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United States District Court,
S.D. Texas, Houston Division.

SPEC'S FAMILY PARTNERS, LTD., Plaintiff,
v.
THE HANOVER **INSURANCE** COMPANY, Defendant.

CIVIL ACTION H-16-438
|
Filed in TXSD on 03/15/2017

MEMORANDUM OPINION & ORDER

Gray H. Miller United States District Judge

***1** Pending before this court is defendant Hanover **Insurance** Company's ("Hanover") (1) motion for judgment on the pleadings (Dkt. 19), (2) request for judicial notice in support of its motion (Dkt. 20), and (3) motion for leave to file supplemental authority in support of its motion (Dkt. 30). Also pending before the court is plaintiff Spec's Family Partners, Ltd. (Spec's) motion for leave to file supplemental authority (Dkt. 35). Upon consideration of the pleadings, motion, response, reply, and applicable law, Hanover's motion is GRANTED. Dkt. 19. Further, Hanover's request for judicial notice (Dkt. 20), Hanover's motion for leave to file supplemental authority (Dkt. 30), and Spec's motion for leave to file supplemental authority (Dkt. 35) are DISMISSED AS MOOT.

I. BACKGROUND

This case is about an **insurance** claim made by plaintiff Spec's Family Partners, Ltd. ("Spec's") following two **data breaches** of its credit card payment system. Dkt. 6 at 2. Spec's is a family-owned retail chain. *Id.* Hanover issued an **insurance** policy to Spec's for the period between October 28, 2013 to October 28, 2014 (the "Policy"). Dkt. 19, Ex. A (Policy No. LHD 8930093 03).

Between October 2012 and February 2014, Spec's credit card payment system suffered from two **data breaches**, resulting in the loss of customer information and credit card numbers. Dkt. 6 at 2. Spec's accepts payments from customers using Visa or MasterCard through a third-party transaction service provided by First Data Merchant Services, LLC ("FirstData"). *Id.* In 2001, Spec's entered into a contract with EFS National Bank for credit card transaction services (the "Merchant Agreement"). *Id.*; Dkt. 19, Ex. B. FirstData is the successor to EFS National Bank in the Merchant Agreement. Dkt. 6 at 2. FirstData sent two demand letters to Spec's for claims arising from the **data breaches**: (1) a December 16, 2013 demand letter for $7,624,846.21 and (2) a March 25, 2015 demand letter for $1,978,019.49. Dkt. 19, Exs. C, D (collectively "the Underlying Claim"). The letters also demanded that Spec's upgrade its security. *Id.* To satisfy its demands, FirstData incrementally withheld an alleged $4.2 million from Spec's daily payment card settlements, placing the funds in a reserve account. Dkt. 6 at 2–3.

On April 8, 2014, Spec's notified Hanover of FirstData's December 16, 2013 demand letter. *Id.*; Dkt. 19 at 11. Hanover and Spec's engaged in a series of exchanges regarding Hanover's duty to defend. *Id.* Ultimately, on November 5, 2014, Hanover and Spec's entered into a Defense Funding Agreement ("DFA") in which Hanover consented to the retention

of Haynes and Boone, LLP as defense counsel in litigation regarding the Underlying Claim. Dkt. 24, Ex. D. On April 1, 2015, Spec's notified Hanover of FirstData's March 25, 2015 demand letter. Dkt. 6 at 2–3.

Then, Spec's initiated a lawsuit in United States District Court for the Western District of Tennessee asserting breach of contract claims against FirstData to recover the money it withheld from Spec's (the "Tennessee Litigation"). Dkt. 6 at 3–4. Hanover eventually refused to pay the litigation expenses for the Tennessee Litigation. *Id.*

***2** On March 11, 2016, Spec's filed an amended complaint against Hanover, asserting causes of action for breach of the Policy and breach of the DFA. Dkt. 6 at 5–6. Spec's seeks declaratory judgment on Hanover's duty to defend, damages under Chapter 542 of the Texas **Insurance** Code, and attorneys' fees. *Id.* at 6–7. Subsequently, Hanover moved for judgment on the pleadings. Dkt. 19. In support of its motion, Hanover has requested the court take judicial notice of the Merchant Agreement and the filings in the Tennessee Litigation. Dkt. 20. Later, both Hanover and Spec's moved to file supplemental authority in support of their pleadings. Dkts. 30, 35. Spec's responded to both of Hanover's motions (Dkts. 23, 25, 31) and Hanover replied (Dkts. 28, 29, 37); Hanover also responded to Spec's motion (Dkt. 36).

