

**ORAL ARGUMENT — 01/14/99**  
**98-0661**  
**TEXAS FARMERS INS. V. MURPHY**

LAWYER: I would like to start off by \_\_\_\_\_ hopefully will be an undisputed proposition, that Texas law will not allow an arsonist to recover benefits directly or indirectly from the intentional destruction of insured property. I think that's our starting point. And the issue before the court today is to apply this precept in a situation where you have a couple of important factors. The insured property at the time of the prior claim and denial was community property. The insurance proceeds, therefore, were community property as well.

ENOCH: You could have sold an insurance company policy that would have covered arson?

LAWYER: That's correct.

ENOCH: Did this insurance policy exclude arson?

LAWYER: It excluded fraud, which encompasses arson. It's got a specific exclusion into that.

ENOCH: And the policy says that includes arson?

LAWYER: The policy does not say in express terms, that that includes arson.

GONZALEZ: Did you raise a fraud as a defense coverage?

LAWYER: Yes.

BAKER: Did you get a jury finding on it?

LAWYER: We got a jury finding that the property was intentionally destroyed by Mr. Murphy, and that we believe brings in a couple of different ways to address this issue. One is under the common law; one is under the policy language itself.

HANKINSON: How does intentional destruction of property equate with fraud legally?

LAWYER: I think it gets there because the whole basis for arson is to recover insurance proceeds on the basis of something that is not an accidental fire and, is therefore, fraudulent. It's an intent to get recovery when there is no entitlement to it. And we would submit that that's what brings that in.

HANKINSON: Having to stretch the law a little bit to get there?

LAWYER: I don't think so. But I also want to make sure that my position here this morning isn't cubby holed in terms of the fraud, because that's one argument. But I think the decision from the 1<sup>st</sup> CA in the way it was approached there what brings us here this morning is the public policy issue under common law separate and apart from the policy provisions. That's one aspect of it. But the real issue here is applying the rules regarding denying benefits to arsonists in this community property context.

HANKINSON: Why wouldn't the starting point in the analysis be whether or not the policy would exclude coverage? Why wouldn't we start at that point before we would get to the common law - look at the contractual relationship between the parties?

LAWYER: I think that that is one logical starting point. In all honesty, this issue sort of picks up where *Kulubis* left off, this court's 1986 decision in *Kulubis*. In *Kulubis* the analysis was phrased more in terms of the public policy and the common law issues rather than the contractual liability or the contractual terms issues. So I think that's where the focus of the CA was and that's where the focus of the analysis has been. And I think that that's where the CA sort of got hung up in terms of what the public policy is and what it should be.

ENOCH: You want us to assume that but for public policy, then the innocent spouse would recover under this insurance policy?

LAWYER: No, I do not ask you to assume that. It is our position as an alternative argument that the specific exclusion under the fraud provision of the contract as to you and any insured encompasses the finding that arson was committed and that that exclusion itself is an independent basis for contending.

HANKINSON: Doesn't fraud under Texas law require an affirmative misrepresentation in most circumstances? Sometimes a failure to disclose, but in most circumstances an affirmative misrepresentation?

LAWYER: Frequently it does.

HANKINSON: Then looking at your exclusion and looking at the proof at trial, was there proof of affirmative misrepresentations or misrepresentations of material fact?

LAWYER: I think that it's more in the nature of nondisclosure in terms of that there was no disclosure that the arson had been committed by Mr. Murphy.

HANKINSON: So what you're relying on is the concealment language then in the exclusion? They concealed the material fact, is that...

LAWYER: I think for purposes of this case both of those get you to the same place. And that under the policy language if that's where the court wishes to focus its attention that recovery was properly denied to Daisy Murphy.

GONZALEZ: What about art. 21.19 of the Insurance Code, which seems to void the fraud clause unless the insurer proves at trial that there was a misrepresentation of material fact and misled the insurance company?

LAWYER: I think what that is going to is more of a situation where you've got proofs of loss submitted, for example, that are inflated, and that are otherwise used in an attempt to try to inflate a claim. I think that this situation has got different aspects to it because of the arson aspect to it. And we're not talking about an inflated proof of claim. What we are talking about is the public policy of Texas and whether because of the community property interest that existed at the pertinent times in this case, Texas public policy is going to allow a recovery of insurance proceeds by the arsonist's spouse given that the arsonist himself has an interest in those proceeds at the pertinent times. I think that's the focus of it here, and I think that the 5<sup>th</sup> circuit's decisions in *Norman* and *Webster* appropriately analyze that public policy question as recognized by the Ft. Worth CA in the *Kizer* decision.

