 S.W.3d 430 (Tex. 2012).

2. *Ruttiger*, 381 S.W.3d at 449.

3. *Id.* at 444–45.

4. *Id.*

5. *Id.* at 455–56.

6. Aetna Cas. & Sur. Co. v. Marshall, 724 S.W.2d 770, 771–72 (Tex. 1987), *overruled by Ruttiger*, 381 S.W.3d 430.

7. Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210, 212 (Tex. 1988), *overruled by Ruttiger*, 381 S.W.3d at 430.

8. *See id.* at 212–13; *see also Marshall*, 724 S.W.2d at 772.

forms.[9] Timothy Ruttiger (Ruttiger) allegedly sustained bilateral hernias while carrying a pipe at work. Ruttiger's workers' compensation carrier began paying temporary income benefits. During the initial investigation, however, some of Ruttiger's co-workers told the claims handler that Ruttiger was injured while playing softball. Based on this information, the insurer denied Ruttiger's claim for hernia surgery. Ruttiger and the carrier then went through a benefit review conference with the Texas Workers' Compensation Commission in an attempt to resolve the dispute. The carrier agreed to pay for the surgery and other medical expenses, and reinstated the weekly benefits. Six months later, while Ruttiger was still receiving benefits, he sued the carrier, alleging bad faith, unfair settlement and investigation practices under the Texas Insurance Code and violations of the Texas Deceptive Trade Practices–Consumer Protection Act (the DTPA).

The case proceeded to trial where a jury found for Ruttiger on all of his claims.[10] The

Houston First District Court of Appeals affirmed.[11] The Texas Supreme Court granted the carrier's petition for review and held that the comprehensive Act barred Ruttiger from pursuing his claim for unfair settlement and investigation practices under the Texas Insurance Code.[12] The supreme court also dismissed Ruttiger's DTPA claim, as it was dependent upon his claim for violation of the Texas Insurance Code.[13] Ultimately, the supreme court was unable to reach a resolution on the bad faith claim, which had its genesis in *Aranda*; therefore, the supreme court remanded the issue to the court of appeals, which had not considered the issue.[14] In October 2011, both sides filed motions asking the supreme court to rehear the case, and the supreme court granted the motions and withdrew its previous decision.[15] In a 5–4 split decision, the majority expressly overruled *Aranda*.[16]

The supreme court began by exploring the pre-1989 workers' compensation scheme that gave rise to the *Aranda* decision, where injured workers then had very little bargaining power and protections from carriers due to the deficient administrative process for remedying arbitrary claim denials.[17] In the supreme court's view, the pre-1989 scheme allowed carriers to refuse to pay benefits while the review was ongoing, thus creating an incentive for delay.[18] Moreover, the review process failed to effect fair resolutions and acted as a "conveyor belt" to litigation because the par-

9. *See Ruttiger*, 381 S.W.3d at 433–36.
10. *Id.* at 435.
11. *Id.*
12. Tex. Mut. Ins. Co. v. Ruttiger, No. 08-0751, 2011 Tex. LEXIS 600, at *37, *39–40 (Tex. Aug. 26, 2011).
13. *Id.* at *42.
14. *Id.* at *2–3.
15. *Ruttiger*, 381 S.W.3d at 432.
16. *Id.* at 433.
17. *Id.* at 449–50.
18. *Id.* at 447.

ties rarely put forth evidence and witnesses.[19] One year after *Aranda* was decided, however, the Texas legislature overhauled the entire workers' compensation scheme by adding more significant proceedings and remedies for injured workers.[20] The supreme court emphasized that significant and timely procedures that subjected carriers to substantial penalties for exercising undue delay were subsequently put in place.[21] Therefore, allowing common law bad faith claims to proceed in the workers' compensation context would "frustrate[ ] the Legislature's intent to have disputes resolved quickly and objectively."[22]

Given these reforms, the supreme court concluded that providing workers with § 541 claims would incentivize delay, as the new dispute resolution process would often be disrupted by these claims (as was the case in *Ruttiger*).[23] Consequently, the supreme court held that the new provisions of the Act established exclusive remedies for injured workers, rendering §§ 541.060 (unfair claim settlement practices) and 542.003 (failure to investigate and pay claims promptly) superfluous in the workers' compensation context.[24] The supreme court, however, did not extend its holding to § 541.061 regarding misrepresentation of policy provisions, as that section did not specify that it applied in the context of settling claims.[25]

In conclusion, the supreme court held in *Ruttiger* that the Act now provides detailed procedures and remedies for injured workers, and so there is no longer any need for extra-contractual liability in the workers' compensation context.[26] Rather, the Act now provides the injured worker with an exclusive remedy and the sole recourse to challenge most insurer misconduct. As such, *Ruttiger* undoubtedly changes the landscape of workers' compensation law in Texas and bad faith litigation in general.

III. INSURED'S RIGHT TO INDEPENDENT COUNSEL

In general, liability insurance policies obligate the insurer to both indemnify the insured for settlements or judgments and provide coverage for the insured's defense expenses. Therefore, pursuant to these policies, the insurer must pay for fees incurred by the insured's defense counsel. This "duty to defend" typically allows the insurer to select defense counsel of its own choosing.[27] However, this right is not absolute, as Texas law has traditionally allowed the insured to select independent counsel under certain circumstances—specifically, where the insurer issues a reservation

19. *See id.* at 441.
20. *See id.* at 440.
21. *Id.* at 442–43.
22. *Id.* at 450–51.
23. *Id.* at 451.
24. *Id.* at 444–45.
25. *Id.* at 446.
26. *Id.* at 451.
27. *See* Downhole Navigator, L.L.C. v. Nautilus Ins. Co., 686 F.3d 325, 328 (5th Cir. 2012) (citing N. Cnty. Mut. Ins. Co. v. Davalos, 140 S.W.3d 685, 688 (Tex. 2004)).

of rights letter and a conflict of interest arises because "the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends."[28]

In *Downhole Navigator, L.L.C. v. Nautilus Insurance Co.*, the United States Court of Appeals for the Fifth Circuit considered whether a liability insurer's reservation of rights letter created a conflict of interest, thereby shifting the right to select defense counsel to the insured.[29] The Texas Supreme Court in *Unauthorized Practice of Law Committee v. American Home Assurance Co.* had "observed that 'the most common conflict between an insurer and [its] insured' is whether a claim falls within [coverage]," and "coverage issues may . . . depend on facts *developed* in the litigation."[30] In rejecting an expansive reading of Texas law regarding the right to select independent counsel, the Fifth Circuit held that the mere issuance of a reservation of rights letter does not entitle an insured to select its own independent counsel at its insurer's expense.[31]

In *Downhole*, an oil well operator hired Downhole to help redirect a well toward a desired reservoir. The operator later brought suit against Downhole, alleging that Downhole negligently executed the redirect plan. Downhole then tendered the suit to its liability insurer, Nautilus, which offered to defend Downhole subject to a reservation of rights. However, Downhole rejected Nautilus's conditional defense, claiming that the offer to defend under a reservation of rights "created a material conflict with respect to the selection of counsel."[32] Nautilus responded by stating that it had reserved rights and would continue investigating the matter, and unless a coverage issue arose, Nautilus would not pay for independent counsel.