II. LEGAL STANDARD

A. Motion for Judgment on the Pleadings

A motion for judgment on the pleadings under Federal Rule of Civil Procedure 12(c) is "[d]esigned to dispose of cases where the material facts are not in dispute and a judgment on the merits can be rendered by looking to the substance of the pleadings and any judicially noticed facts." *Great Plains Tr. Co. v. Morgan Stanley Dean Witter & Co.*, 313 F.3d 305, 312 (5th Cir. 2002). Federal Rule of Civil Procedure 12(c) allows a party to move for judgment on the pleadings after the pleadings are closed, as long as it is early enough not to delay trial. Fed. R. Civ. P. 12 (c). The standards for a Rule 12(c) motion for judgment on the pleadings and a 12(b)(6) motion to dismiss are the same. *Gentilello v. Rege*, 627 F.3d 540, 543–44 (5th Cir. 2010).

Rule 12(b)(6) allows dismissal if a plaintiff fails to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). Additionally, the Supreme Court has confirmed that Rule 12(b)(6) motions must be read in conjunction with Rule 8(a), which requires "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a); *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 555, 127 S. Ct. 1955 (2007). In considering a Rule 12(b)(6) motion to dismiss a complaint, courts generally must accept the factual allegations contained in the complaint as true. *Kaiser Aluminum & Chem. Sales, Inc. v. Avondale Shipyards, Inc.*, 677 F.2d 1045, 1050 (5th Cir. 1982). The court does not look beyond the face of the pleadings in determining whether the plaintiff has stated a claim under Rule 12(b)(6). *Spivey v. Robertson*, 197 F.3d 772, 774 (5th Cir. 1999). "[A] complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, [but] a plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555 (citations omitted). And, "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Id.* The supporting facts must be plausible—enough to raise a reasonable expectation that discovery will reveal further supporting evidence. *Id.* at 556.

A court considers only the pleadings in deciding a motion for judgment on the pleadings, but "[d]ocuments that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim." *Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498–99 (5th Cir. 2000). Because the standards for Rule 12(c) and 12(b)(6) motions are the same, a court may consider the same kind of documents in a Rule 12(c) motion that it could consider in a Rule 12(b)(6) motion. *See Horsley v. Feldt*, 304 F.3d 1125, 1134 (11th Cir. 2002) (permitting the consideration of additional documents in a motion for judgment on the pleadings).

B. Duty to Defend

***3** Under Texas law, courts follow the "eight corners rule" to determine whether an insurer has a duty to defend. *Federated Mut. Ins. Co. v. Grapevine Excavation Inc.*, 197 F.3d 720, 723 (5th Cir. 1999). "Under this rule, courts compare the words of the **insurance** policy with the allegations of the plaintiff's complaint to determine whether *any* claim asserted in the pleading is potentially within the policy's **coverage**." *Id.* "The duty to defend analysis is not influenced by facts ascertained before the suit, developed in the process of litigation, or by the ultimate outcome of the suit." *Primrose Operating Co. v. Nat'l Am. Ins. Co.*, 382 F.3d 546, 552 (5th Cir. 2004). Rather, it is determined by examining the eight corners of the pleadings and the policy. *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 491 (Tex. 2008). All doubts with regard to the duty to defend are resolved in favor of the duty. *Id.* Courts applying the eight corners rule "give the allegations in the petition a liberal interpretation." *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997). Courts must not, however, "read facts into the pleadings, ... look outside the pleadings, or imagine factual scenarios which might trigger **coverage**." *Id.* at 142.

The insured has the burden of showing that a claim is potentially within the **coverage** of the policy. *Federated Mut. Ins. Co.*, 197 F.3d at 723. However, "if the insurer relies on the policy's exclusions, it bears the burden of proving that one or more of those exclusions apply. ... Once the insurer proves that an exclusion applies, the burden shifts back to the insured to show that the claim falls within an exception to the exclusion." *Id.* Courts "must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not itself unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent." *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 623, 666 (Tex. 1987). However, the "rules favoring the insured ... are applicable only when there is an ambiguity in the policy; if the exclusions in question are susceptible to only one reasonable construction, these rules do not apply." *Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 99 F.3d 695, 701 (5th Cir. 1996).