And I would submit to the court that where the DC got it exactly right when it entered a take nothing judgment as to both spouses. And the 1<sup>st</sup> CA obviously disagreed with that and reversed insofar as it awarded ½ of the proceeds to Daisy Murphy. And we submit that that was error.

ENOCH: It seems to me this question is sort of backwards. Clearly Mr. Murphy's wife is an insured under the policy because she's a relative. He's actually the insured. Mr. Murphy is the insured, she is one of the beneficiaries because she's named in the policy, and she's covered by this policy.

LAWYER: She has an interest that's protected by the policy.

ENOCH: But if the insured defrauds the insurance company, it voids the policy doesn't it?

LAWYER: That is correct.

ENOCH: So why do we get into any sort of discussion about whether or not a derivative interest survives the voided policy? The innocent spouse would come and say: I'm still covered because it's against public policy to exclude me from that policy. It seems to me that's the way the argument ought to go. It seems to me your argument ought to be, it's against public policy to pay her. \_\_\_\_\_ it's void, and they ought to be up here arguing: well that's against public policy.

LAWYER: Well that is our position. In honesty we've approached it from a couple of different angles because in the case law in Texas and elsewhere courts have approached this from several different angles. One of those angles is to look at it from pure common law public policy point of view, which is where we started off on, and which is where I think *Kulubis* was coming from. A separate way to look at it, which I understand Justice Enoch to be sort of the way you're thinking about it, is in terms of if the policy language results in coverage being voided, then end of inquiry. And I think that's an equally valid way to take a look at it. Frankly, I don't think up till this date that that's the way that the Texas courts have looked at it. That's certainly the way that other CA's in other community property states have looked at it, and it's a perfectly legitimately way to go about it. What it is is addressing of the reasonable expectations argument, which is what - it's language that props up in *Kulubis*. It's what the first CA sort of seized on in reversing the DC's take nothing judgment as to Daisy Murphy, the notion being that there is some reasonable expectation of her ability to recover proceeds even if her arsonist husband's receipt of those share proceeds is foreclosed due to his arson.

BAKER: But you can't make that argument in the face of this exclusion clause and concealment for fraud can you? If I'm trying to make that argument and there is the policy sitting in front of me and it says: My husband or me, how can I make that argument. I've got a reasonable expectation. I can recover.

LAWYER: That's our point. There is no reasonable expectation of coverage in light of this policy.

BAKER: Well I'm still concerned about what Justice Gonzales raised, that you have to put on evidence and get a finding of that, and it doesn't seem to be in the charge or in the judgment, that finding based on this exclusion even though you argue, well arson is included.

LAWYER: I understand, and I will try to make the distinction that I'm trying to draw a little bit clearer. I think that anti-technicality statute, art. 21.19 issue that has been focused on here is going to be a situation again where we are talking about an inflated proof of claim or something like that where something after the fact...

BAKER: Can I answer your argument by saying, well this is a 100% inflated claim because they are really not entitled to anything because arson is not covered. So if I put in a claim for \$100,000, I've inflated it by the whole figure. I don't think that's a good viewpoint.

LAWYER: I think that there is a difference when you're talking about arson and the claim being voided ab initio, because of the fact that it results from arson, and the claim that there was some kind of post-loss inflation of the proof of loss or something like that.

BAKER: Well there's a post-loss statement by the husband when he files the claim that this was an accidental fire, because he omits saying, I did it, which is a material fact that's concealed

isn't it?

LAWYER: I think it's more in the nature of a statement of: I don't know who burned the house down.

ABBOTT: Isn't that why you have the fraud language in there? For instance, if the cause of the fire was arson, and had it been you who set that fire, they would have been able to recover the proceeds, correct?

LAWYER: Correct.

ABBOTT: And isn't the reason why you have fraud in the contract is because it's only when the arsonist is the one who submits the claim that results in the fraud that would prohibit you having to pay on the claim?

LAWYER: Correct.

ENOCH: If he had come in and said, The house is burned down, and I burned it down, then you say, well there's no fraud so it's covered?

LAWYER: No.

ENOCH: What would you say?