Downhole then filed a declaratory judgment action against Nautilus in the United States District Court for the Southern District of Texas, seeking a declaration that Nautilus was obligated to reimburse Downhole for its defense costs.[33] The magistrate judge held that Nautilus had no duty to reimburse Downhole for its independent counsel's fees.[34] Downhole appealed, arguing that *Unauthorized Practice* stood for the proposition that a conflict of interest arises any time facts that could be developed in the underlying suit are the same facts upon which coverage depends.[35] More specifically, Downhole argued that where an insurer defends its insured under a reservation of rights, counsel appointed by the insurer may be inclined to develop facts in the underlying litigation that could reinforce defenses to coverage.[36]

28. *Id.* (quoting *Davalos*, 140 S.W.3d at 689) (internal quotation marks omitted).
29. *Id.* at 326–27.
30. *Id.* at 329 (quoting Unauthorized Practice of Law Comm. v. Am. Home Assurance Co., 261 S.W.3d 24, 40 (Tex. 2008)).
31. *Id.* at 330.
32. *Id.* at 327.
33. *Id.* at 327–28.
34. *Id.* at 328.
35. *Id.* at 329.
36. *Id.* at 329–30.

Ultimately, the Fifth Circuit rejected Downhole's "strained reading of . . . [an] inconsequential line of dicta" from *Unauthorized Practice* as "an illogical leap," holding that no conflict was created by Nautilus's offer to defend under a reservation of rights.[37] The Fifth Circuit found that the facts to be adjudicated in the underlying suit were not the same "facts upon which coverage depends."[38] Rather, the underlying suit concerned only whether Downhole negligently performed its work.[39] The policy did not exclude coverage for Downhole's negligence and Nautilus did not reserve its right to deny coverage based on Downhole's negligence.[40] Accordingly, "'the facts to be adjudicated' in the underlying [suit were] not [equivalent to the] 'facts upon which coverage depends,'" and therefore no conflict of interest existed.[41] Based on this, the Fifth Circuit affirmed the magistrate judge's ruling.[42]

Since the Texas Supreme Court issued its opinion in *Davalos* in 2004, confusion had existed as to whether the mere issuance of a reservation of rights letter precluded an insurer from controlling the insured's defense. In *Downhole Navigator*, however, the Fifth Circuit took a practical and equitable approach by requiring that an actual conflict exist between the interests of the insurer and those of the insured.[43] Policies imposing a duty to defend on an insurer generally confer a corresponding right upon the insurer to control the insured's defense. Accordingly, had the Fifth Circuit adopted Downhole's position, insurers seeking to discharge their contractual obligations to defend their insureds, while also preserving their own contractual rights under their policies by issuing reservation of rights letters, would have been deprived of a substantial contractual right under the insurance contract. The Fifth Circuit avoided such a harsh and arbitrary result by prudently limiting the scope of the insured's right to independent counsel to only those situations where liability and coverage issues so overlap that the outcome of the underlying suit practically resolves the coverage issues.[44]

IV. COMMERCIAL GENERAL LIABILITY INSURANCE

For the past several decades, courts have struggled with how to apply the terms of a Commercial General Liability (CGL) policy to construction defect claims involving issues of contractual liability. For example, in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Texas Supreme Court found that because the language of CGL policies does not distinguish between tort and contract damages, "any preconceived notion that a CGL policy is only for tort liability must yield to the policy's actual

37. *Id.* at 330.
38. *Id.* at 331.
39. *Id.* at 329.
40. *Id.*
41. *Id.* (quoting N. Cnty. Mut. Ins. Co. v. Davalos, 140 S.W.3d 685, 689 (Tex. 2004)).
42. *Id.* at 331.
43. *See id.*
44. *See id.*

language."[45] Several years later, the Texas Supreme Court concluded that contractual liability was excluded by the standard CGL policy.[46]

In *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, the Texas Supreme Court held that the "contractual liability" exclusion applies to exclude coverage for claims where the insured assumes liability in a contract, unless an exception to the exclusion is implicated.[47] Although the carrier conceded that the claims in the underlying suit fell within the broad, general terms of the policy, it argued that because the insured's only basis for liability was Gilbert's contractual obligations assumed under contract, the contractual liability exclusion applied to bar coverage.[48] The insured countered that a narrow reading should be given to the exclusion and that "assumption" in the exclusion's terms referred only to the assumption of "liability *of another* such as in hold-harmless or indemnity agreements."[49] The insured further argued that, at the very least, the exclusion was ambiguous and should therefore be interpreted in favor of coverage.[50] To the extent the exclusion actually applied, the insured took the position that its liability to the underlying plaintiff fell within the exclusion's exception for liability for damages that the insured would bear even in the absence of the contract or agreement.[51]

Ultimately, the supreme court rejected the insured's arguments in *Gilbert*, noting that the insured "agreed under its contract with DART to 'repair any damage to . . . facilities, including those that are the property of a third party, resulting from failure to comply with the requirements of this contract or failure to exercise reasonable care in performing the work.'"[52] Because the insured had defeated all potential tort liability through summary judgment, the only remaining theory of liability arose from "an obligation or liability contractually assumed by [the insured]."[53] Furthermore, the supreme court found the language of the exclusion to be plain and unambiguous, and had the parties intended the narrow exclusion for which the insured advocated, the parties easily could have drafted a more narrow exclusion.[54]

In *Ewing Construction Co. v. Amerisure Insurance Co.*, the United States Court of Appeals for the Fifth Circuit interpreted *Gilbert* as

45. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 13 (Tex. 2007).
46. Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118, 126 (Tex. 2010).
47. *Id.* at 131–32. The "contractual liability" exclusion in standard commercial general liability policies states: "[This] insurance does not apply to 'bodily injury' or 'property damage' for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages: (1) [a]ssumed in a contract or agreement that is an 'insured contract;' or (2) [t]hat the insured would have in the absence of the contract or agreement." *See id.* at 124.
48. *Id.* at 125.
49. *Id.*
50. *Id.*
51. *Id.* at 133.
52. *Id.* at 126.
53. *Id.* at 127.
54. *Id.*

"stand[ing] for the proposition that [the] contractual liability exclusion" applies when an insured has entered into a contract, and by doing so has assumed liability for its own performance under that contract.[55] Therefore, according to the Fifth Circuit, the exclusion barred coverage for the faulty workmanship alleged in the underlying suit.[56] However, less than two months after issuing its opinion, the Fifth Circuit withdrew *Ewing* and certified the following two questions to the Texas Supreme Court:

> 1. Does a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike manner, without more specific provisions enlarging this obligation, "assume liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion.
>
> 2. If the answer to question one is "Yes" and the contractual liability exclusion is triggered, do the allegations in the underlying lawsuit alleging that the contractor violated its common law duty to perform the contract in a careful, workmanlike, and non-negligent manner fall within the exception to the contractual liability exclusion for "liability that would exist in the absence of contract."[57]

In *Ewing*, the insured contracted to construct tennis courts for the Tuloso–Midway Independent School District in Corpus Christi, Texas (the District).[58] Shortly after the construction was completed, the District complained that the tennis courts were flaking and cracking. The District then brought suit against the insured seeking damages for the alleged defective construction. In its petition, the District alleged that the insured failed to: (1) properly prepare for and manage construction, (2) retain and oversee subcontractors, (3) perform in a good and workmanlike manner, and (4) complete construction in accordance with the contract terms and specifications. In addition, the petition alleged that the insured "breached [its] duty to Plaintiff to use ordinary care in the performance of [its] contract[ ], proximately causing damages to Plaintiff."[59] The insured then tendered defense of the suit to its insurer; however, the insurer denied that it owed a duty to defend. Both parties then filed declaratory judgment actions to determine their rights and duties under the policy. Ultimately, the district court applied *Gilbert* and found that the District's petition alleged contractual liability; therefore, the contractual liability exclusion applied to bar coverage.[60]

On appeal, the insured argued that pursuant to *Gilbert*, a distinction should be made between entering into a construction contract and assum-

55. Ewing Constr. Co., Inc. v. Amerisure Ins. Co., 684 F.3d 512, 519 (5th Cir. 2012), *opinion withdrawn and superseded by* Ewing Constr. Co., Inc. v. Amerisure Ins. Co., 690 F.3d 628 (5th Cir. 2012).