III. ANALYSIS

First, the court will consider the nature of the Underlying Claim and whether Hanover has a duty to defend Spec's. Dkt. 6, 19. As part of the duty to defend analysis, the court will address Spec's causes of action for breach of Policy and breach of the DFA. Dkt. 6. Then, the court will consider if a cause of action arises from a breach of the duty to defend under the Texas **Insurance** Code. Dkts. 6, 19. Finally, the court will address Hanover's request for a declaratory judgment on the duty to indemnify (Dkt. 19), Hanover's request for judicial notice (Dkt. 20) and Hanover and Spec's motions for leave to supplement the pleadings (Dkt. 30, 35).

A. The Underlying Claim

As an initial matter, the court will clarify the nature of the Claim at issue in this case to define the scope of the duty to defend analysis.

The Policy contains the following relevant provisions:

1. Defense of Claims:

   We have the right and duty to defend "Claim," even if the allegations in such "Claims" are groundless, false or fraudulent. We have no duty to defend "Claims" or pay related "Defense Expenses" for "Claims to which this **insurance** does not apply."

Dkt. 19, Ex. A at HJOP 0014.

2. Definition of Claim

> [A] "Claim" means: (1) Any written demand presented for monetary "Damages" or non-monetary relief for a "Wrongful Act"; or (2) Any complaint or similar pleading initiating a judicial, civil, administrative, regulatory, alternative dispute, or arbitration proceeding, including any appeal resulting from it, to which an "Insured" is provided notice and which subjects an "Insured" to a binding adjudication of liability for monetary or non-monetary relief for a "Wrongful Act ...."

***4** Dkt. 19, Ex. A at HJOP 0025–26.

Spec's offers two items that qualify as "written demand[s] presented for monetary 'Damages' or non-monetary relief" under the definition of a "Claim" in the policy—the two demand letters from FirstData to Spec's for "indemnification" of monetary damages and security upgrades. Dkt. 19, Exs. C (December 16, 2013 demand letter), D (March 25, 2015 demand letter). The court concludes these two demand letters fall under the definition of a "Claim" as defined in the Policy. Dkt. 23 at 16.

However, both Hanover and Spec's argue for a more inclusive definition of a claim beyond these two demand letters: (1) Spec's alleges that the fines from MasterCard and Visa are part of the claim, and (2) Hanover argues that the claim is actually the Tennessee Litigation, which presents no claim to defend. Dkt. 23 at 19; Dkt. 28 at 3.

First, Spec's asserts that fines from MasterCard and Visa, as well as the administrative process to dispute those fines, are part of the Underlying Claim. Dkt. 23 at 19. Though the two demand letters detail fines owed or potentially owed to MasterCard and Visa, the demand letters are not from either MasterCard or Visa, they are from FirstData. *Id.* In FirstData's December 16, 2013 demand letter, the letter concludes that "... in accordance with Spec's indemnification obligation in the EFS National Bank Merchant Agreement ... First Data Merchant Services Corporation will be establishing a Reserve Account ... to fund the MasterCard and the anticipated Visa fines." Dkt. 19, Ex. C. The letter provides no other grounds for FirstData's collection of these fines beyond the Merchant Agreement. *Id.* In FirstData's March 25, 2015 demand letter, FirstData also concludes the letter by stating that it is establishing a reserve account to collect the fines "in accordance with Spec's various contractual obligations." Dkt. 19, Ex. D.

Based on these statements, taken with the content of the letters, the court concludes that the MasterCard and Visa fines are levied against FirstData. The details of the fines in the demand letters are provided as the basis for the amount demanded by FirstData under the indemnification obligation of the Merchant Agreement. These fines from MasterCard and Visa do not represent a separate demand against Spec's and so they are not a "claim" by the definition in the Policy.