LAWYER: The position is is that as a matter of public policy. Let's talk about it in two terms: outside of the contract terms; and within the contract terms. Outside of the contract terms as a matter of public policy reflected in *Kulubis* and cases before and after, the arsonist is not going to be permitted to recover, period. Bolstered by the provision that I've pointed to the court with respect to the fraud, and that that is a species of fraud and it's a species of fraud that's not really so much aimed at misrepresentation as it is that it is improper and not going to be permitted to allow an arsonist to recover benefits after intentionally burning the insured's property. I hope that answers the question, because I really am trying to come down squarely on both sides of the issue. I think that as a matter of public policy, we prevail. I think that as a matter of the contract, the policy language, we prevail. And I think those are alternative ways to go about it.

ABBOTT: But doesn't public policy also dictate that an innocent party to the situation should be entitled to recover?

LAWYER: Up to where we are right now with *Kulubis*, is that in a separate property situation, that is an accurate statement of the law. And the difficulty or the issue before the court in this case is the one that *Kulubis* said, We are going to reserve for another day. Well today is the other day, because it is the issue of: How do you treat it when there is a community property interest in the

insurance proceeds?

ABBOTT: That would be true for instance if they had not gotten a divorce and had the property not been separated.

LAWYER: And that raises the timing question. I think that the public policy issue that arises here is that if it's community property, the arsonist has an interest in those spouse's proceeds regardless of the spouse's culpability or lack of culpability in connection with the fire itself. You say in response to that, the community property interest when. And I think that's the point where the CA seized on and said: Well there was a partition agreement filed after the claim was denied. It was filed on the eve of trial, and then 7 months after the trial just before judgment got entered there was a divorce decree that was signed. Those actions purported to separate the property interests and, therefore, we don't need to deal with the public policy issue that *Kulubis* raised, but did not resolve, because the insurance proceeds going to Daisy Murphy were separate property by the time it came judgment time.

I would submit to the court that the proper way to analyze this issue is to focus on the facts as they existed at the time of the claim, the time of the fire, the time of the claim and the time of denial. But the universe of facts that existed at those time periods is the one that should be looked at.

HECHT: So if they had gotten divorced before the fire, you would lose?

LAWYER: If they got divorced before the fire and if there was no indication that the effort to separate property interests was collusive, then the spouse would get the insurance proceeds.

HECHT: Despite what this provision in the policy says?

LAWYER: Independent of what the provision of the policy says. I will come back to the policy language in a moment. I'm talking in answer to your question purely on the common law approach to it. Again I want to draw that distinction that these are alternative grounds and alternatives arguments.

GONZALES: Do we even have to get to that analysis about whether or not it was community property or separate property? Should we look at the reasonable expectations of the spouse here and whether or not we should infer knowledge upon her about that provision in the insurance policy that if either one of them commits fraud that it voids coverage?

LAWYER: I think that that is an appropriate way to approach the issue. Again it could be either, or. It's either a public policy - and the reason I keep coming back to public policy is I think that's where Texas law is right now in terms of how *Kulubis* framed the issues. If in this case this court wants to encompass within the analysis more of a focus on the policy language, then of course

this court is entitled to do so. I'm not sure that the court has really done that to date. And so that's why I've approached it first from a public policy standpoint, and then from the policy language standpoint.

BAKER: You've mentioned three dates that you feel are important in the determination of this kind of case. Which one is the most important, and why?

LAWYER: I think that probably the date of the resolution of the claim, the denial of the claim is going to be the operative date. Because that is the date at which the investigation has been conducted, the facts have been investigated and found, and the parties and everybody at that point is going to be on notice of what the situation is.

BAKER: What date was submitted to the jury in this case?

LAWYER: There was no specific date submitted. The way that this was submitted was...

BAKER: Defined in it what an innocent spouse was, and said: Was she or wasn't she. But the only date in the charge as I recall, Did he commit arson on the date of the fire, is that right?

LAWYER: That is correct.

BAKER: So when did she have to be an innocent spouse under that submission?

LAWYER: What's built in and there is sort of an assumption there about whether or not the jury was allowed to consider the effect of the partition agreement.

BAKER: No, that's not what I mean. You said there are three dates. All of them proceed the litigation. All of them at least under the facts of this case precede any business about partitioning and divorce and so forth.

LAWYER: I think the answer to your question is this, there wasn't a specific date built into the innocent spouse question. But in effect there was because it said: Do you find that she was an innocent spouse? More properly: Do you find that she was not an innocent spouse? And you are instructed that an innocent spouse means that she either participated in the fire or knew about it beforehand. So I guess that takes it up to the date of the fire.

BAKER: And so if that's what you think the inference was, then your viewpoint that the date of denial is not the best date, because the jury was asked a different question and could draw different inferences from what you suggest?