56. *Id.*

57. *Ewing Constr. Co., Inc.*, 690 F.3d at 633.

58. *Ewing Constr. Co., Inc.*, 684 F.3d at 516.

59. *Id.* at 517.

60. *Id.* at 518.

ing liability for faulty workmanship under the contract.[61] In other words, the insured characterized the promise to repair third-party property in *Gilbert* as an "assumption of liability," while the "implied promise . . . to perform the contract with ordinary care" here was not.[62] More specifically, the insured cited dicta from *Gilbert* that the contractual liability exclusion does not "'preclude[ ] liability for all breach of contract claims.'"[63] However, the Fifth Circuit found that the insured's argument "elevates ambiguous dicta from *Gilbert* while minimizing that opinion's clear holding."[64] In the eyes of the majority, "*Gilbert*, principally, stands for the proposition that a CGL policy's contractual liability exclusion excludes coverage for property damage when 'the insured assumes liability for . . . property damage by means of contract.'"[65] Because the District's petition demonstrated that the insured assumed liability for defective construction by executing a contract to complete the project, whether the breached promise was express or implied was insignificant as the promise was "contractual [in] nature."[66] Furthermore, the Fifth Circuit characterized the Texas Supreme Court's approach to the exclusion in *Gilbert* as being "straightforward: Apply the plain language of the exclusion, rather than grafting additional language to it."[67] According to the Fifth Circuit, this "plain meaning approach" conforms to the traditional "principle that a CGL policy is not protection for the insured's poor performance of a contract."[68]

After determining that the contractual liability exclusion applied, the Fifth Circuit next examined whether any exception to the exclusion restored coverage.[69] Here, the insured argued that the exception "for liability that 'the insured would have in the absence of the contract or agreement'" applied.[70] Because the petition in the underlying suit used the word "negligence," and liability for negligence "exists irrespective of a contract," the insured believed the district court erred in finding that the exception did not apply.[71] The Fifth Circuit, however, found that use of the term "negligence" was not dispositive, as courts must evaluate the substance of the underlying petition to "determine whether it alleges an action in contract, tort, or both."[72] This is accomplished by looking to the basis of liability and the nature of the alleged loss; therefore, "'[w]hen the only loss or damage is to the *subject matter of the contract*, the plaintiff's

61. *Id.*
62. *Id.* at 518–19.
63. *Id.* at 519. (quoting Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118, 128 (Tex. 2010)).
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* (citing Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 10 (Tex. 2007)).
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at 520.

action is ordinarily on the contract.'"[73] Because the insured's duty to construct the bargained-for tennis courts arose out of its contract with the District, the contract was the source of the insured's liability.[74] Moreover, the damages alleged were "to the subject matter of the contract, the tennis courts, not to any other property."[75] Consequently, the exception to the exclusion did not apply, and the insurer owed no duty to defend.[76]

In withdrawing its original ruling and certifying the above questions to the Texas Supreme Court, the Fifth Circuit retreated from its original position by first recognizing that the correct application of *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*[77] and *Gilbert*[78] is unclear and presents a disputed and important question of Texas law.[79] The Fifth Circuit further noted that it was unclear which interpretation would better advance "the goals of Texas insurance law and [would be] more compatible with the structure of the CGL [policy]."[80] The Fifth Circuit's original ruling undoubtedly conferred a broad reading upon the contractual liability exclusion, which some viewed as barring CGL coverage for virtually all faulty workmanship cases arising from construction contracts. Consequently, the stakes are high for those in the construction and insurance businesses as we wait for the supreme court's answers to the certified questions.

V. THE EIGHT-CORNERS RULE

During the Survey period, several cases addressed the application of the eight-corners (or "complaint-allegation") rule in determining an insurer's duty to defend. Based on these cases, it seems clear that, for the time being, Texas state and federal courts will strictly adhere to the eight-corners rule and will only deviate from the rule under limited circumstances.

A. General Rule and Interpretation

In *GuideOne Specialty Mutual Insurance Co. v. Missionary Church of Disciples of Jesus Christ*, the United States Court of Appeals for the Fifth Circuit addressed several aspects of duty to defend jurisprudence in Texas, including whether application of the eight-corners rule is linked to any specific policy language.[81]

73. *Id.* (emphasis added) (quoting Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494–95 & n.2 (Tex. 1991)).
74. *Id.*
75. *Id.*
76. *Id.*
77. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007).
78. Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118 (Tex. 2010).
79. Ewing Constr. Co., Inc. v. Amerisure Ins. Co., 690 F.3d 628, 632 (5th Cir. 2012).
80. *Id.*
81. GuideOne Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ, 687 F.3d 676, 678–81 (5th Cir. 2012).

In March 2006, two members of the Missionary Church of the Disciples of Jesus Christ (the Church) were involved in an automobile accident while driving a vehicle owned by another member of the Church.[82] A group of the Church's members had originally driven from Dallas to San Antonio to visit one of the Church's fathers, but upon arrival at the Church's prayer center, the group decided that the center was dirty and needed to be cleaned. The vehicle owner, however, had to leave San Antonio. While the owner was gone, the remaining members drove the vehicle to lunch and were involved in the subject accident. Thereafter, the driver of the other vehicle filed suit against the Church, the driver, and the vehicle's owner, alleging that the Church and owner negligently entrusted the vehicle to the driver. GuideOne provided automobile insurance to the Church, with coverage for both owned and "nonowned 'autos.'"[83] By amendment, the policy defined nonowned autos as "those autos [the Church does] not own, lease, hire, rent or borrow that are used in connection with [the Church's] business. This includes 'autos' owned by [the Church's] employees or partners or members of their households but only while used in [the Church's] business or [the Church's] personal affairs."[84]

In January 2011, GuideOne initiated a declaratory judgment action in the District Court for the Northern District of Texas, seeking a declaration of no duty to defend or indemnify in the underlying suit. In GuideOne's motion for summary judgment, default was entered against the driver.[85] The Church and the vehicle owner argued that factual issues precluded a determination of the duty to defend and indemnify while the underlying plaintiff argued that the allegations in its complaint triggered both duties under the policy.[86] Ultimately, the district court ruled in GuideOne's favor, holding that because the policy language created coextensive defense and indemnity obligations, the eight-corners rule did not apply and extrinsic evidence related to liability in the underlying suit could therefore be considered.[87] More specifically, the district court found that when the eight-corners rule originally developed, the standard CGL form contained language obligating the insurer to defend regardless of whether the allegations were "groundless, false or fraudulent."[88] Since 1986, however, subsequent forms have deleted this particular language.[89]

On appeal, the Fifth Circuit began by considering the propriety of the

82. *Id.* at 679.
83. *Id.* at 680.
84. *Id.*
85. *Id.* at 681.
86. *Id.* at 680.
87. *Id.* at 681.
88. *Id.* at 683 n.5.
89. *See* David S. White, *Federal District Judge Says Texas' "Eight-Corner Rule" Is No Longer Law. Really?*, LAW & INS. (June 25, 2010), http://lawandinsurance.typepad.com/law_and_insurance/2010/06/federal-district-judge-says-texas-eightcorner-rule-is-no-longer-law-really.html (citing International Risk Management Institute, *Annotated Commercial General Liability Insurance*, p. v.c.12 (15th ed. 2008)).