Second, Hanover makes a collateral attack in its reply that there is no underlying petition at all, and therefore the eight corners rule does not apply to this case. Dkt. 28 at 3. If the only claim at issue is the Tennessee Litigation, in which Spec's is the plaintiff, there is no claim under the definition of the Policy that gives rise to the duty to defend. Dkt. 28 at 3 (citing to *Agilis Ben. Servs. LLC v. Travelers Cas. & Sur. Co. of Am.*, No. 5:08-CV-213, 2010 WL 8573372, at *2 (E.D. Tex. Apr. 30, 2010) and *SMBC Rail Servs., LLC v. W. Petroleum Co.*, No. 3:14-CV-03982-P, 2015 WL 7709608, at *3 (N.D. Tex. June 17, 2015)). Hanover's argument in its reply appears to ignore the existence of the two demand letters, which form the Underlying Claim. Dkt. 19, Exs. C, D. The court rejects any argument that there is no underlying claim and concludes the eight corners rule is applicable to the duty to defend analysis. The court will consider the four corners of the demand letters and the four corners of the Policy. Dkt. 19, Exs. A, C, D.

***5** Spec's also counters that Hanover is improperly trying to raise the merits of the Underlying Claim by presenting details of the Tennessee Litigation outside of the eight corners rule. Dkt. 23 at 28. "Facts ascertained before suit, developed in the process of litigation, or determined by the ultimate outcome of the suit do not affect the duty to defend." *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 528 (5th Cir. 2004) (citing *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997)). The eight corners rule prevents the court from considering the merits and nature of the Tennessee Litigation in determining whether Hanover has a duty to defend.

B. Duty to Defend Analysis

The court turns to the central issue of whether Hanover has a duty to defend Spec's against FirstData's demands. Hanover argues that the only claim Spec's asserted is FirstData's demand for indemnification based on the Merchant Agreement —which is expressly excluded from Policy **coverage**. Dkt. 19 at 14–15. The Policy contains the following exclusion which precludes claims based upon a written contract:

> N. 'Loss' on account of any 'Claim' made against any 'Insured' directly or indirectly based upon, arising out of, or attributable to any actual or alleged liability under a written or oral contract or agreement. However, this exclusion does not apply to your liability that would have attached in the absence of such contract or agreement.

Dkt. 19, Ex. A at HJOP 0029 ("Exclusion N").

Hanover bears the burden of proof to demonstrate the applicability of the policy exclusion. *Federated Mut. Ins. Co.*, 197 F.3d at 723. Both demand letters stated that FirstData's claims against Spec's are asserted in accordance with Spec's indemnification obligation under the Merchant Agreement, so Hanover argues this is proof that it is a clearly excluded claim under Exclusion N. Dkt. 19 at 14–15. The court will consider Spec's arguments that Exclusion N does not apply because (1) Hanover agreed to defend Spec's, (2) there is a potential for claims that are not barred by Exclusion N, and (3) this case arises out of underlying criminal activity.

1. Hanover's alleged agreement to defend Spec's

First, Spec's argues that Exclusion N is inapplicable because Hanover already agreed to defend Spec's against FirstData. Dkt. 23 at 8; Dkt. 24, Ex. C (August 22, 2014 message). Hanover counters that in any agreements it made with Spec's, it properly reserved its rights to challenge its duty to defend or withdraw its defense. Dkt. 28 at 2–3. Normally, in a duty to defend suit, the court does not consider extrinsic evidence that is outside of the limits of the eight corners rule, which only allows the court to consider the petition in the Underlying Claim and the Policy. *Federated Mut. Ins. Co.*, 197 F.3d at 723. However, the court will review evidence of Hanover's agreements with Spec's for the limited purposes of determining whether Hanover's representations modified the Policy. Dkt. 24, Exs. C (August 22, 2014 message), D (DFA).

First, in its August 22, 2014 message to Spec's, Hanover stated it "agrees to withdraw its denial of **coverage** and provide a defense under a reservation of rights as set forth below." Dkt. 24, Ex. C at 17. However, in reviewing Hanover's message, the court finds that Hanover reserved its rights to challenge its duty to defend or to withdraw its defense by stating:

> Please be advised that ... nothing contained herein, nor any action nor inaction on the part of Hanover or any agent or representative thereof, should be construed as a waiver of any [of] Hanover's rights, privileges, and defenses under the Policy, included but not limited to ... any rights and defenses available at law or in equity to deny **coverage** in the event that any terms, conditions, exclusions and endorsements ... are found to be applicable, including the right to withdraw from the defense ...

