

Texas Duty to Defend: To Deviate or Not to Deviate

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Texas is among the minority of states that permit few, if any, deviations from the “eight-corners rule,” which provides that an insurer’s duty to defend must be determined from the complaint and the policy, without regard to extrinsic evidence or facts. In *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, No. 19-51012, 2022 WL 1090800 (5th Cir. Apr. 12, 2022) (“*Bitco*”), the Fifth Circuit Court of Appeals declined to consider extrinsic evidence in determining Bitco’s duty to defend and outlined when a court applying Texas law can deviate from the state’s strict eight-corners rule under the *Monroe* exception.

Bitco and Monroe issued commercial general liability policies to 5D Drilling & Pump Services, Inc. for the years 2013-2014 and 2015-2016, respectively. 5D was sued after it allegedly failed to properly drill a well in the summer of 2014. Both insurers were put on notice. Bitco agreed to defend 5D and Monroe refused, citing two business risk exclusions and asserting that the damage occurred outside the policy period. Bitco filed a declaratory action seeking a declaration that Monroe also owed a duty to defend and seeking to recover Monroe’s share of the defense costs. The District Court granted summary judgment in Bitco’s favor based on the allegations of the underlying complaint. Monroe appealed.

On appeal, Monroe relied on a stipulation between the parties that the loss occurred in November 2014, outside of its policy period. However, because the stipulation was extrinsic to the policy and underlying complaint, an issue arose as to whether the extrinsic stipulation could be considered in determining the duty to defend.

On appeal, the court in *Bitco* noted that in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), the Fifth Circuit previously predicted that Texas law would recognize a limited exception to the eight-corners rule where the extrinsic evidence goes solely to the question of coverage and does not overlap with the facts of the underlying case. Citing to *Northfield*, the Fifth Circuit in *Bitco* certified two important questions to the Texas Supreme Court:

1. Whether the exception in *Northfield* is permissible under Texas Law?
2. When applying such an exception, may a court consider extrinsic evidence of the date of an occurrence when (1) it is initially impossible to discern whether a duty to defend potentially

exists from the eight-corners of the policy and pleadings alone; (2) the date goes solely to the issue of coverage and does not overlap with the merits of liability; and (3) the date does not engage the truth or falsity of any facts alleged in the third party pleadings?^[1]

In response, the Texas Supreme Court in *Monroe* laid out what is now referred to as “the *Monroe* exception,” which provides:

[I]f the underlying petition states a claim that could trigger the duty to defend, and the application of the eight-corners rule, due to a gap in the plaintiff’s pleading, is not determinative of whether coverage exists, Texas law permits consideration of extrinsic evidence provided the evidence (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved.^[2]

The *Monroe* Court also looked to its earlier decision in *Richards v. State Farm Lloyds*, 597 S.W. 3d 492 (Tex. 2020), where the Court had previously addressed the use of extrinsic evidence and declined to permit a deviation from the eight corners rule. In *Richards*, the policy required a defense if “a claim is made or a suit is brought against an insured for damages because of bodily injury . . . to which this coverage applies.” The court noted that “[w]hile some liability policies agree to defend an insured even if the allegations of the lawsuit are ‘groundless, false, or fraudulent,’ the [] policy at issue did not contain that language.” Nevertheless, the insurer sought to rely on extrinsic evidence to prove that the allegations of the underlying complaint were false. The court rejected the insurer’s attempts to rely on a “policy-language exception” in avoidance of the eight-corners rule, noting that the “presence or absence of a groundless-claims clause has rarely, if ever, been important to Texas courts’ analysis of the contractual duty to defend,” and reiterated that the Court has “never held or suggested that the eight-corners rule is contingent on a groundless-claims clause.”

On remand, the Fifth Circuit in *Bitco* declined to consider the stipulation and apply the newly established *Monroe* exception. The stipulation would impermissibly overlap with determining the merits of liability because “[a] dispute as to *when* property damage occurs also implicates *whether* property damage occurred on that date, forcing the insured to confess damages at a particular date to invoke coverage, when its position may very well be that no damage was sustained at all.”^[3]

Bitco demonstrates that courts applying Texas law are still bound by strict standards as to when they may permit extrinsic evidence in determining the duty to defend. To date, Texas permits extrinsic evidence in very few instances. In addition to the *Monroe* exception, the Texas Supreme Court also recently approved a “fraud” exception. In *Loya Ins. Co. v. Avalos*, 610 S.W.3d 878, 881 (Tex. 2020), *reh’g denied* (Oct. 2, 2020), the court held that “[g]iven 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.”

FOOTNOTES

^[1] *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, 846 F. App’x 248, 252 (5th Cir. 2021), *certified question accepted* (Mar. 19, 2021), *certified question answered*, 640 S.W.3d 195 (Tex. 2022).

^[2] *Monroe Guar. Ins. Co. v. BITCO Gen. Ins. Corp.*, 640 S.W.3d 195, 199 (Tex. 2022) (“*Monroe*”). The *Monroe* exception was recently applied in *Pharr-San Juan-Alamo Indep. Sch. Dist. v. Tex. Political Subdivisions Prop./Cas. Joint Self Ins. Fund*, No. 20-0033, 2022 WL 420491 (Tex. 2022).

^[3] *Bitco*, 2022 WL 1090800, at *3 (citing *Monroe*, 640 S.W.3d at 203) (emphasis in original).

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National Law Review, Volume XII, Number 138

Source URL: <https://natlawreview.com/article/texas-duty-to-defend-to-deviate-or-not-to-deviate>