

Honesty Still Matters, As Told By *Espedito V. Nat'l Fire*

Law360, New York (August 07, 2013, 12:47 PM ET) -- In "Huckleberry Finn," Mark Twain examined questions of honesty and deceit as his young protagonist sought adventure on the shores of the Mississippi River. Asked about the novel's theme, humorist Twain replied: "If you tell the truth, you don't have to remember anything." Recent case law teaches that policyholders should heed Twain's advice when presenting insurance claims.



Jonathan Mutch *Melissa D'Alelio*

A contract of insurance is premised on the insured's continuous and complete candor with its carrier. To enforce this requirement, insurance policies often provide that a policy will be void if "any" insured at "any" time knowingly misrepresents or omits a material fact or engages in fraud concerning the policy, the subject of the policy or a claim under the policy. Courts will void the insurance policy when an insured fails to uphold its promise to tell the truth.

Recently, in *Espedito Realty LLC v. National Fire Insurance Company of Hartford*, No. 10-CV-30039-MAP, 2013 U.S. Dist. (D. Mass. March 29, 2013), the United States District Court for the District of Massachusetts granted summary judgment to National Fire because the insured misrepresented facts about a claim for lost rental income. The authors represented National Fire, a CNA entity.

Espedito owned a warehouse in Springfield, Mass. Espedito leased space in the warehouse to a tenant, Horizon Sheet Metal. Espedito, through an insurance agent (the FSC Agency), purchased first-party coverage insuring against physical damage to the warehouse and lost rental income. The National Fire policy contained a "misrepresentation" condition similar to that described above.

On March 6, 2009, water pipes in a small office area of Espedito's warehouse burst. Espedito made claim for damage to the interior walls and ceiling of the office area. Months later, Espedito claimed that the accumulated water from the pipe burst caused a portion of the warehouse slab floor to settle.

Coverage for the slab settlement was disputed. Soon after that, a claim was made for lost rental income. Through the FSC Agency, Espedito's claimed that the tenant (Horizon) quit the warehouse and stopped paying rent because of the settled slab.

Detail and specifics matter greatly in any misrepresentation case, but the following summary presents the most critical evidence: During the claim adjustment, FSC informed National Fire by email that Espedito was "now losing rental income as a result of the loss." Days later, FSC emailed National Fire and reiterated that Espedito had "lost the rental income" because the tenant left. Espedito's principal was

copied on that email.

Days later, the FSC Agency emailed with Espedito's principal asking about the "income [Espedito] is losing ... due to your tenant having to leave." That day, FSC reported to National Fire that the lost rent was \$4,150 per month "as the tenant has left due to the loss." National Fire requested documentation of the amount of loss. FSC emailed Espedito's principal, passing along the request.

The next day, FSC sent National Fire a copy of a lease and a modification agreement stating that in 2009 (the year of the loss), monthly rent from Horizon to Espedito would increase to \$4,100 per month. National Fire then advanced \$16,400 on the lost rent claim while the parties sought to resolve the slab settlement coverage issues.

Third-party discovery from the tenant Horizon revealed that the lost rent claim was entirely misrepresented. Horizon never left the warehouse space, although it did make less use of it. Horizon never stopped paying rent, although it did reduce its rent several times, both before and after the claimed slab settlement.

Indeed, ledgers and check stubs showed that Horizon consistently paid the (reduced) rent on time. Horizon never paid \$4,100 per month in rent. Lower amounts were agreed to after execution of the lease and modification agreement and then again three months after the loss.

Finally, National Fire learned that the lease and modifying agreement — documents sent to National Fire as proof of the amount of monthly rental loss — were void even before they were sent. By letter sent in 2008, Horizon terminated the lease at the conclusion of 2008; the parties subsequently agreed to a month-to-month agreement at reduced rent amounts. The termination letter was never given to National Fire during the adjustment.

National Fire amended its pleadings to raise the "misrepresentation, concealment and fraud" condition and moved for summary judgment voiding the policy on that condition. In granting that motion, the U.S. District Court for the District of Massachusetts ruled that Massachusetts law requires a carrier to prove three elements in order to apply that condition: that a misrepresentation exists, that it was material and that the insured acted intentionally in misrepresenting the material fact presented to the insurance company.

The Espedito decision illustrates that summary judgment for an insurer on a misrepresentation defense, although not common, is appropriate where the evidence is clear.

As to the first element, the court found the evidence compelling — there was no doubt that misrepresentations were made to National Fire regarding the status of Horizon as tenant and the true amount of its monthly rental obligations.