***6** *Id.* at 27.

Further, Spec's alleges that Hanover also consented to defense by executing the DFA. Dkt. 23 at 13–14; Dkt. 24, Ex. D. The DFA states "Hanover has agreed to defend the claim ... subject to a reservation of rights ..." Dkt. 24, Ex. D at 28. The DFA also states that "the Parties disagree regarding the effect of Hanover's reservation of rights on its right and duty to defend the Claim under the Policy." *Id.* Finally the DFA states that "Hanover consents to the continued retention of Haynes and Boone as defense counsel and will pay, subject to its reservation of rights ...." Dkt. 24, Ex. D at 28.

"A reservation of rights is a proper action if the insurer believes, in good faith, that the complaint alleges conduct which may not be **covered** by the policy." *Rhodes v. Chicago Ins. Co., a Div. of Interstate Nat. Corp.*, 719 F.2d 116, 120 (5th Cir. 1983); *see also Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 132-33 (Tex. 2000). Under Texas law, an insurer can undertake a defense subject to a reservation of rights, which "permit the insurer to provide a defense for its insured while it investigates questionable **coverage** issues." *Canal Ins. Co. v. Flores*, 524 F. Supp. 2d 828, 834 (W.D. Tex. 2007) (citing to *Katerndahl v. State Farm Fire & Cas. Co.*, 961 S.W.2d 518, 521 (Tex. App.—San Antonio 1998, no pet.)); *see also Certain Underwriters at Lloyd's London v. A & D Interests, Inc.*, 197 F. Supp. 2d 741, 745 (S.D. Tex. 2002). Under a valid reservation of rights, the insurer may withdraw its defense when it is clear there is no **coverage** under its policy. *Id.*; *see also Ross v. Marshall*, 456 F.3d 442, 443 (5th Cir. 2006) ("An insurer who defends its insured under a full reservation of rights provides a defense in the liability action, but reserves the right to contest **coverage** later.") (citing to *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp.*, 932 F.2d 442, 445 (5th Cir. 1991)).

Here, Hanover properly reserved its rights in the August 22, 2014 message. Dkt. 24, Ex. C. The DFA directly addresses the issue of the disagreements over the meaning of the Agreement and includes the provision: "Except as may be stated herein, no part of this Agreement shall constitute a waiver, release or relinquishment of any of the Parties' respective rights, obligations, claims or defenses under the Policy, nor shall this Agreement constitute an admission by either party of any disputed matter between them." Dkt. 24, Ex. D at 29. The express terms of the DFA contradict Spec's assertion that the DFA functions as an "admission" of Hanover's duty to defend and a waiver of its rights under the Policy. *Id.* The court finds that August 22, 2014 message and the DFA expressly reserve Hanover's rights, and neither serve to modify the Policy or act as a waiver to Exclusion N. Therefore, Spec's is not entitled to a defense by the terms of the August 22, 2014 message or the DFA. Spec's claim that Hanover breached the DFA is DISMISSED.

2. Potential claims that are not barred by Exclusion N

***7** Second, Spec's argues that the Underlying Claim potentially includes non-contract claims, which are not excluded by the Policy. Dkt. 23 at 17–19. Exclusion N does not apply if liability "would have attached in the absence of such contract or agreement." Dkt. 19, Ex. A. Further, under the eight corners rule, if the petition in the Underlying Claim contains any allegations that do not fall under a policy exclusion, the insurer continues to have a duty to defend. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997) ("[I]n case of doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the **coverage** of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in insured's favor.") (internal citations omitted). But, "[i]f the petition only alleges facts excluded by the policy ... the insurer is not required to defend." *Northfield.*, 363 F.3d at 528 (citing *Fid. & Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex.1982)). In evaluating the duty to defend, the court only looks at the alleged facts in the Underlying Claim, not any asserted legal theories. *Id.* (citing *St. Paul Fire & Marine Ins. Co. v. Green Tree Fin. Corp.-Tex.*, 249 F.3d 389, 392 (5th Cir.2001)).