district court's ruling on GuideOne's defense obligation.[90] Here, the Fifth Circuit noted that "Texas courts and federal courts have consistently applied the eight-corners rule," whereby the insurer's defense obligations are determined solely "'by the allegations in the pleadings and the language of the . . . policy.'"[91] The district court, however, did not follow this "well-established approach," as it reasoned that the parties contracted around the eight-corners rule by employing the language "we have no duty to defend suits for 'bodily injury' or 'property damage' not covered by this endorsement."[92] The Fifth Circuit disagreed, explaining that "[t]he eight-corners rule is a judge-made rule," and while the Fifth Circuit had previously held that parties could contract around the rule,[93] the parties had not provided any "cases in which a Texas court or a federal court interpreting Texas law did not apply the eight-corners rule when ascertaining the scope of a duty to defend."[94] Furthermore, GuideOne was unable to persuade the court to do so.[95]

Here, the Fifth Circuit disagreed with GuideOne's reasoning that by defining the duties to defend and indemnify in the same terms, the duty to defend was no longer broader than the duty to indemnify.[96] Rather than finding that the distinction between the two duties is based on specific policy language, the Fifth Circuit explained that "[t]he contrast instead results from what the language setting forth those duties is compared with: While courts compare the language setting forth the duty to defend with the allegations in the petition, they compare the language setting forth the duty to indemnify with the evidence presented by the parties."[97] Moreover, the Fifth Circuit found that the mere fact that the same policy language sets forth both the duty to defend and the duty to indemnify does not require the court to examine extrinsic evidence in ascertaining defense obligations.[98] Therefore, the policy "language [gave] no reason to depart from Texas's time-honored manner of interpreting insurers' duty to defend."[99]

As discussed below, the Texas Supreme Court has not yet expressly recognized any exception to the eight-corners rule, instead maintaining strict adherence to the rule. The Fifth Circuit, however, has shown more

90. *GuideOne Specialty Mut. Ins. Co.*, 687 F.3d at 682.

91. *Id.* at 682–83 (quoting Nat'l Cas. Co. v. W. World Ins. Co., 669 F.3d 608, 612 (5th Cir. 2012)).

92. *Id.* at 683–84.

93. *Id.* at 683 (citing Pendergest-Holt v. Certain Underwriters at Lloyd's of London, 600 F.3d 562, 574 (5th Cir. 2010); 14 Lee R. Russ & Thomas F. Segalla, COUCH ON INS. § 200:5 (3d ed. 2009)).

94. *Id.* By footnote, the Fifth Circuit also explained that it had uncovered no Texas cases making application of the "eight-corners" rule contingent "on policy language providing that the duty to defend applies to 'groundless, false or fraudulent' allegations." *Id.* at 683 n.5.

95. *Id.* at 683.

96. *Id.* at 684.

97. *Id.* (citing Utica Nat. Ins. Co. of Tex. v. Am. Indem. Co., 141 S.W.3d 198, 201, 203 (Tex. 2004)); Northfield Ins. Co. v. Loving Home Care, 363 F.3d 523, 531 (5th Cir. 2004)).

98. *Id.* at 686.

99. *Id.* at 684.

willingness to deviate from the rule, expressly applying a narrow exception under limited circumstances when determining the duty to defend.[100] Nevertheless, the Fifth Circuit in *GuideOne* refused to hold that the deletion of the "groundless, false or fraudulent" language from the 1986 policy form amendments changed the rule.[101] Therefore, it appears that absent the limited criteria set forth in *Northfield Insurance Co. v. Loving Home Care, Inc.*, the Fifth Circuit will strictly adhere to the eight-corners rule.

B. The Policy Period Requirement

In *GEICO General Insurance Co. v. Austin Power Inc.*, the Houston Fourteenth District Court of Appeals examined whether an insured was entitled to a defense by its insurer against a personal injury lawsuit, despite the fact that the underlying complaint did not name a specific date of injury.[102] Ultimately, the appellate court rejected the insurer's argument that the underlying plaintiffs must affirmatively and expressly allege an injury occurring within the policy period in order to trigger the duty to defend.[103] Rather, because the complaint was written in the past tense, the plaintiffs' injuries potentially occurred during the policy period; accordingly, the insurer's duty to defend was triggered.[104]

In the underlying suit, the plaintiffs sued several defendants (including Austin Power), alleging injuries due to exposure to the defendants' asbestos-containing machinery and products.[105] In their complaint, the plaintiffs did not identify the date that the alleged injuries occurred. Austin Power was ultimately dismissed as a party to the underlying suit,[106] but it sought coverage from GEICO for costs incurred in defending the suit. The trial court granted Austin Power's motion for summary judgment on its coverage claim and ordered GEICO to pay Austin Power's defense costs.[107] GEICO then appealed, arguing that because the underlying "petition lacked a specific temporal factual allegation it was not a potentially covered claim under the insurance policy and thus did not trigger GEICO's duty to defend."[108]

The appellate court began its analysis by recognizing that "[a]n insurer has a duty to defend when a third party sues the insured on allegations that, if taken as true, potentially state a cause of action within the cover-

100. *See, e.g.*, *Northfield Ins. Co.*, 363 F.3d at 529–35; Liberty Mut. Ins. Co. v. Graham, 473 F.3d 596, 602–04 (5th Cir. 2006).

101. *See GuideOne Specialty Mut. Ins. Co.*, 687 F.3d at 684–86.

102. GEICO Gen. Ins. Co. v. Austin Power Inc., 357 S.W.3d 821, 822-23 (Tex. App.—Houston [14th Dist.] 2012, pet. denied).

103. *Id.* at 824–26.

104. *Id.* at 825–26.

105. *Id.* at 823.

106. *Id.*

107. *Id.*

108. *Id.*

age terms of the policy."[109] "Even [where these] allegations are groundless, false, or fraudulent, the insurer [must] defend."[110] The appellate court further explained that when analyzing the duty to defend question, a Texas court must employ the eight-corners or "complaint-allegation rule: '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.'"[111] When applying this rule, the pleadings' allegations must be construed liberally,[112] and all doubts regarding the duty to defend must be resolved in the insured's favor.[113] Moreover, the rule does not require the court "to ignore those inferences logically flowing from the facts alleged in the petition."[114]

Despite the fact that the underlying petition contained no allegations regarding the date of injury, the appellate court found "other indications of the time of injury."[115] Specifically, the petition alleged that one of the plaintiffs was exposed to asbestos on numerous occasions and that each additional exposure caused or contributed to his injuries, which included asbestos-related lung disease. The plaintiffs also brought a claim for conspiracy, alleging that the conspiracy took place over several decades. In its argument, GEICO attempted to distinguish *Gehan Homes Ltd. v. Employers Mutual Casualty Co.*, which held that bodily injury or property damage alleged to have happened in the "past" potentially fell within the policy's coverage period.[116] Here, GEICO argued that because the underlying petition in the present case lacked the signifier "past," the court could not take the "logical step" to conclude that the plaintiffs' injuries occurred in "a prior window of time."[117] The appellate court, however, disagreed, explaining that the petition was written in the past tense, the alleged conspiracy took place over several decades, and asbestos-related diseases generally occur over long periods of time.[118] In keeping with the general rules that pleadings must be construed liberally and doubts must be resolved in the insured's favor, the appellate court held that the petition alleged a "potential occurrence within the policy's coverage period."[119]

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109. *Id.* (citing GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 310 (Tex. 2006)).

110. *Id.* (citing Zurich Am. Ins. Co. v. Nokia, Inc., 268 S.W.3d 487, 491 (Tex. 2008)).

111. *Id.* at 824 (quoting *Zurich Am. Ins. Co.*, 268 S.W.3d at 491).

112. *Id.* (citing Nat'l Union Fire Ins. Co. v. Merchs. Fast Motor Lines, Inc., 939 S.W.2d 139, 141 (Tex. 1997)).

113. *Id.* (citing King v. Dallas Fire Ins. Co., 85 S.W.3d 185, 187 (Tex. 2002)).