LAWYER: I think that the date of the denial - really where the date of denial comes from is the *Norman* and *Webster* analysis of the issue in terms of addressing the question of whether a

post-arson separation of property interests is going to be allowed to have some impact on the decision about how the spouse's insurance proceeds are treated. So I think that's where that comes from. And I think what that does is allow for the investigative period of the claim's handling to be undertaken to see what are the surrounding facts and circumstances? Does it look like it was an arson fire? Is there some indication that this married couple is divorced, getting divorced, separating property interests, whatever? It allows a little bit broader snapshot of time to look at some of those issues. So it wasn't really tied specifically to that jury question.

**ABBOTT:** So the real issue here is you want and I think the legal system wants to prevent say a couple from perpetrating a fraud by causing their house to burn down, and then getting a divorce so that they will be able to collect at least half the value. But what if you have a situation if you come up with a rigid test that you perhaps are offering where what happens is that the wife says: She is leaving the husband; the husband gets mad and says: Well I want money, I'm going to burn down the house to get money and to pay her back. And she goes off to Kansas for a month, he files a claim the next day and within a month the insurance company denies the claim after investigating it. She comes back and says: Where is the house? Where is the money? And she doesn't get to recover despite the fact that when she comes back, she promptly files for divorce and after the adequate time waiting period she gets her divorce. She's out of luck.

**LAWYER:** I understand your concern. And I guess what I would gently take issue with is the notion the rule that Texas Farmers has proposed as a matter of Texas common law, talks about the facts and circumstances as they existed. And I would submit to you that if the court has some concern that applying a common law rule is going to result in some harsh results in that hypothetical or others that could be devised, that if the rule is phrased in terms of the surrounding facts and circumstances, then that could be taken into consideration. If you're talking about a situation where there really are no indicia of collusion, or if you've got an abusive spouse situation, or for some kind of forcing of conduct on someone, or something like that, that can be accommodated. So I would submit to the court that if you've got concerns that you can come up with situations where you say to yourself: Gee that just doesn't feel right, that doesn't feel fair, I would respond to you that the rule we put forth leaves enough flexibility that that can be addressed. What rule we proposed here today is designed to do is to avoid a situation like the one that we're present in here, where there is no indication of any of those kinds of concerns, but what you do have is a post-arson eve of trial effort to separate the property interests.

**BAKER:** Well whose viewpoint does this test apply from, the insurance policy, or the carrier, or the so-called innocent spouse?

**LAWYER:** Well you've got reasonable expectations language in *Kulubis*, and I think that suggests reasonable expectations of the insured. So I think that's a factor that this court has said, this is one of the things that's got to be taken into the mix. I think the larger question is the perspective of Texas public policy as a whole, and whether there is going to be allowed to be room for indirect recovery of benefits that arises because of this community property circumstance. So I think there's



more than one perspective that the standards at least as the issue has been framed by *Kulubis*, there's more than one perspective that has to be taken into consideration.

HECHT: I just want to be sure I understand you. Your position is, that if the spouse in this instance thinks she really should recover and she is sympathetic enough, you're going to waive your policy provision?

LAWYER: No, sir.

HECHT: Then I'm not following you.

LAWYER: It may be that I haven't drawn the distinction clearly...

HECHT: If she's going to lose under the policy what difference does the public policy make?

LAWYER: Two separate issues. If this court decides that it is going to address this issue solely in terms of the policy and contract language, then that's one inquiry. I don't understand that to be where the court is today, but that's one approach to it.

ENOCH: Why do you not understand that's where the court is today?

LAWYER: Because there is no discussion of that in *Kulubis*, which has teed up this issue, but then left the community property aspect of it open for resolution at a different time. I don't understand that this court's decision in *Kulubis* makes a focus on the policy language any kind of significant part of the analysis.

HECHT: Is it your position it should not be a significant part of the analysis?

LAWYER: I think that it should be a part of the analysis. I think that if the policy language is clear and explicit, then it would trial. If the policy language is not clear or not explicit in the court's view, then where you go is to the public policy consideration, and then we are going to take a look at it and...

HECHT: What's your position on whether this is clear or not?

LAWYER: I submit to the court that it is clear and unambiguous, that the any insured language as demonstrated by the cases that have been cited in our brief on the merits, do indeed encompass any claim to proceeds by the arsonist's spouse.

ENOCH: And that's because arson is a public policy issue that voids the policy and he filed a claim having failed to identify himself as an arsonist, and therefore, it violated the fraud

provision of this policy, so this contract is now void?