Here, Spec's argues that the MasterCard and Visa fines and the funding of a reserve account to pay for those fines do not arise out of its contract with FirstData. Dkt. 23 at 19 ("FirstData's own allegations against Spec's do not articulate a contractual basis for liability.") As the court has already discussed, there is no written demand directly from MasterCard and Visa against Spec's, the Underlying Claim is that of FirstData against Spec's. Spec's argues that FirstData does not "suggest any provision of the Merchant Agreement [which] entitles it to 'establish a Reserve Account' and unilaterally withhold funds. ..." Dkt. 23 at 20. The court agrees that FirstData is not specific in referencing the provisions of the Merchant Agreement it is invoking in its demand letters, but FirstData explicitly states that it is demanding "indemnification," which is a contractual obligation that arises from the Merchant Agreement Dkt. 19, Exs. C, D.

"A court may not ... speculate as to factual scenarios that might trigger **coverage** or create an ambiguity." *Gilbane Bldg. Co. v. Admiral Ins. Co.*, 664 F.3d 589, 596 (5th Cir. 2011). Spec's is asking the court to look beyond FirstData's demand letters, in violation of the eight corners rule, to find a speculative factual scenario or legal theory in which MasterCard or Visa make a claim directly against Spec's. Dkt. 28 at 5. Spec's does not identify what this speculative cause of action

might be or explain how a claim could arise outside of FirstData's identification demands, other than to make conclusory statements that such a claim would include "no contractual liability." Dkt. 23 at 19–20. Though the court construes coverage liberally and policy exclusions narrowly, the court is not required to imagine a legal theory for a potential claim from a third party who has not even sent a demand letter or filed a petition. *Northfield,* 363 F.3d at 528. The claim at issue here is FirstData's demand letters, which are based only in contractual indemnification.

3. Underlying criminal causation

Third, Spec's argues the Underlying Claim arises out of superceding criminal conduct, the data breach, which was the "but for" cause of the claim. Dkt. 23 at 24. Spec's argues that because the criminal activity is an independent cause of the claim, Exclusion N does not apply. Dkt. 23 at 24. In support, Spec's reference cases where an independent cause of action gives rise to claims that also arise from excluded causes. *See, e.g. Utica*, 141 S.W.3d at 204 (affirming a duty to defend based on an injury allegedly caused concurrently by covered and excluded events). Hanover counters that the appropriate standard to use is the "incidental relationship" standard rather than "but for" causation. Dkt. 28 at 4 ("[a] claim need only bear an incidental relationship to the described conduct for the exclusion to apply") (quoting *Scottsdale Ins. Co. v. Texas Sec. Concepts and Investigation*, 173 F.3d 941 (5th Cir.1999)).

***8** Again, Spec's is making the argument that there is "potential" for liability that is not precluded by Exclusion N and urges the court avoid construing Exclusion N too broadly. *Id.* at 25. But, the court applies the eight corners rule to look at the policy and the Underlying Claim, and finds that the only claim being made here is by FirstData for indemnification under a contract. Dkts. 19, Ex. C, D. There is nothing in FirstData's demand letter to suggest that it is attempting to recover damages based on a criminal liability theory. Dkt. 28 at 5. That criminal conduct gave rise to this contract claim does not change the basic nature of FirstData's claim against Spec's for contractual liability. This is not the case of a criminal claim that exists independently as Spec's argues—this is just a contractual claim. Spec's fails to allege any facts that show it would be liable or have any form of privity or obligation to pay damages to FirstData for any other reason that those that arise out of contractual liability.

The court finds that Spec's arguments do not assert any ambiguity in the applicability of Exclusion N. The Underlying Claim is based on the Merchant Agreement, and coverage of contract claims is clearly excluded by the Policy. Therefore, the court concludes Hanover has no duty to defend the Underlying Claim. Spec's claim against Hanover for breach of the Policy is DISMISSED.

C. Insurance Code claims

Spec's also alleges that Hanover is liable under Chapter 542 of the Texas Insurance Code by failing to promptly pay for defense expenses incurred. Dkt. 6 at 6; Tex. Ins. Code Ann. §§ 542.058, 542.060. The liability "does not apply in a case in which it is found as a result of ... litigation that a claim received by an insurer is invalid and should not be paid by the insurer." § 542.058(b). Because the court has concluded that Hanover does not have the duty to defend Spec's in the Underlying Claim, Hanover does not owe defense expenses under the Texas Insurance Code. Therefore, Spec's claim under the Texas Insurance Code is DISMISSED.