114. *Id.* (citing Gen. Star Indem. Co. v. Gulf Coast Marine Assocs., Inc., 252 S.W.3d 450, 456 (Tex. App.—Houston [14th Dist.] 2008, pet. denied) (citing Allstate Ins. Co. v. Hallman, 159 S.W.3d 640, 645 (Tex. 2005))).

115. *Id.*

116. *See* Gehan Homes Ltd. v. Emp'rs Mut. Cas. Co., 146 S.W.3d 833, 846 (Tex. App.—Dallas 2004, pet. denied).

117. *GEICO Gen. Ins. Co.*, 357 S.W.3d at 825.

118. *Id.* ("In effect, the [plaintiffs] alleged that [a plaintiff] was injured sometime before the petition was filed. Nothing in the pleadings negates the possibility that the injury occurred [during the policy period].").

119. *Id.*

Furthermore, the appellate court explained that coverage did not turn on extrinsic evidence or facts that were "not encompassed within the factual allegations in the underlying suit."[120] Rather, a liberal construction of the "allegations themselves" was enough to state a potentially covered claim, thereby triggering the duty to defend.[121] Accordingly, the appellate court affirmed the trial court's judgment.[122]

In a similar case, the Dallas Court of Appeals considered whether a negligence suit brought against a home builder by the purchaser triggered a defense obligation where no dates of property damage were alleged.[123] In 1999, Vines-Herrin Custom Homes, LLC (Vines-Herrin) built a single-family home in Plano, Texas.[124] Vines-Herrin was covered by a CGL policy with an initial policy period from November 9, 1998, to November 9, 1999. The policy was renewed the next year for an additional policy period, ending on November 9, 2000. At the policy's expiration, Vines-Herrin purchased another policy from one of the original insurer's sister companies, with a policy period from November 9, 2000, to November 9, 2001. The final policy purchased by Vines-Herrin covered the period from September 18, 2001, to September 18, 2002. Thus, Vines-Herrin had CGL coverage from November 9, 1998, to September 18, 2002.

In May of 2000, the purchaser bought the home from Vines-Herrin for $989,353. Within a few days of moving in the purchaser began experiencing problems with the home, including water intrusion and doors not shutting correctly after a rainstorm. Over the course of the next few months, the purchaser noticed water collecting on the home's window sills and damage to the home's sheetrock and baseboards. Cracks also began developing in the home's ceiling. In late November of 2000, the purchaser found that a window in the back of the home's master bathroom had begun to sink into the home's frame. More cracks and leaks continued to develop in 2001, and the home's ceiling and roof began to sag in early 2002. Alarmed by these ongoing problems, the purchaser notified Vines-Herrin of the issues with the home; however, no effort was made to repair the damages. Ultimately, the purchaser filed suit against Vines-Herrin in January of 2003 for damages resulting from negligent construction.[125] After Great American Lloyds Insurance Company (Great American) denied Vines-Herrin's request for a defense, Vines-Herrin sought a declaration of coverage on both defense and indem-

120. *Id.* at 826 (distinguishing Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co., 279 S.W.3d 650 (Tex. 2009)).

121. *Id.* ("The plaintiffs in the underlying suit alleged facts that supported an inference of coverage and that were 'sufficient to permit proof on a trial' of the truth of the inference." (quoting Heyeden Newport Chem. Corp. v. So. Gen. Ins. Corp., 387 S.W.2d 22, 26 (Tex. 1965))).

122. *Id.*

123. Vines-Herrin Custom Homes, LLC v. Great Am. Lloyds Ins. Co., 357 S.W.3d 166, 168–70 (Tex. App.—Dallas 2011, pet. filed).

124. *Id.* at 168.

125. *Id.* at 168–69.

nity.[126] Vines-Herrin also brought claims for breach of the duty of good faith and fair dealing, breach of contract, and DTPA and insurance code violations.[127]

In May of 2006, Vines-Herrin informed Great American that it no longer had funding for defense costs and agreed to arbitrate the dispute with the purchaser. Although the arbitration petition dropped all allegations except negligence, Great American still refused to participate in the arbitration. The arbitrator ultimately awarded the purchaser $2,487,507.77 in damages, and the parties executed a settlement agreement assigning all claims, rights, and causes of action against Great American to the purchaser. The trial court in the coverage action, applying the "manifestation rule," initially ruled in favor of Great American.[128] However, shortly thereafter, the Texas Supreme Court in *Don's Building Supply, Inc. v. OneBeacon Insurance Co.* rejected the "manifestation rule" in favor of the "actual injury" approach.[129] Because of this change in law, the trial court set aside the original judgment and reopened the case to hear evidence on when the actual damage to the resident occurred.[130] Ultimately, the trial court found that although Vines-Herrin and the purchaser established that "(1) the [home's construction] was covered by an uninterrupted period of insurance . . . and (2) that the damages . . . manifested during [that] uninterrupted period . . . , [they] failed to show, by expert testimony, the date when actual physical damage to the property occurred."[131] Furthermore, the trial court found that the purchaser's original complaint against Vines-Herrin "failed to allege the date when actual physical damage to the property occurred."[132] Accordingly, the trial court held that Great American had no duty to defend Vines-Herrin.[133] On appeal, Vines-Herrin and the purchaser argued that the "actual injury" approach does not "require a party to allege [the] exact date [on which the property] damage occurred," nor must the party present "expert testimony [proving] an actual date of [damage]."[134]

After disposing of Great American's jurisdictional argument, the appellate court turned to *Don's Building*, which governed the parties' remaining issues.[135] In *Don's Building*, certain homeowners sued a stucco distributor "alleging [that] the stucco was defective and allowed moisture to seep into the wall cavities . . . , causing . . . wood rot that [went] unno-

126. *Id.* at 169.
127. *Id.*
128. *Id.*
129. *Id.* (citing Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co., 267 S.W.3d 20, 24–25 (Tex. 2008)) ("Under the 'actual injury' approach, property damage 'occurs' when actual physical damage takes place rather than when the damage manifests itself or becomes discoverable.").
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.* at 169–70.
135. *Id.* at 170–71.

ticed because" the wall's exterior was not damaged.[136] The distributor's insurer refused to provide a defense and sought a declaration of no coverage, arguing that "the damage was not discovered until after the policy period . . . ended."[137] The Texas Supreme Court focused on the policy language and "adopted the actual-injury rule, holding that property damage occurs during the policy period if 'actual physical damage to the property occurred' during the policy period."[138]

Turning to the case *sub judice*, the appellate court initially noted that the trial court had found "that '[t]here was an uninterrupted period of insurance coverage'" during the home's construction and that the purchaser "'suffered a continuing series of injuries and damages throughout [this] period[ ].'"[139] Additionally, after hearing uncontradicted expert testimony, the trial court found that the damages were caused by defective framing.[140] Based on these findings and conclusions, the appellate court determined that "the trial court interpreted *Don's Building* to require (1) an exact date of actual injury and (2) expert testimony establishing [such] date."[141] However, "*Don's Building* held only that property damage under the CGL policy 'occurred when actual physical damage to the property occurred.'"[142]

The appellate court next examined the duty to defend, whereby under the eight-corners rule "only the pleadings and policy language are considered."[143] Here, the appellate court found that the purchaser's petition potentially stated a claim within the scope of the policies.[144] The "policies provided continuous coverage from November 9, 1998 . . . to September 18, 2002."[145] Furthermore, the purchaser's petition alleged that the home was built in 1999 and that by April of 2001, the home was showing signs of damage. Therefore, applying the eight-corners rule, "the pleadings sufficiently allege[d] the policies were in effect prior to construction and actual damage occurred sometime during or after construction . . . ."[146] At a minimum, then, "the petition[ ] adequately plead that actual physical damage to the property potentially occurred during the . . . policy period[ ]"; accordingly, Great American owed Vines-Herrin a defense obligation.[147]