LAWYER: It's void under the contract language, and separately and independently voids the matter - his claims is void as a matter of public policy.

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RESPONDENT

BARTLETT: I think foremost this court needs to be aware of and consider the importance of this issue that this court is going to consider today, not just from the context of Daisy Murphy, who lost all of her property and now is in a situation where she is not going to recover any proceeds to reimburse her for that loss, but also for all the other future women, innocent spouses who will find themselves in this position in the future.

OWEN: You haven't focused very much either on the policy provisions?

BARTLETT: And there's a good reason why. The two concepts that the policy and the contract are interrelated, but in this situation, I don't believe that the contract analysis can be put before this court or that this court can decide this case on its contract analysis because there was no contract, no policy ever issued.

HECHT: Your client pleaded the policy.

OWEN: You're suing on the contract aren't you?

BARTLETT: We are suing on the binder and the application. There was two different pleadings filed. There was a pleading filed by Robert Murphy. There was a pleading filed by Daisy Murphy. The standard form that was attached was never issued and was just offered to reflect what the Insurance Commission has approved. That doesn't necessarily mean that in this situation the insurance company would have issued this, or was required to issue this. That merely sets the minimum standards by which the policy that is ultimately issued will be judged by. But the fact remains that in this case there was an application made on Sept. 23, 1993, the fire happened 7 days later, the cancellation notice was sent out Oct. 11, 1993, canceling the policy coverage effective Nov. 12, 1993, and no policy was ever issued.

HANKINSON: So if you buy insurance and you burn your house down quick enough before the policy gets issued, then you can have a benefit of the policy but not be bound by the terms of the policy?

BARTLETT: I think that and when we fall back to the public policy analysis, which I think will kick in. Now there are many...

HANKINSON: Isn't that basically your position: if the house had burned down the day after the policy was received in the mail, then you would be bound by the terms? But your point is, is that because there was only a binder, and the fire occurred so quickly, the jury found here arson was the cause of this fire, that if you burn your house down quick enough you don't have to worry about the terms of the policy and you can fall back on public policy arguments to decide whether or not you have coverage or not?

BARTLETT: I believe that you're confusing the analysis between the arsonist and the innocent spouse.

HANKINSON: No, I am trying to determine the legal effect of the insurance policy separate and apart from who is trying to recover.

BARTLETT: It of course depends on what policy is issued. The majority of the jurisdictions that consider this issue hold that if there is any ambiguity in terms of whether or not the exclusion under the concealment issue, the act of any insured barring recovery for any other one will not be enforced in the event of ambiguity. That line of cases, the majority position assumes that there has to be a policy issue, and the reason being very clear it ties back to the *Kulubis* decision and virtually every other decision that has addressed this issue is the reasonable expectation of the innocent spouse whether it be determined by the circumstances or the written language.

OWEN: Let's back up to the contract issue. Is there any dispute about what kind of policy would have been issued had the house not been burned down?

BARTLETT: They contacted that a homeowner's policy be issued.

OWEN: And we know what the terms of that would have been. There is no dispute about that?

BARTLETT: We know what the state Insurance Commission has promulgated as a minimum. We do not know for a fact what it would have been.

HANKINSON: Doesn't the binder say that? Doesn't the binder say that a policy is going to issue in accordance with a particular form so that it's all part of the binder?

BARTLETT: I think that it says: The binder does not commit them to limit the coverage to the form required by the insurance commission. It requires them to issue a form that provides that minimum coverage. They of course are entitled to change that...

HANKINSON: And give more coverage than what the binder indicates?

BARTLETT: Yes if they so choose.

HANKINSON: It's not less?

BARTLETT: Exactly.

HANKINSON: But in the binder there appears to be as a result of that an expectation on the part of both the insurance company and the insured that they should expect a Homeowners Form B policy to be in the mail?

BARTLETT: There is an expectation of coverage. You're right. There is an expectation that it is covered for 60 days unless cancelled otherwise.

HANKINSON: And it's covered under the same terms as Homeowner's Form B?

BARTLETT: I respectfully disagree.

HANKINSON: I'm just trying to understand the effect of the binder and where we are in terms as of Judge Owen is, what do we do with this contract?

BARTLETT: What we did with this contract is one of two ways that this court can go. If this court wants to follow the majority jurisdiction that had considered this issue, the court can make the determination that there is no policy issue that was in the possession of Daisy Murphy that would otherwise affect her reasonable expectation of coverage. When you look at *Kulubis* and the many, many other cases that address that issue, you look at the perspective of the innocent spouse: Did she expect that her property be covered?