D. Duty to Indemnify

Hanover requests a declaratory judgment that Hanover does not have a duty to indemnify because the court finds Hanover lacks a duty to defend. Dkt. 19 at 21; Dkt. 28 at 6. In Texas, an "insurer's duty to defend and duty to indemnify are distinct and separate duties." *Farmers Tex. Cty. Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997). An "insurer may have a duty to defend but, eventually, no duty to indemnify." *Id.* A duty to indemnify may be adjudicated even before the underlying suit proceeds to judgment. *Id.* Here, Spec's complaint does not seek a declaratory judgment on Hanover's duty to indemnify. Dkt. 6 at 7–8. Hanover did not move for a declaratory judgment on the duty to indemnify, but rather raised the issue in its motion for judgment on the pleadings, so Hanover has not properly raised the issue.

Dkt. 19 at 21; Dkt. 28 at 6. Therefore, the court will not consider the merits of a declaratory judgment on the duty to indemnify. Dkt. 23 at 32.

E. Request for Judicial Notice and Motions for Supplemental Authority

Hanover seeks to supplement the record with (1) a request that the court take judicial notice of filings in the Tennessee litigation and the Merchant Agreement and (2) a motion to file supplemental authority. Dkts. 20, 30. Spec's responded and Hanover replied to both of these motions. Dkts. 25, 29, 31, 37. Spec's also moved for leave to file supplemental authority, and Hanover responded. Dkts. 35, 36.

First, Spec's objects to use of extrinsic evidence from the Merchant Agreement and the Tennessee Litigation as because they are not admissible under the eight corners rule.[1] Dkt. 19, Ex. B (the Merchant Agreement) and Dkt. 24, Ex. 1–4 (Tennessee Litigation documents). "Resort[ing] to evidence outside the four corners of [the underlying petition and the **insurance** policy] is generally prohibited." *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 307 (Tex. 2006). The court can review extrinsic evidence as a narrow exception to the eight corners rule only "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 case." *Evanston Ins. Co. v. Lapolla Indus., Inc.*, 634 F. App'x 439, 444 (5th Cir. 2015) (internal quotations omitted). The court did not need to apply this narrow exception and use the Merchant Agreement or any of the Tennessee Litigation documents to determine the duty to defend issue.

9** With regard to the supplemental authority, Spec's seeks to introduce a case out of the Eighth Circuit, which does not offer binding precedent for this court to follow. Dkt. 35 (offering *State Bank of Bellingham v. BancInsure, Inc.*, 2016 WL 2943161 (8th Cir. May 20, 2016)). Likewise, Hanover seeks to introduce a case out of the District of Arizona, which does not offer binding precedent for this court to follow. Dkt. 30 (offering *P.F. Chang's China Bistro Inc. v. Federal* ***Insurance *Co.*, 2016 U.S. Dist. LEXIS 70749 (D. AZ. May 31, 2016)). Moreover, the court in its ruling has not relied on the material offered in any of these motions. Therefore Hanover's request for judicial notice, Hanover's motion for leave to file supplemental authority, and Spec's motion for leave to file supplemental authority are DISMISSED AS MOOT. Dkts. 20, 30, 35.

IV. CONCLUSION

Hanover's motion for judgment on the pleadings (Dkt. 19) is GRANTED. Hanover's request for judicial notice (Dkt. 20), Hanover's motion for leave to file supplemental authority (Dkt. 30), and Spec's motion for leave to file supplemental authority (Dkt. 35) are DISMISSED AS MOOT. Spec's claims are DISMISSED WITH PREJUDICE.

The parties are directed to notify the court within seven (7) days if they wish to have this Memorandum Opinion & Order remain sealed.

All Citations

Slip Copy, 2017 WL 3278060

Footnotes

1 The court notes there may be some confusion regarding Spec's response in objection to the motion for judicial notice because of offset exhibit numbering. The Merchant Agreement is attached twice, as Dkt. 19, Ex. B and Dkt. 20, Ex. 1. Tennessee Litigation documents are attached twice as Dkt. 19, Exs. 1–4 and Dkt. 20, Exs. 2–5. It appears that Spec's objected to the

Merchant Agreement twice and failed to object to the last document in the Tennessee Litigation (Dkt. 20, Ex. 5), when Spec's may have intended to object to the full set of Tennessee Litigation documents. Dkt. 25.

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