To summarize, *Austin Power* and *Vines-Herrin* demonstrate that Texas state courts continue to strictly abide by the eight-corners rule—even

136. *Id.* at 171 (citing Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co., 267 S.W.3d 20, 22 (Tex. 2008)).
137. *Id.* (citing *Don's Bldg. Supply, Inc.*, 267 S.W.3d at 22).
138. *Id.* (quoting *Don's Bldg. Supply, Inc.*, 267 S.W.3d at 24).
139. *Id.*
140. *Id.*
141. *Id.* at 172.
142. *Id.* (quoting *Don's Bldg. Supply, Inc.*, 267 S.W.3d at 24).
143. *Id.* (citing Burlington N. & Santa Fe Ry. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 334 S.W.3d 217, 219 (Tex. 2011)).
144. *Id.* at 173.
145. *Id.*
146. *Id.*
147. *Id.*

where no dates of injury or damage are alleged in the pleading—thereby requiring the insurer to point to specific allegations removing any inference that the alleged injury or damage occurred during the policy period. Such a rule may incentivize vague pleadings while also hindering challenges by insureds to these vague pleadings, as plaintiffs and defendant-insureds alike will want to trigger the maximum amount of available insurance coverage. Thus, it appears that unless and until the Texas Supreme Court expressly carves out an exception to the eight-corners rule, Texas state courts will continue to strictly apply the rule.

C. Application of the Eight-Corners Rule to the "Known Loss" Provision

Recently, the United States Court of Appeals for the Fifth Circuit had occasion to rule on the use of extrinsic evidence in determining whether the "known loss" provision bars coverage.[148] As previously discussed, Texas courts apply the eight-corners rule in determining whether the duty to defend exists.[149] When conducting the duty to defend analysis, "it is inappropriate . . . to consider 'facts ascertained before the suit, developed in the process of litigation, or by the ultimate outcome of the suit.'"[150] Therefore, "extrinsic evidence such as '[f]acts outside the pleadings, even those easily ascertained, are not ordinarily material to the [duty to defend] determination' . . . ."[151] Applying these general principles, the Fifth Circuit in *Colony National Insurance Co. v. Unique Industrial Products Co.* held that application of the known loss provision in the duty to defend context is resolved by the eight-corners rule; in other words, courts generally may not consider extrinsic evidence in analyzing the known loss provision.[152]

Unique Industrial Product Company, L.P.—the insured in *Colony National*—had an agreement with Uponor, Inc. to supply brass fittings and swivel nuts for plumbing products.[153] Uponor then distributed the finished plumbing products to other companies for installation in home plumbing systems. These companies, however, began complaining that the parts supplied by Unique were failing and causing damages at the residences where the finished plumbing systems were installed. Because of these failures, Unique was sued in federal district court in both Texas and Minnesota. In both suits, Uponor alleged that it had purchased the parts since 2002, but that before or in June of 2004, Uponor notified Unique of its product failures. Unique thereafter provided different

148. Colony Nat'l Ins. Co. v. Unique Indus. Prod. Co., 487 F. App'x 888, 893–94 (5th Cir. 2012).

149. Zurich Am. Ins. Co. v. Nokia, Inc., 268 S.W.3d 487, 491 (Tex. 2008).

150. *Colony Nat. Ins. Co.*, 487 F. App'x at 891 (quoting Primrose Operating Co. v. Nat'l Am. Ins. Co., 382 F.3d 546, 552 (5th Cir. 2004)).

151. *Id.* at 891–92 (quoting Weingarten Realty Mgmt. Co. v. Liberty Mut. Fire Ins. Co., 343 S.W.3d 859, 862 (Tex. App—Houston [14th Dist.] 2011, pet. denied)).

152. *Id.* at 892.

153. *Id.* at 889.

swivel nuts to Uponor; however, Unique allegedly did not monitor these new parts for defects.

Uponor's problems did not stop with the swivel nuts, as it began receiving complaints of brass fittings failing in the home plumbing systems with subsequent water damages to the homes. Uponor decided to remove the defective products from the inventories of its customers and returned these products to Unique. After representatives from Uponor and Unique met to discuss the product defects, Unique allegedly "agreed to take responsibility for existing and future claims" if Uponor purchased the remaining inventory.[154] According to Uponor, Unique never followed through with the agreement, despite the fact that Unique had knowledge of the problems and never notified Uponor or made necessary modifications to its products. Ultimately, Unique requested defense and coverage for the suits from its general liability insurer, Colony National Insurance Company (Colony).[155] Colony, however, declined Unique's request and instead sought a declaratory judgment in federal court. In granting Colony's motion for summary judgment, the district court judge considered the affidavit of an underwriter for Colony along with the policy application.[156] Based on this extrinsic evidence, the district judge concluded that Unique had knowledge of the alleged losses prior to the inception of the policy.[157] Therefore, the policy's known loss provision within the insuring agreement applied to bar coverage for Unique. Aggrieved, Unique appealed to the Fifth Circuit.

On appeal, the Fifth Circuit noted that "[s]ome Texas intermediate appellate courts . . . have carved out a narrow exception [to the eight-corners rule, which allows] the use of extrinsic evidence [where it] is 'relevant to an independent and discrete coverage issue, not touching on the merits of the underlying third-party claim.'"[158] Specifically, some Texas courts (along with the Fifth Circuit) have previously held "that extrinsic evidence may be used 'when 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 cases.'"[159] However, the Fifth Circuit also noted that while "the Texas Supreme Court has never recognized . . . any exception to the eight-corners rule, it has acknowledged that . . . 'such [an] exception would not extend to evidence . . . relevant to both insurance

154. *Id.*

155. *Id.* at 890.

156. *Id.*

157. *Id.*

158. *Id.* at 892 (quoting GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 308–09 (Tex. 2006)).

159. *Id.* (quoting Northfield Ins. Co. v. Loving Home Care, Inc., 363 F.3d 523, 531 (5th Cir. 2004)); *see also* Gonzales v. Am. States Ins. Co. of Tex., 628 S.W.2d 184, 186 (Tex. App.—Corpus Christi 1982, no writ).

coverage and the factual merits of the [underlying lawsuit].'"[160]

Applying the foregoing analysis, the Fifth Circuit held that the district court improperly considered extrinsic evidence—the underwriter's affidavit and the policy application—in determining that the known loss provision applied.[161] The Fifth Circuit began by noting that the factual allegations in the underlying complaint must be liberally construed in performing the duty to defend analysis, with all doubts resolved in favor of the insured.[162] Here, the underlying lawsuits were based on allegations that plumbing fixtures manufactured by the insured failed, thereby causing damages to residences.[163] Part of Uponor's case required proof that Unique had knowledge of the defects in its swivel nuts prior to selling them to Uponor in 2004 (prior to the inception of the first policy) and that Unique had agreed to supply different swivel nuts.[164] The Fifth Circuit found, however, that Uponor did not allege that Unique had knowledge of the defects in these *different* swivel nuts prior to the first policy's inception; therefore, the allegations did "not clearly and unambiguously fall outside the scope of coverage of the CGL policies and a potentially covered claim clearly exist[ed]."[165] Because the claim fell within the general coverage of the policies thereby triggering the duty to defend, the Fifth Circuit next turned to whether an exclusionary basis existed.[166]

Here, the Fifth Circuit examined the district court's use of extrinsic evidence in applying the known loss provision, whereby the district court found that Unique had knowledge of the losses prior to purchasing the policies because Unique admitted in its "application that it had 'sold a batch of T-fittings from one manufacturer which was defective.'"[167] Under Texas law, the fortuity doctrine prohibits an insured from seeking coverage for losses that have already begun and are or should be known to have begun.[168] Nevertheless, according to the Fifth Circuit, "application of the fortuity doctrine in [making] the duty-to-defend [determination] is resolved by the eight-corners rule."[169] Moreover, because the extrinsic evidence used by the district court "overlapp[ed] with the merits of or engage[d] the truth or falsity of [the] facts alleged in the underlying [lawsuits]," the narrow exception to the eight-corners rule did not ap-

160. *Colony Nat. Ins. Co.*, 487 F. App'x at 892 (quoting Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co., 279 S.W.3d 650, 654 (Tex. 2009) (citing *GuideOne*, 197 S.W.3d at 308–09)).