OWEN: Let me short-circuit this. You keep talking about *Kulubis*, but there was a policy in effect there correct? *Kulubis* doesn't address the issue: what do we do here where there is a binder and the policy had not yet been sent? *Kulubis* has nothing to do with the issue that we've been talking about here the last few minutes. Assuming that we disagree with you and we say that the terms of Form B are the contractual parameters that we deal with don't we have to strike down as void against public policy the fraud provision in this contract as to Daisy?

BARTLETT: Absolutely not. Public policy is a completely different issue. There is two ways to conduct the analysis. One is the contract analysis that if you look at the contract that actually issued and take the position that this written document defines the reasonable expectations of the party and if there is ambiguity then you resolve that against the insurance company and assume there is coverage. The other way, and there are a line of cases that hold despite the terms of the written policy public policy recognizes the importance of protecting the innocent spouse.

OWEN: Assuming that we disagree with you and we conclude that the concealment of fraud provision is not ambiguous that it applies to Daisy Miller, and that on its face she is another insured and cannot recover under the literal terms of the policy, the unambiguous terms, then aren't

you left with an argument that because of public policy in Texas about community property in a spouse's interest, that that provision is unenforceable and against public policy as applied to Daisy?

BARTLETT: Yes.

OWEN: So we have to strike down in essence that particular part of the policy as applied to an innocent spouse?

BARTLETT: If you assume that that policy was issued and \_\_\_\_\_, and I take issue with that, then you still have to take the position that in Texas as a matter of public policy an innocent spouse should be bound by the terms of the policy and it should not have the protection contemplated in *Kulubis*.

OWEN: *Kulubis* was construing a policy was it not?

BARTLETT: *Kulubis* did not analyze the policy. *Kulubis* decision came from the time when the harsh traditional rule of forfeiture was applied presumably on the theory of \_\_\_\_\_ that if the husband did it, the wife is going to go down with the ship. Texas has at that point a majority of jurisdictions have abandoned the traditional rule and have opted for the new majority rule under which the intentional destruction of property by a co-insured will not affect the right of an innocent co-insured to recover and that upon a jury finding of innocence shall be permitted to recover. That is the public policy principle addressed in *Kulubis* and the majority of other community property jurisdictions that have considered the issue. The issue posed in *Kulubis*, the problem was it was a destruction of a trailer given to them by their parents and being a gift was separate property. The court went on to hold in *Kulubis* because the wrongdoing spouse has no legal entitlement to the insurance proceeds awarded to the wife, we're going to allow recovery. They then go on to say, we are not presented with the situation involving community property. That will be another day. But do say that we are not to be considered a whole that in a community property situation the innocent spouse should be barred because it's community property. They posed the question essentially that it's not a question of if the innocent spouse should recover. It's a question of how to permit the innocent spouse to recover and yet not permit the wrongdoer to benefit from his wrongdoing. And that is the principal behind the rule adopted in most community property jurisdictions and separate property jurisdictions that allow an innocent spouse to recover.

HANKINSON: What's your definition of innocent spouse?

BARTLETT: An innocent spouse is one who does not have knowledge nor participate in the causing or setting of the fire, the exact issue that was submitted to the jury and it's not in dispute in Texas.

HANKINSON: What if the spouse knows nothing about the fire and doesn't participate in it, and not realizing the terms of the policy he thinks great I am going to get to recover and maybe even

the arsonist thinks they are going to recover because they are going to be able to convince a jury or whatever. And then further down the line the couple gets together and says: why don't we divorce and partition this, we can at least get 50%, I'm going to get hung out to dry on the arsonist thing, we will go our separate ways till you collect the money. Is that still an innocent spouse if after the fact, not having participated in it there is an effort to collude with the arsonist to collect at least half the proceeds of the policy?

BARTLETT: That's a very difficult question.

HANKINSON: That's why I want to know what an innocent spouse is.

