

06-1018

IN THE SUPREME COURT OF TEXAS
AUSTIN, TEXAS

D.R. HORTON-TEXAS, LTD.

Petitioner

v.

MARKEL INTERNATIONAL INSURANCE COMPANY, LTD.

Respondent

PETITIONER'S REPLY BRIEF ON THE MERITS

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ARGUMENT AND AUTHORITIES

I. D.R. Horton preserved the right to request that this Court formally recognize the coverage-only-facts exception to the eight-corners rule.

Markel leads with the puzzling assertion that D.R. Horton waived the right to request that this Court formally recognize the exception to the eight-corners rule for coverage-only facts. D.R. Horton, Markel contends, “failed to present the issue expressly to the trial court during summary judgment proceedings or to the Court of Appeals in its Original and Reply Briefs.” (Resp. Br. at 9). Markel’s waiver argument is without merit.

From the outset, D.R. Horton asserted that Markel was not entitled to a summary judgment on duty to defend because D.R. Horton’s evidence showed that its subcontractor Rosendo Ramirez built and repaired the Holmeses’ chimney. (*See, e.g.*, CR 279, 276, 284-85, 287; Br. of Appellant at 25-27). In other words, D.R. Horton insisted that in determining whether Markel owed a duty to defend it, the courts below were required to consider extrinsic evidence establishing D.R. Horton’s right to a defense under Ramirez’s insurance policy with Markel. By doing so, D.R. Horton preserved the right to request that this Court hold that the lower courts must consider its extrinsic evidence, consisting of coverage-only facts, and give that evidence the proper legal effect.

To preserve its right to request that this Court formally approve the coverage-only-facts exception to the eight-corners rule, D.R. Horton was not obliged to go further and argue below: “Although the Supreme Court has not yet recognized the eight-corners rule exception for extrinsic evidence consisting of coverage-only facts, other courts have, and D.R. Horton requests that this Court apply that exception.” As this Court observed

in *GuideOne*, many courts have permitted the use of extrinsic evidence consisting of coverage-only facts.¹ By requesting that the courts below do so as well, D.R. Horton preserved the right to now ask that *this* Court formally recognize the coverage-only-facts exception and apply it here.

II. Markel's contention that the exception does not apply because it was not "initially impossible to discern whether coverage is potentially implicated" is without merit.

When this Court in *GuideOne* acknowledged the coverage-only-facts exception to the eight corners rule, it cited several cases as examples of how that exception has been formulated. 197 S.W.3d at 308 n.2. Although the courts have stated it in various ways, the gist of the exception is this: when a duty-to-defend question raised by an insurer or an insured cannot be definitively answered by consulting the plaintiff's petition in the underlying case, extrinsic evidence is admissible to resolve the question so long as it does not touch on the merits of the plaintiff's claim in the underlying lawsuit. *See id.*

One of the cases mentioned in *GuideOne* is a Fifth Circuit decision stating that the exception does not apply unless "it is initially impossible to discern whether coverage is potentially implicated." *Id.* at 309 (quoting *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004)). Seizing on that phrase, Markel argues that the courts below properly refused to consider D.R. Horton's extrinsic evidence because it was not

¹ *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 308-09 (Tex. 2006). Texas cases allowing the use of extrinsic evidence consisting of coverage-only facts include *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712, 715 (Tex. Civ. App.—Texarkana 1967, no writ); *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 454 (Tex. App.—Corpus Christi 1992, writ denied).

initially impossible to determine whether it was entitled to a defense as an additional-insured.

Markel's flawed reasoning is as follows: the Holmeses alleged that D.R. Horton built their house without mentioning the work done by its subcontractor Rosendo Ramirez; the eight corners rule does not permit a court to look beyond the Holmeses' petition; therefore, under the eight-corners rule, D.R Horton was not entitled to a defense; therefore, the coverage-only-facts exception cannot apply because it was not "initially impossible to discern whether coverage is potentially implicated." The theory refutes itself. If strict application of the eight-corners rule at the outset prevents an insured or an insurer from invoking the coverage-only-facts exception, then the exception is meaningless. The exception's very purpose is to prevent such formalistic application of the eight-corners rule.

There is no absolute requirement that it must be "impossible to discern whether coverage is potentially implicated" before extrinsic evidence consisting of coverage-only facts may be considered. The Fifth Circuit made no mention of any such requirement when it permitted extrinsic evidence to be used in *John Deere Ins. Co. v. Truckin' U.S.A.*, 122 F.3d 270, 272 (5th Cir. 1997). Nor do commentators embrace that requirement. *See, e.g., Rick Virnig, Perspectives on the "Eight Corners": Making Sense of the Complaint Allegation Rule*, 4 J. TEX. INS. LAW 12, 18 (Winter 2003) [hereinafter "Virnig"]; Ellen S. Pryor, *Mapping the Changing Boundaries of the Duty to Defend in Texas*, 31 TEX. TECH. L. REV. 869, 891 (2000) [hereinafter "Pryor"]. But even if that was a blanket requirement, whether it

is “impossible to discern whether coverage is potentially implicated” necessarily would have to be determined with reference to the *reason* given for demanding or, as the case may be, denying a defense.