161. *Id.* at 893.

162. *Id.* at 892 (citing Zurich Am. Ins. Co. v. Nokia, Inc., 268 S.W.3d 487, 491 (Tex. 2008)).

163. *Id.* at 889.

164. *Id.* at 892–93.

165. *Id.* at 893.

166. *Id.*

167. *Id.*

168. *Id.* (citing Two Pesos, Inc. v. Gulf Ins. Co., 901 S.W.2d 495, 501 (Tex. App.—Houston [14th Dist.] 1995, pet. denied)).

169. *Id.* (citing Warrantech Corp. v. Steadfast Ins. Co., 210 S.W.3d 760, 766 (Tex. App.—Fort Worth 2006, pet. denied)).

ply.[170] Specifically, the Fifth Circuit found that the insured's "knowledge of problems with its products and the timing of that knowledge [was] relevant to its liability" in the underlying lawsuit; accordingly, it was "not wholly outside the issues in the underlying liability case."[171] In other words, considering the extrinsic evidence required accepting as proven facts that Unique manufactured defective products and had knowledge of those defects—however, such a finding "would be highly prejudicial to Unique[ ] . . ." in the underlying lawsuits.[172] Given the foregoing, the Fifth Circuit held that the district court improperly considered extrinsic evidence in applying the known loss provision.[173]

Since 1982, when a Texas court first recognized a narrow exception to the eight-corners rule,[174] Texas courts have struggled with crafting the proper scope of such an exception. Accordingly, application of the exception has been inconsistent.[175] Adding to this confusion was a 2004 ruling whereby the Fifth Circuit made an *Erie* guess that the "Texas Supreme Court would not recognize any exception to the strict eight corners rule."[176] However, the Fifth Circuit also predicted that if the Texas Supreme Court *were* to recognize any such exception, it "would only apply in very limited circumstances . . . ."[177] The Texas Supreme Court subsequently opined on the scope of the exception—albeit in a narrow fashion and without express recognition—in 2006[178] and later in 2009; thus, the supreme court left open the possibility that a narrow exception could in fact apply.[179]

Furthermore, application of the eight-corners rule in cases such as *Unique Products* may allow insureds to circumvent the known loss provision and fortuity doctrine, which provides that "an insured cannot seek insurance coverage for a loss that has already begun and which is or should be known to have begun."[180] In other words, by applying the eight-corners rule in these circumstances, courts allow insureds to receive

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170. *Id.*

171. *Id.*

172. *Id.*

173. *Id.*

174. Gonzales v. Am. States Ins. Co. of Tex., 628 S.W.2d 184, 186 (Tex. App.—Corpus Christi 1982, no writ) (citing Fort Worth Lloyds v. Garza, 527 S.W.2d 195, 196 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.)).

175. *See, e.g.*, Chapman v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 171 S.W.3d 222, 230 (Tex. App.—Houston [1st Dist.] 2005, no pet.); Utica Lloyd's of Tex. v. Sitech Eng'g Corp., 38 S.W.3d 260, 263 (Tex. App.—Texarkana 2001, no pet.); State Farm Fire & Cas. Co. v. Wade, 827 S.W.2d 448, 452 (Tex. App.—Corpus Christi 1992, writ denied).

176. Northfield Ins. Co. v. Loving Home Care, Inc., 363 F.3d 523, 531 (5th Cir. 2004).

177. *Id.*

178. GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 309 (Tex. 2006) (citing *Northfield Ins. Co.*, 363 F.3d at 531).

179. Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co., 279 S.W.3d 650, 654 (Tex. 2009).

180. Colony Nat'l. Ins. Co. v. Unique Indus. Prod. Co., 487 F. App'x 888, 893 (5th Cir. 2012) (citing Two Pesos, Inc. v. Gulf Ins. Co., 901 S.W.2d 495, 501 (Tex. App.—Houston [14th Dist.] 1995, pet. denied)).

a substantial benefit of a defense under a policy procured in violation of the known loss provision and fortuity doctrine.

VI. INSURER'S RIGHT OF REIMBURSEMENT

In prior articles, we discussed the Texas Supreme Court's decision in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*[181] and its continuing impact on insurers' rights of contribution and subrogation under Texas law. Since the opinion was issued in 2007, some appellate courts have limited the decision to its facts while others have interpreted the decision broadly.

In *Mid-Continent*, the Texas Supreme Court held that any "direct claim for contribution between co-insurers disappears when the insurance policies contain 'other insurance' or 'pro rata' clauses."[182] Additionally, the supreme court held that because the right of subrogation is based on a situation where the insurer "stands in the shoes" of its insured, if the insured is fully indemnified it will have no right to pass to the insurer for the insurer to enforce.[183] These holdings created confusion among both insureds and their insurers regarding the intended scope of the holdings and the relative obligations among co-insurers. Specifically, worries centered around whether restricting a co-insurer from seeking reimbursement or contribution from another co-insurer for payments made on a mutual insured's behalf would stifle settlement negotiations. This situation would leave a contributing co-insurer seeking to accept a settlement demand on the mutual insured's behalf with two equally displeasing options: (1) pay more than its proportionate share of liability for the mutual insured's loss, or (2) decline a reasonable settlement demand and proceed with the risk of an excessive verdict at trial.

In 2010, the Fifth Circuit dispelled some of these concerns by holding that the Texas Supreme Court in *Mid-Continent* addressed only whether a co-insurer may seek reimbursement under its "other insurance" clause through contribution or subrogation from a nonpaying co-insurer for amounts paid to *indemnify* their common insured.[184] Here, the Fifth Circuit specifically noted that "*Mid-Continent* left open the separate question of whether a co-insurer that pays more than its share of *defense costs* may recover such costs from a co-insurer who violates its duty to defend a common insured."[185] Rather, it is a long-standing principle of Texas insurance law that although an insurer may owe only a portion of the costs associated with the defense of its insured, the insurer nevertheless has a complete duty to defend that is "'equally and concurrently due by all' . . . insurers."[186]

181. Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765 (Tex. 2007).
182. *Id.* at 772.
183. *Id.* at 774–75.
184. Trinity Universal Ins. Co. v. Emp'rs Mut. Cas. Co., 592 F.3d 687, 694 (5th Cir. 2010).
185. *Id.*
186. *Id.* at 695 (quoting *Mid-Continent Ins. Co.*, 236 S.W.3d at 772).