The court reiterated an important principle of law when addressing the second element, materiality. The insured did not contest that issues of the amount of rent and whether or not Horizon had left the warehouse were material to a claim for lost business income.

The insured argued, however, that National Fire only made an "advance," and there was no final adjustment of the lost rent claim. Therefore, the insured argued, materiality presented an issue of fact.

In rejecting that argument, the court explained that even if National Fire had to compensate Espedito, to some extent, for the lower rents paid after the claimed slab settlement, and even if Espedito did not, ultimately, intend to secure more than it was due, Massachusetts law is clear that the

misrepresentations were material as a matter of law.

On the third element, intent, the clarity, character and number of misrepresentations allowed the court to establish this element without need for a trial: “This was not a question of valuing losses, of which reasonable minds might differ. ... Neither was it a question of credibility, where one witness was disputing another.”

The court also stressed that the false statements Espedito made to National Fire were made repeatedly, over an extended period of time, and persisted despite ample opportunities for Espedito to set the record straight.

The Espedito decision reaffirmed another important principle: An insured may not shield itself by passing material misrepresentations through a third party such as an insurance agent. Espedito argued that its intent could not be determined on summary judgment because most communications at issue were made by the FSC Agency.

The court rejected this argument: “Courts are obliged to bear in mind that the misrepresentation of an insured’s agent are attributable to the insured. ... Any other rule would facilitate the circumvention of policy provisions by permitting the insured to completely delegate the claims process to a third party whose acts may be disavowed.”

In awarding summary judgment to National Fire and voiding the insurance policy, the court concluded: “Where an insured intentionally misrepresents the loss suffered, whether in pursuing a payment he is not entitled to, trying to obtain a faster resolution of his claim, or seeking an advantage in negotiations, the policy is void.”

The Espedito opinion merits study for its thoroughness and treatment of several important principles of law. But in its outcome, it is not an outlier. The cases set out below are examples drawn from just the preceding six months. They show that a lack of candor to the court has dire consequences for an insured.

In one recent case, a policy covering multiple insureds was voided in its entirety — as to all insureds — where only one insured misrepresented material facts. *Mon Chong Long Trading Corp. v. Travelers Excess and Surplus Lines Co.*, 1013 U.S. Dist. (S.D.N.Y. June 27, 2013) (one member of family business misrepresented damage caused by Hurricane Irene; court found insurer may void the policy as to all named family member insureds on the policy).

Next, while the Espedito decision teaches that a large number of misrepresentations constitutes evidence of the intent element, even a single instance of fraud can void a policy. *Wingz and Thingz Inc. v. Penn-Star Insurance Co.*, 2013 U.S. Dist. (E.D.Mich. Feb. 1, 2013) (insured’s statements under oath directly contradicted statement made in an affidavit regarding the amount of repair costs; court found that insured violated the fraud provision and voided the policy).

Finally, candor with the company is also required before the policy issues. Material misrepresentations during the application and underwriting process, well before any claim materializes, will void the policy. *Meah v. A. Aleem Construction Inc.*, 963 N.Y.S.2d 714 (April 24, 2013) (insured’s application stated that he would perform no “roofing” work or work at heights over two stories; at time of accident, insured’s employees were performing work on a roof six stories above ground; court voided the policy); *Jackson v. Peerless Ins. Co.*, 2013 U.S. App. (11th Cir. May 17, 2013) (insured’s application misrepresented that the insured home was a primary residence with an existing policy; court voided the policy).

At one point, Mark Twain's appealing and sympathetic Huck Finn declares: "Ask me nothing — then I won't have to tell no lies." Huck's suggestion did not prove workable even for him. It clearly is no solution to anyone contemplating applying for insurance or making a claim.

Policyholders should be certain that their material representations, and those of their agents and any co-insureds, are accurate. The misrepresentation, concealment and fraud condition is central to the bargain of an insurance contract, and the consequence for its breach is dire: Misrepresenting facts, even stretching truths in an attempt to gain a perceived negotiating advantage, can result in the forfeit of insurance.

--By Jonathan Mutch and Melissa D'Alelio, Robins Kaplan Miller & Ciresi LLP

Jonathan Mutch is a principal at Robins Kaplan in the insurance and catastrophic loss litigation group. His practice focuses on advising and representing property and liability insurers in complex, large loss insurance and reinsurance matters and inspection and engineering liability issues. Melissa D'Alelio, an attorney at the firm, also focuses on counseling and representing property and liability insurers in complex coverage and large loss matters, as well as in bad faith litigation.

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