BARTLETT: I don't think that affects the finding of innocence. I think that goes to the issue of collusion, that Texas Farmers asked this court to adopt a very restricted time frame because of the possibility of collusion. I would suggest to the court that when this very court in *Price v. Price* and the other cases that did away with the interspousal immunity was faced with a very similar question, is that we should deny the abolition of the interspousal immunity because lead to collusion. And the court said in *Price* and in *Kulubis* that the TC is uniquely situated to address the issue of collusion. So I would suggest that there may be situations where that's going to arise, but I suggest to the court that an over-kill that Texas Farmers is asking this court to adopt to exclude any recovery for that remote possibility does not strike a reasonable balance, an appropriate balance taking into mind the true harshness and the tremendous burden that is going to be imposed on the innocent spouse, and the *Kulubis* case is a prime example. *Kulubis* rose from the fact that the husband lost his control when the wife filed divorce. His burning of the property was not to collect insurance proceeds. It was aimed at her. And situations like this arise. In one of the other cases I cited, *Powell*, I think is the New Jersey case, the arsonist's husband was convicted of attempting to murder his wife in the fire. Those situations arise.

The real problem that I have with Texas Farmer's proposal, and I think this court really needs to think about this, because I didn't put it in the reply two things: 1), it confuses the issue, the *Kulubis* situation tort says that you look to see how to compensate the innocent spouse and yet not permit benefit. The CA properly did that. The CA held that in this situation at the time of judgment there was not only a partition but there was also a divorce. Very similar to the situation presented in *Travelers v. Wolfe*.

They want to ask this court to adopt their rule for the purpose of removing all indirect incentives for the husband to commit arson. I suggest that is improper when you balance that against the burden imposed on the wife. More significantly, their proposal is not workable in terms of time. They make a couple of contradictions: 1) they say that after the fact the \_\_\_\_\_ must be disregarded. Then they say that the innocent spouse should be afforded a reasonable opportunity to protect herself as long as it is at the beginning of the proceeding. In this situation here, the fire occurred on Sept. 30, the claim was submitted 60 days later and it was denied Jan. 21, 1994, about 112 days from the fire. Now they are asking this court to adopt the position that contract partitions

are collusive, shouldn't be considered. We have to have the severance at the beginning of the proceeding; therefore, a judicial proceeding as suggested by the court in *Norman* and many other jurisdictions. That's not available. The only other alternative in Texas to make community property separate is to get a divorce. They are asking this court to adopt a rule that would compel an innocent spouse to protect herself to get a divorce. But the real problem is, is that it's not workable. First in terms it assumes that she knows the husband did it. What if she has no idea: No honey, I don't know who did it. What if she suspects that maybe he did it? Should she then run down and file a divorce in hopes that she can get divorced before the insurance company denies the claim? In this situation here, they deny the claim in 112 days from the date of the fire. Did she have time to get a divorce? I suggest that she didn't. What happens if she thought that her husband did it, ran down and did get a divorce and the jury says he didn't do it? It's overkill.

ENOCH: If this court determines that the contract is unambiguous that the wife is excluded because the insured committed a fraud, are we arguing that public policy voids that provision in the policy as to the innocent spouse or are you are you arguing from the standpoint that you're assuming that the provision is ambiguous, and therefore, we have to decide whether she's covered or not?

BARTLETT: It's not either, or. I am arguing both. I am saying that if it's ambiguous, the public policy is clear that I should win. If the court finds that it was not ambiguous somehow even though no contract was issued, I suggest to the court that the *Kulubis* decision controls and is not enforceable in a community property state. Because the CA held that at the time of the entry of judgment, the innocent spouse could be compensated and the wrongdoing spouse could not benefit. So I think that in both situations the public policy issue has to be addressed.

ABBOTT: Are you conceding that arson constitutes fraud as that term is used in the contract?

BARTLETT: There is no specific arson exclusion in the contract. Other jurisdictions they do have an arson exclusion. In Texas there is not an arson exclusion. I think that the exclusion that we're talking about, the fraud and the concealment, it goes to the concealment. I think Justice Gonzalez was right, is that you need to have the allegation, submission and finding that the concealment...

ABBOTT: Let me try to do this one more time. In the part of the policy that says: the policy is void as to you and any other insured, if you or any other insured under this policy has intentionally concealed or misrepresented any material fact or circumstance, made false statements or committed fraud relating to this insurance, what I want to know is what your position is on whether or not arson constitutes the commission of fraud as it is used in that phrase?

BARTLETT: The courts have held that that provision does include arson. Now I will say this, there are other jurisdictions that given with a reasonable expectation, dealing with that particular

language say that to have it be enforceable it needs to be somehow brought to the attention of the innocent spouse so as to truly and meaningfully affect her reasonable expectation, whether it be brought to the front of the policy, or in bold letters, or something to that effect. There are cases that address that issue. But it goes to the reasonable expectation of the insured as a basis to deny coverage.

