

*Spring, 2023*

## AEI CLAIMS LAW QUIZ

### Is Evidence of State's Failure to Prosecute Arson Admissible in Insured's Civil Case for Insurance Proceeds?

*[Ref. Proving Fraud, Para. 4.05; Arson and Fraud, Para 3.04]*

**FACTS:** Beckey and her daughter Kimberly jointly owned a home in Tupelo, Mississippi. Haley, Kimberly's daughter, also lived in the home. Beckey and Kimberly insured the dwelling and their personal property through a homeowners policy. Haley insured her personal property through a separate renters policy. Both policies were issued by USAA.

On October 1, 2019, the home was damaged by fire. USAA was promptly notified of the loss. The insureds alleged that the fire was caused by a defective laptop computer that caught fire in the living room of the insured dwelling. USAA retained expert consultants to investigate the loss and determine the origin and cause of the fire. Following the investigation the consultants came to the following conclusions:

- Three separate fires with unconnected areas of origin occurred with the largest at a sofa in the living room, another at a roll of paper towels on the kitchen counter, and the third at paper towels under the kitchen sink.
- Three separate areas of origin and the elimination of all accidental causes at those areas would identify the fires as having human intervention in their origins.
- The fires should be classified incendiary in origin as a result of an open flame device being applied to combustibles within the house.
- The insureds had a motive to cause the fires based on their deteriorating financial condition, limited fixed incomes, and depletion of savings, including their last CD being cashed within days of the fire, with the possibility of obtaining insurance proceeds of \$1.6 million.
- The insureds had the opportunity to cause the fires as evidenced by the alarm system showing no entry into the home by any third party on the evening that the fires occurred.

The essential elements of a circumstantial civil arson defense require proof of an incendiary fire, motive, and opportunity. USAA's consultants established the incendiary origin of the fire, meaning that it was intentionally set rather than an accident. In addition, the investigation established that the insureds were experiencing financial difficulties at the time of the fire

(motive) and all of the insureds were home when the fire occurred with no evidence of intruders (opportunity). USAA denied the claims based on the intentional loss exclusion and the concealment provision in both of the insurance policies. In pertinent part, the intentional loss exclusion stated:

We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss:

...

4. Intentional loss, meaning any loss arising out of any act committed:

- (a) by or at the direction of an insured; and
- (b) with the intent to cause a loss.

The concealment provision stated:

With respect to all insureds, the entire policy is void if, whether before or after a loss, any insured:

- (a) intentionally conceals or misrepresents any material fact or circumstance; or
- (b) makes false statements or engages in fraudulent conduct, relating to this insurance.

Haley filed suit against USAA alleging both breach of contract and bad faith. Becky and Kimberly filed a separate suit against USAA, but they only alleged breach of contract. The cases were consolidated in federal court. Following discovery, USAA filed a motion for summary judgment seeking to dismiss the bad faith claim. The court concluded that USAA had presented sufficient evidence to support each of the elements required to establish an arson defense, and it had an arguable basis to deny Haley's claim. That good-faith basis for the denial established that the insurer did not commit a willful or malicious wrong required to prove bad faith. In addition, Haley didn't produce any contrary evidence to rebut the insurer's position. Consequently, the court dismissed the bad faith claim with prejudice. The breach of contract claims remained and were scheduled for trial.

USAA defended against the breach of contract claims by contending that the insureds were responsible for setting the fires, and therefore coverage was precluded based on both the intentional loss exclusion and the concealment provision in the policy. Anticipating that the insureds would seek to introduce evidence that the state hadn't prosecuted them for criminal arson, USAA filed a motion *in limine*, seeking to prohibit that evidence at trial. The insurer argued that evidence of that sort would be prejudicial to its arson defense in that it would confuse and mislead the jury. The purpose of a motion *in limine* is to allow the trial court to rule in advance on the admissibility and relevance of certain evidence expected to be introduced at trial. Such motions are made when issues likely to arise at trial are complex or fraught with the possibility of prejudice if raised for the first time at trial.

**QUESTION:** When an insurer raises an arson defense will evidence that its insured wasn't prosecuted by the state for the crime of arson be admissible in the civil lawsuit?

**ANSWER:** No. In *Williams v. USAA Insurance Agency, Inc.*, 2022 U.S. Dist. LEXIS 35601 (N.D. Miss., 2022), the court held that evidence of non-prosecution of criminal arson in a civil case seeking insurance proceeds would be unfairly prejudicial to the insurer because the jury could decide the case based solely on the state's decision not to prosecute, rather than basing its

decision on all of the facts of the case. The potential prejudice to the insurer from the improper use of this evidence goes directly to the ultimate issue the insurer must prove to support its defense – that the insureds intentionally set the fire. It is for this reason that evidence of this sort is not admissible.

In support of its motion, USAA cited *Munoz v. State Farm Lloyds of Texas*, 522 F3d 568 (5th Cir. 2008). *Munoz* involved the recovery of funds under a fire insurance policy after the insureds' home burned. While the parties agreed that the fire was intentionally started, the insureds took the position that their neighbors started the fire. The insurer, however, took the position that one of the insureds (Mr. Munoz) was responsible. Over the insurer's objection at trial, the district court admitted evidence of a grand jury's decision not to indict Mr. Munoz. On appeal, the Fifth Circuit reversed:

Several of our sister circuits have considered the issue of introducing evidence of non-prosecution or acquittal of arson in a civil case regarding insurance proceeds. They have uniformly held that such evidence is impermissible because it is highly prejudicial. As the Fourth Circuit stated: "We adopt and apply here the rule that a federal trial court commits reversible error when it permits the plaintiff in a suit for fire insurance proceeds to present evidence of his non-prosecution or acquittal on related criminal arson charges. *Rabon v. Great Southwest Fire Ins. Co.*, 818 F2d. 306 (4th Cir. 1987).

While evidence of this sort may be probative to some extent, it must be balanced against its prejudicial effect and its tendency to confuse and mislead the jury. The court granted USAA's motion in limine based on the cited authorities and its conclusion that the probative value of the evidence was significantly outweighed by its prejudicial effect on the insurer's arson defense. As a result, the court prohibited the plaintiffs/insureds from making reference to, eliciting testimony about, or otherwise alluding to the fact that they had not been criminally prosecuted for arson.

**CONCLUSION:** The rationale for precluding this type of evidence is based on the inherent differences in criminal and civil proceedings. In a criminal trial, the state must prove its case against the defendant beyond a reasonable doubt, which is a very high standard of proof. In contrast, in most states, the insurer can prove a civil arson defense against its insured by a preponderance of the evidence, which is much less onerous than the criminal burden of proof. Under the preponderance of the evidence standard, the insurer only has to prove that its insured more likely than not intentionally set the fire.

The state may have any number of reasons for not proceeding with a criminal prosecution, including the belief that it doesn't have the evidence necessary to satisfy the heavy burden of proof required for a criminal conviction. The state's decision not to criminally prosecute the insured, however, doesn't necessarily mean that the insurer can't prove a civil arson defense by the lesser standard of a preponderance of the evidence. According to most courts, allowing evidence of non-prosecution of criminal arson in a breach of contract claim for insurance proceeds is too likely to confuse the jury in the civil action. These courts have prohibited an insured from eliciting testimony or otherwise alluding to the fact that the insured wasn't criminally prosecuted for arson. The rationale that applies to the inadmissibility of evidence of non-prosecution applies equally to evidence that the insured was prosecuted, but was acquitted of the charges.