Shortly after the Fifth Circuit issued its opinion in *Trinity*, the Austin Court of Appeals criticized the Fifth Circuit's analysis, holding that the Fifth Circuit misinterpreted the meaning of *Mid-Continent*.[187] In rejecting the argument that *Mid-Continent* does not bar a contribution claim by a co-insurer against another co-insurer that breaches the duty to defend, the court of appeals noted that "the supreme court's holding was that, in the absence of a contractual agreement between the insurers to be obligated for the proportional amount, the presence of 'other insurance' clauses in the polices precludes an equitable contribution claim."[188] Here, the court of appeals disagreed that the Texas Supreme Court had left unresolved the question of whether a co-insurer may recover when it pays more than its proportionate share of defense costs, finding instead that the contribution claim for defense costs was barred as a matter of law.[189]

During the Survey period, the Houston Fourteenth District Court of Appeals examined *Mid-Continent* as applied to contractual subrogation.[190] Here, the court of appeals held that *Mid-Continent* does not prohibit a co-insurer from bringing a subrogation claim against another co-insurer where the insured was not fully indemnified because the later co-insurer did not contribute to amounts owed in the insured's settlement.[191] The court of appeals reasoned that "the facts of the two cases differ[ed] significantly" in that a jury had found that none of the subrogees in *Coastal* had voluntarily paid to settle the underlying claim, and the co-insurer against whom subrogation was sought had not discharged any of its obligations to the insured.[192] Furthermore, the court of appeals found that while the pro rata "other insurance" clauses in *Mid-Continent* were compatible and limited the co-insurer's indemnity obligations, those at issue in *Coastal* were mutually repugnant and did not limit the co-insurer's indemnity obligations.[193] Because the facts of *Coastal* were significantly different from those in *Mid-Continent*, the court of appeals held that *Mid-Continent* did not apply.[194]

Also during the Survey period, the Fifth Circuit had occasion to apply *Mid-Continent*, holding that an excess insurer may recover defense costs from primary insurers who wrongfully refuse to provide a defense, even where the insured transferred its rights against the primary insurers.[195] Here, Valero Refining Company had contracted with Encompass Power Services for the designing, engineering, and construction of a co-genera-

187. *See* Truck Ins. Exch. v. Mid-Continent Cas. Co., 320 S.W.3d 613, 622–23 (Tex. App.—Austin 2010, no pet.).

188. *Id.* at 622 (citing *Mid-Continent Ins. Co.*, 236 S.W.3d at 773).

189. *Id.* at 622–23.

190. U.S. Fid. & Guar. Co. v. Coastal Ref. & Mktg., Inc., 369 S.W.3d 559 (Tex. App.—Houston [14th Dist.] 2012, no pet.).

191. *Id.* at 566.

192. *Id.*

193. *Id.* 569.

194. *Id.* at 566.

195. Cont'l Cas. Co. v. N. Am. Capacity Ins. Co., 683 F.3d 79, 85–88 (5th Cir. 2012).

tion facility in California.[196] After a fire caused significant damages to the facility, Valero brought suit against Encompass seeking more than $40 million in damages. During the litigation, the excess carrier assumed Encompass's full defense after the only primary carrier had agreed to defend Encompass settled with Valero—to which Encompass had assigned all of its rights against its insurers as part of its bankruptcy. One of the two remaining primary insurers also settled with Valero, and the excess insurer then sought subrogation from the primary insurers, citing a provision of its policy whereby the insured assigned all of its rights to recover payments made by the excess carrier under its policy.

On appeal to the Fifth Circuit, the primary insurers argued that because contractual subrogation requires that the subrogee "stand in the shoes" of the insured, and Encompass had "empty shoes" as it had assigned all of its rights to Valero, the excess insurer's claim for subrogation was improper.[197] In other words, the primary insurers argued that because their insured no longer had any rights of recovery against them, the excess insurer stood in empty shoes and also could not recover. The Fifth Circuit, however, disagreed, holding that refusing to allow the excess insurer "to recover from the primary carriers when those carriers had an obligation to protect the insured would encourage the primary carriers to breach their duties to defend rather than place their insured's interests above their own by defending and seeking reimbursement later."[198] Furthermore, the Fifth Circuit held that the assignment of Encompass's rights in bankruptcy did not "empty" the insured's shoes because the "right to demand a defense from the insurers who owed that defense could not flow to its adversary in the very action that it was actively contesting."[199]

Lastly, the Fifth Circuit held that the *Mid-Continent* bar is not applicable to consecutive insurers because, unlike the insurers in *Mid-Continent*, the insurers here were not co-primary as the policies at issue were consecutive, not concurrent.[200] However, Fifth Circuit's discussion of the scope of *Mid-Continent* was dicta, as the court had already resolved the dispute based on the parties' other issues. Still, the Fifth Circuit explained that despite the fact that the "other insurance" clauses at issue were identical to those in *Mid-Continent*, the policies provided coverage only for "bodily injury" or "property damage" occurring "*during the policy period.*"[201] Consequently, because the policies did not cover the same policy period, "by necessity the policies do not cover the same injury or damage and

196. *Id.* at 82.
197. *Id.* at 85.
198. *Id.* at 87 (citing Amerisure Ins. Co. v. Navigators Ins. Co., 611 F.3d 299, 308 (5th Cir. 2010); Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exch., 444 S.W.2d 583, 589 (Tex. 1969)).
199. *Id.* at 88.
200. *See* Great Am. Lloyds Ins. Co. v. Audubon Ins. Co., 377 S.W.3d 802, 810–812 (Tex. App.—Dallas 2012), *opinion withdrawn and superceded*, No. 05-11-00021-CV, 2013 WL 85240 (Tex. App.—Dallas Jan. 8, 2013, no pet.).
201. *Id.* at 811.

there is no 'other valid and collective insurance [that] is available to the insured for a loss we cover.'"[202]

To summarize, based on the opinions issued since *Mid-Continent*, it appears that federal and state courts are split with regard to the proper scope of *Mid-Continent* as applied to contribution and subrogation claims by co-insurers. Federal courts have seemingly attempted to limit the holding in *Mid-Continent* to its particular facts, one state court has given the decision a broader application, and at least two state courts have limited *Mid-Continent* to its facts. During the Survey period, the Fifth Circuit rejected the empty shoes argument whereby the insured has assigned all of its rights under the policy, while the Dallas Court of Appeals held that *Mid-Continent* does not apply to consecutive insurers. Therefore, while the trend in federal courts is to apply the case in a limited fashion, application in Texas intermediate appellate courts seems less clear. More specifically, Texas state courts have yet to apply *Mid-Continent* to a factual scenario where the insured was fully indemnified for a mutually covered loss. Unless and until the Texas Supreme Court specifies the contours of its holding in *Mid-Continent*, we anticipate that courts will continue to struggle with the proper scope of the opinion.

VII. CONCLUSION

During this Survey period, Texas courts continued to examine important issues arising under various insurance policies affecting both policyholders and insurers. Significantly, the Texas Supreme Court overruled two landmark decisions from the 1980s giving injured workers broad protections, thereby eviscerating nearly all extracontractual remedies in workers' compensation cases. Furthermore, the Fifth Circuit certified two important questions regarding the proper application of the contractual liability exclusion. Guidance from the Texas Supreme Court on these issues will undoubtedly have a profound effect on construction professionals and their insurers alike.

Additionally, with respect to the duty to defend, decisions during this Survey period indicate that unless and until the Texas Supreme Court articulates specific exceptions to the eight-corners rule, lower Texas state courts and the Fifth Circuit will be reluctant to deviate from the rule. With regard to an insured's right to select its own counsel, the Fifth Circuit seemingly dispelled the concern that the mere issuance of a reservation of rights letter creates a conflict allowing the insured to control its own defense at the insurer's cost.

Lastly, this Survey period saw continued inconsistencies among the state and federal courts applying *Mid-Continent*; nevertheless, it appears that the trend is to limit its applications to its specific facts. We anticipate that the Texas Supreme Court will need to revisit the issues addressed

202. *Id.* (quoting Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765, 769 (Tex. 2007)).

therein to provide guidance on the intended scope of its opinion and resolve litigated and unlitigated issues left unanswered over the past five years.