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#### REBUTTAL

LAWYER: Fraud does indeed encompass arson. And I would direct you to the decision that was discussed in *Kulubis*. I think this part of the case is still alive and well. This is *Jones v. Fidelity* case that *Kulubis* discussed. If you look at the bottom of page 281, top of page 282, I think you will see there that it is treated as arson as a species of fraud and it's got nothing to do with misrepresentations or reliance or anything. It is fraud for purposes of that, for that insurance contract provision. And Justice Abbott I think that fits with where I think your question was going is that the provision itself draws a distinction between misrepresentations or fraud. We suggest that it's not one in the same thing, or completely overlapping.

I want to step back on the policy language aspect a moment to just drive home the point...

HANKINSON: How does this policy language square with *Kulubis*? If I have separate property, personal property that's in my house and my husband burns the house down, and you say that arson then this condition 2 then covers arson. And if I'm an anti-insured, I guess I don't get to recover for my separate property either under the terms of this policy. How does that square?

LAWYER: If our situation involved separate property, then I think that would be an issue, and that may be something that's going to have to be addressed in another case whether or not this public policy discussion in *Kulubis* really does trump that or not. I would submit to you that for purposes of this case, we're dealing with community property and that the two, the public policy and the \_\_\_\_\_ policy are...

HANKINSON: I understand we're dealing with community property. And since we don't have a discussion in *Kulubis* about specific policy language or anything, it would seem that if what you're saying that this is a valid condition in the policy, *Kulubis* in the face of this homeowner's policy would not live anymore. Because if I'm excluded from recovering because I'm an anti-insured, and my husband burns the house down, and gifts that I was given are in there, then I'm lost; my separate property is gone and it's not insured.

LAWYER: Part of it is a question of how this court wants to approach the issue. Does the court want to approach it from a strict policy contract interpretation point of view? Does it want to approach it from a purely public policy point of view, divorce from the policy language or is it



going to try to make the two intersect and peacefully coexist. And I will grant you there is some tension there. There really is when *Kulubis* departs in my view from a discussion of policy language.

I want to drive home the point which I think was perhaps suggested by your question, Justice Owen, with respect to whether or not the policy applies here because the policy was cancelled before the policy was actually issued. I come back to the point, I look at Mr. Murphy's petition. I look at Mrs. Murphy's intervention. They sued us under the policy. They invoked the policy. And more specifically than that they invoked the terms and conditions of the policy. And I would submit to the court that on this record there really is no wiggle room for Mrs. Murphy to contend that it is somehow unfair or improper to assess her reasonable expectations on the basis of a contract that she invoked and that she sued us on. I'm not going to berate the point other than to also mention that there is based on my review of Mr. Murphy's petition or answering counterclaim and Mrs. Murphy's intervention, there is no pleading of ambiguity. Ambiguity has never come up in terms of this specific policy provision and the cases that are cited in footnote 1 of our brief on the merits I think provide ample authority that the any insured language is unambiguous. So I just want to put that point to rest.

ABBOTT: In that regard, let me ask you something. The policy that you issued to the plaintiffs in this case was issued after the fire, correct?

LAWYER: Chronologically the binder was issued, the fire occurs, the policy is cancelled. The binder contemplated that the Texas Homeowner's Policy Form B was the contract at issue. I'm not sure that the record shows that they physically had it in hand at the time of the fire.

ABBOTT: On the binder that they received before the fire it said Homeowners' Policy Form B?

LAWYER: Correct.

ABBOTT: And then they received after the fire the policy that had all the explicit terms in it like what we're talking to about the fraud?

LAWYER: Correct.

ABBOTT: The policy in *Kulubis* was actually worded different than the policy here. The policy there said that the entire policy shall be void if whether before or after a loss the insured has willfully concealed or misrepresented...it talks about the insured as opposed to the language in this case where it talks about you or any other insured. Arguably...

LAWYER: That may be a basis for distinction, and Justice Hankinson that may go to your question in terms of the insured has been interpreted to encompass only the arsonist as opposed to the arsonist's spouse.

ABBOTT: Here's my question though. What year was this policy issued to the plaintiffs in this case?

LAWYER: 1993.

ABBOTT: In 1993 were you all issuing any homeowners' policies that use the language consistent with the language used in *Kulubis*?

LAWYER: As I stand here, I don't know the answer to that. I can certainly try to get that answered for you, but I can't answer that. Co-counsel warns me that the answer to that is no, but I'm not sure that that is reflected in the record.