Here, for example, when D.R. Horton asserted that it was entitled to a defense because the Holmeses’ chimney was built and repaired by its subcontractor Ramirez, it was impossible to discern from the Holmeses’ petition whether that was in fact the case. The Holmeses’ allegation that “D.R. Horton” built and repaired their house shed no light on whether Rosendo Ramirez was one of the D.R. Horton subcontractors performing the actual work. Extrinsic evidence establishing that Ramirez built and repaired the chimney was therefore admissible to establish Markel’s duty to defend because it did not contradict any allegation in [the Holmeses’ petition] “material to the merits of [their] underlying claim.” *GuideOne*, 197 S.W.3d at 310.

III. D.R. Horton’s extrinsic evidence is admissible because it does not contradict any allegation material to the merits of the Holmeses’ claims.

In *GuideOne*, the Court cited *Int’l Serv. Ins. Co. v. Boll*, 392 S.W.2d 160 (Tex. Civ. App.—Houston 1965, writ ref’d n.r.e.) as an example of a case where the exception for coverage-only extrinsic evidence was applied. 197 S.W.3d at 310. The Court appears to have approved *Boll’s* holding because the extrinsic evidence went strictly to the coverage issue and “did not contradict any allegation in the third-party claimant’s pleadings material to the merits of that underlying claim.” *Id.* Markel, however, contends that extrinsic evidence may not be considered if it contradicts *any* allegation in the plaintiff’s petition, whether material to the merits of the plaintiff’s claim or not. (Resp. Br. at 13).

There are two problems with Markel's argument. First, it is not the law. *See, e.g., Ohio Cas. Ins. Co. v. Cooper Mach. Corp.*, 817 F. Supp. 45, 48 (N.D. Tex. 1993). One commentator uses an example to underscore why that is not the law. *See* Virnig, 4 J. TEX. INS. LAW at 18. In Virnig's hypothetical, a plaintiff attempts to bring his claims within the defendant's insurance coverage by pleading that the defendant "was a named insured under an insurance policy issued by Acme Insurance Company which was valid, fully paid up, in force on the date of the accident, and which covered just such an occurrence." *Id.* In that situation, the defendant's insurance company is permitted to introduce extrinsic "insurance facts" contradicting the plaintiff's allegation because:

[T]his [allegation] does not present a "liability fact." It has nothing to do with the [plaintiff's] case against the defendant; it only addresses who will pay the damages if liability is found. It is a pure "insurance fact," and should be ignored by a court determining the issue of insurance coverage. At the very least, if the court will not ignore the allegation, it should allow the insurer to contradict the allegation with extrinsic evidence showing the true situation.

Id.; *see also* Pryor, 31 TEX. TECH. L. REV. at 880 ("The key issue should be whether the extrinsic evidence overlaps with the merits of the underlying lawsuit.").

Second, even if it were the law that an insured or an insurer can never contradict *any* allegation in the plaintiff's petition to resolve a duty-to-defend issue, D.R. Horton's extrinsic evidence would not be barred for this simple reason: it does not contradict the Holmeses' allegations. Markel contends that the evidence establishing that Rosendo Ramirez built and repaired the Holmeses' chimney contradicts their allegation that D.R. Horton built and repaired their house. (Resp. Br. at 13-14). But it borders on sophistry to

insist that evidence showing that a particular subcontractor built part of a house for a homebuilder contradicts an allegation that the homebuilder built the house.

In the name of slavish subservience to the eight-corners rule, Markel is inviting the Court to feign ignorance of the real-world fact that homebuilders use subcontractors to build the houses they sell. *Cf.* TEX. PROP. CODE § 27.003(a)(1)(A) (addressing residential contractors' liability *vel non* for acts of their subcontractors). The Court should decline the invitation and instead acknowledge that D.R. Horton is relying on its extrinsic evidence to say, in effect: "Yes, we built the Holmeses' house, and we used subcontractor Ramirez to do the allegedly defective chimney work; therefore we are entitled to coverage as an additional insured under his liability policy with Markel." By using its extrinsic evidence for that purpose, D.R. Horton is in no way "fundamentally challeng[ing] the truth of the Holmeses' petition," as Markel wrongly contends. (Resp. Br. at 14).

IV. D.R. Horton's extrinsic evidence could not have had any effect whatsoever on the merits of the Holmeses' claims.

Markel contends that the court of appeals "correctly determined that D.R. Horton's evidence was 'relevant to both coverage and liability.'" (Resp. Br. at 14). The evidence that Ramirez built and repaired the Holmeses' chimney, Markel insists, "effectively identifies a potentially responsible third party and would be an affirmative defense to the Holmes' [*sic*] suit." (Resp. Br. at 18). But Markel cites no authority to support that assertion, and there is none. As D.R. Horton explained in its opening brief, it could not have gained *any* legal advantage *whatsoever* in the underlying lawsuit by pointing the finger at Ramirez. (Pet. Br. at 16-17). Ramirez's role in the construction

and repair of the Holmeses' house is relevant only to the issue of whether D.R. Horton is entitled to a defense, and Markel cannot show otherwise.

Markel's argument that D.R. Horton is asking the Court to decide the duty to defend question by examining the legal theories asserted in the Holmeses' petition is also incorrect. (Resp. Br. at 19-20). It is true that when examining a plaintiff's petition to determine whether an insurer owes a duty to defend, the court must focus on the factual allegations, not the legal theories. And in keeping with that rule, D.R. Horton is not asserting that the Holmeses' legal theories imposed a duty to defend on Markel. On the contrary, D.R. Horton's position is that Markel owed a duty to defend it because of the *fact* that Rosendo Ramirez performed part of the work giving rise to the Holmeses' claims. D.R. Horton's discussion of the Holmeses' legal theories is solely to demonstrate that allowing extrinsic evidence of the facts about Ramirez's role could not have had any effect on its potential liability to the Holmeses.

V. This is an appropriate case in which to formally recognize the exception to the eight-corners rule for coverage-only facts.

Impugning this Court's ability to carefully craft its decisions, Markel says this is the wrong case in which to formally recognize the exception to the eight-corners rule for coverage-only facts because "virtually all manner of extrinsic evidence then could be considered in a coverage analysis." (Resp. Br. at 20-21). But a ruling for D.R. Horton would mean nothing of the sort. D.R. Horton's extrinsic evidence consists of a single fact – that subcontractor Rosendo Ramirez performed the construction and repair work on the Holmeses' chimney for D.R. Horton. That fact does not contradict any allegation

in the Holmeses' petition material to the merits of their claim, and it would not have strengthened or weakened the Holmeses' claims against D.R. Horton in any way. The only legal consequence of judicially recognizing that fact would have been to establish D.R. Horton's right to additional-insured coverage under Ramirez's liability insurance policy with Markel.

Moreover, D.R. Horton is asking the Court to take a relatively small step by approving "a narrow exception" for the use of extrinsic evidence "when the coverage question is fundamental to the question of insured status, such as whether the person seeking a defense is an 'insured' under the policy. . . ." Pryor, 31 TEX. TECH. L. REV. at 885. "Arguably," commentator Pryor observes, "several Texas cases" have already recognized that exception. *Id.* This Court, however, has not yet done so, and its guidance is needed both to ensure uniform application of the law and to answer the questions engendered by *GuideOne*. By formally approving an exception for coverage-only facts in *this* case, the Court will make it clear that the exception can also work to the benefit of policyholders, not just the insurance industry, which has long advocated the exception.

VI. Markel's duty to indemnify may be established by evidence that was not developed in the underlying *Holmes v. D.R. Horton* case.

Markel contends that the court of appeals reached the correct result when it held that Markel owes no duty to indemnify D.R. Horton for this reason: D.R. Horton did not inject evidence of the fact that Ramirez built and repaired the Holmeses' chimney into the underlying *Holmes v. D.R. Horton* lawsuit. (Resp. Br. at 22-23). Markel is wrong.

A court addressing whether an insurer must indemnify an insured may consider evidence that was not developed in the underlying case. See *Swicegood v. Med. Protective Co.*, 2003 WL 22234928, at *14 (N.D. Tex. 2003). In *Swicegood*, after surveying Texas law, Judge Sidney Fitzwater predicted that:

[T]he Texas Supreme Court will hold that new evidence can be introduced at a coverage trial when the proof is necessary to resolve a controlling coverage question that was not conclusively decided in the indemnity suit. By “not conclusively decided” the court means the issue was not determined in a way that binds all affected parties in the coverage case (e.g., via collateral estoppel). An undecided issue could include one that the parties in the indemnity case had no reason to litigate, e.g., an exclusion from coverage, where the burden of proof would be on a non-party insurer.

Id.; see also *Nat'l Union Fire Ins. Co. of Pittsburgh v. Puget Plastics Corp.*, 450 F. Supp. 2d 682, 702-03 (S.D. Tex. 2006) (examining Judge Fitzwater’s reasoning and conclusion and finding it consistent with existing Texas law). Here, there was no reason for D.R. Horton and the Holmeses to litigate whether Rosendo Ramirez built and repaired the Holmeses’ chimney.

VII. The Holmeses’ allegations did not foreclose any possibility that Markel would owe a duty to indemnify D.R. Horton.

Next, Markel insists that because the Holmeses did not plead that Rosendo Ramirez played a role in the construction of their house, the courts below correctly held that Markel owed no duty to indemnify D.R. Horton. (Resp. Br. at 23-25). This Court, however, recently reiterated that whether an insurer owes a duty to indemnify is determined not “by allegations but rather proof at trial.” *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, ___ S.W.3d ___, 2007 WL 2459193, at *1 (Tex. 2007).

That correct statement of the law cannot be reconciled with the court of appeals' reasoning that Markel owes no duty to indemnify D.R. Horton because "the *Holmes* suit did not allege facts covered by the policy. . . ." *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co., Ltd.*, 2006 WL 3040756, at *6 (Tex. App.—Houston [14th Dist.] 2006, pet. filed). And for the reasons stated in D.R. Horton's opening brief, this Court's reasoning in *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81 (Tex. 1997) simply does not apply here. (See Pet. Br. at 25-29).

VIII. Markel's indignation is unfounded.

Throughout its brief, Markel indignantly criticizes D.R. Horton for not raising evidence of Ramirez's role in the construction of the Holmeses' house until after the conclusion of the *Holmes v. D.R. Horton* lawsuit. But there are two simple reasons why D.R. Horton did not attempt to inject that fact into the underlying case. First, the fact of Ramirez's role could not have affected D.R. Horton's liability in any way and thus was completely irrelevant in the *Holmes v. D.R. Horton* lawsuit. (See Pet. Br. at 16-17). Second, as discussed above, a party is not required to inject irrelevant coverage-only facts into an underlying liability suit to preserve its right to later seek reimbursement from its insurer for defense and settlement expenses.

Furthermore, on an equitable level, Markel has no right to be indignant. A mere 16 days after the Holmeses filed their lawsuit, D.R. Horton notified Markel that because of Ramirez's involvement, Markel was required to defend it against the Holmeses' lawsuit (CR 426). Markel could have responded by immediately seeking a declaratory judgment

that it owed no duty to defend, but it instead chose to remain silent. (CR 320 at ¶ 7). In any event, Markel has known almost from day one that D.R Horton is taking the position that it is entitled to additional-insured coverage in light of Ramirez's role in the construction of the Holmeses' house. It is pure theatrics for Markel to now feign surprise and indignation.

CONCLUSION

This Court's guidance is needed on two important facets of insurance law. First, Texas courts have long struggled with, and reached differing conclusions on, the question of whether there is an exception to the eight-corners rule for facts that (i) would clarify whether a plaintiff's claims are covered by the defendant's insurance policy thus triggering the insurer's duty to defend, but (ii) would not have any effect on the defendant's liability or the plaintiff's damages in the underlying lawsuit. In *GuideOne*, the Court alluded to the possibility that it might recognize that eminently-reasonable and much-needed exception, and this case presents the Court with the opportunity to do so.

Second, as evidenced by the court of appeals' erroneous ruling on the duty to indemnify issue, courts frequently fail to understand the holding in *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81 (Tex. 1997). After *Griffin*, a tendency has developed among some courts to automatically assume that because the allegations in the plaintiff's petition do not trigger a duty to defend, the insurer, as a matter of law, can never owe a duty to indemnify. The Court's remark in *Lamar Homes* that the duty to indemnify is determined not "by allegations but rather proof at trial" was an important step toward

eliminating that problem, and correcting the court of appeals' misapplication of *Griffin* in this case will ensure that the lower courts get the message.

PRAYER

D.R. Horton-Texas, Ltd. prays that the Court grant its petition for review, reverse that portion of the court of appeals' judgment affirming in part the trial court's summary judgment for Respondent Markel International Insurance Company, Ltd., and remand this case for further proceedings consistent with the Court's opinion and judgment. D.R. Horton also requests any other relief to which it may be justly entitled.

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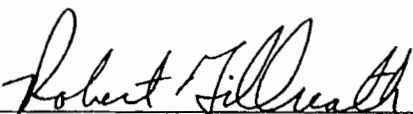
This is to certify that on the 10th day of September 2007, I forwarded a true and correct copy of this Reply Brief on the Merits to those identified below via certified mail, return receipt requested.

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