

DEFENDING THE INSURED UNDER THE COMBINATION SAFE DEPOSITORY POLICY

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I. INTRODUCTION

Banks and other financial institutions often provide facilities to their customers for the safe keeping of valuables. These facilities, usually safe deposit boxes, are typically located in a vault. Access to the vault is restricted, and each box requires two keys to withdraw. One key is retained by the Bank, and one key is given to the customer renting the box. A system of sign-in cards restricts access to the box, so even if someone else has possession of the key, he or she should not have access to the box.

Since the Bank does not normally know what a customer has put in his or her safe deposit box, it has an unknown exposure if it is found to be liable for the loss or destruction of the customer's property. The Bank can protect itself against this exposure in three ways.

First, it can have facilities and procedures which minimize the chance of theft or destruction of the customer's property. Concrete and steel vaults, combination locks, alarm systems, water and smoke detectors and security cameras all help to prevent the theft or destruction of safe deposit box contents. At least equally important are procedures to assure that only the box holder is given access to the box. Perhaps most important, however, is that Bank employees follow these procedures. The Bank is unlikely to prevail against a plaintiff who can prove that the Bank's established procedures, if followed, would have prevented the loss.

Second, the Bank can seek to limit its liability by contract with its customer. There are, however, two countervailing considerations. A customer rents a safe deposit box to keep his or her property safe. If the Bank disclaims all responsibility or liability, the customer has far less reason to rent the box in the first place, and the renter may well be a customer of other bank services. The Bank has a business incentive not to try to disclaim all liability in the safe deposit agreement.

In addition, many states, by statute or case law, limit the enforceability of such disclaimers. In most, but not all, jurisdictions, a total disclaimer is unenforceable but a reasonable contractual limitation of the Bank's liability is permitted. For example, a contractual limitation to loss caused by the Bank's lack

of ordinary care or to a reasonable dollar limit or to loss of certain types of property have been enforced.

Third, the Bank can purchase insurance to protect itself against liability for loss or destruction of customer's property kept in safe deposit boxes. The Surety Association of America's Combination Safe Depository Policy ("CSD Policy") provides such coverage and will be discussed in this article. Some companies, however, combine such safe deposit liability coverage in a package policy which also provides fidelity, forgery and D&O Coverages. Other companies have proprietary "all risks" safe deposit coverages which are more liberal than the CSD Policy.

II. COVERAGE UNDER THE COMBINATION SAFE DEPOSITORY POLICY

The CSD Policy's two Insuring Agreements provide that the Insurer agrees:

(A) To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay by reason of liability for loss of Customers' Property.

The Company also agrees to:

(1) investigate all claims against the Insured for such loss of Customers' Property and defend any suit against the Insured alleging loss and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless, false or fraudulent; but the Company shall not, without written consent of the Insured, settle any claim or suit except by payment of judgment finally rendered against the Insured;

(2) pay, in addition to the applicable Limit of Insurance stated in the Declarations:

(a) all expenses incurred by the Company, all costs taxed against the Insured in any such suit and all interest on the entire amount of any judgment therein which accrues after entry of the judgment and before the Company has paid or tendered or deposited in court that part of the judgment which does not exceed the limit of the Company's liability thereon;

(b) premiums on appeal bonds required in any such suit and premiums on bonds to release attachments for an amount not in excess of the applicable Limit of

Insurance of this policy, but without any obligation to apply for or furnish any such bonds;

(c) all reasonable expenses, other than loss of earnings, incurred by the Insured at the Company's request.

LOSS OF CUSTOMERS' PROPERTY; PREMISES DAMAGE

(B)(1) To pay for loss of Customers' Property by Burglary or Robbery or attempt thereat for damage to or destruction of Customers' Property, provided such loss is included in the Insured's proof of loss.

(2) To pay for damage to the premises and all furnishings, fixtures, fittings, equipment, safes and vaults therein by Burglary or Robbery or attempt thereat or by vandalism or malicious mischief, provided the Insured is the owner thereof or is liable for such damage.

Unlike other fidelity and crime coverages, the CSD Policy obligates the Insurer to defend the Insured. This is an important part of the coverage, and most litigation involving the CSD is between the Bank, being defended by the Insurer, and the claimant rather than between the Insurer and the Bank.

The CSD Policy, however, is not unlimited. Under Insuring Agreement (A), the Insurer agrees to pay sums for which the Insured is *legally liable*. The Insured, however, may want to pay for a customer's loss even if it has a legal defense. If it does so without the Insurer's agreement, it cannot recover the resulting loss under the CSD Policy.

In *Michigan National Bank v. St. Paul Fire & Marine Ins. Co.*, 566 N.W. 2d 7 (Mich. App. 1997) the Bank lost or destroyed the customer's safe deposit box in re-locating a branch office. The Bank paid the customer's full loss of \$173,323. The contract between the Bank and the customer, however, limited the Bank's liability to \$10,000. The Court of Appeals held that St. Paul owed the Bank only \$10,000 because that was the limit of the Bank's legal obligation. The Court rejected the Bank's argument that the limitation of liability clause in its own form safe deposit box lease was void as against public policy.

This case illustrates a dilemma faced by some Banks. If a Bank limits its liability and then wants to pay the entire loss for business reasons, it will not be entitled to indemnification under the CSD Policy. On the other hand, if the Bank does not limit its liability, or if the limitation is unenforceable, it will have higher loss experience and, thus, higher insurance premiums. The Bank or the Insurer will

have to pay customers when the Bank has no business reason to pay because the Bank did not exercise its right to limit its liability contractually.

III. THE BANK'S DEFENSES AGAINST THE CUSTOMER'S CLAIM

In most safe deposit box losses, the dispute is between the Bank and Insurer on one side and the claimant on the other. This Article addresses the issues in such disputes from the point of view of the Insurer conducting the Bank's defense. It assumes that there is coverage under the CSD Policy.

A Bank leasing a safe deposit box to its customer does not become an insurer of the property which the customer places in the box. Unless it provides otherwise by contract, the Bank is not strictly liable to return the property without regard to the cause of the loss. Instead, the relationship of the Bank and its customer is one of bailee and bailor in regard to property stored in the box.

11 Am. Jur. 2d, Banks and Financial Institutions § 1013, p. 143 states:

The prevailing rule appears to be that where a safe-deposit company leases a safe-deposit box or safe and the lessee takes possession of the box or safe and places therein his securities or other valuables, the relation of bailee and bailor is created between the parties to the transaction as to such securities or other valuables; the fact that the safe-deposit company does not know, and that it is not expected that it shall know, the character or description of the property which is deposited in such safe-deposit box or safe does not change that relation.

(Footnote omitted).

In *Paehler v. Union Planters National Bank, Inc.*, 971 S.W. 2d 393 (Tenn. App. 1997) the Court stated:

The rental of safe deposit boxes by banks creates a bailment relationship between the bank and the customer that is governed by the application of common law and statutory bailment principles.

Barclift v. American Savings Bank, 577 N.Y.S. 2d 573 (Sup. Ct. 1991) states:

The relationship of a bank to the lessee of a safe deposit box is generally considered to be that of bailee to bailor with the bank responsible for loss due to its negligence in the absence of a different agreement . . .

As a bailee, the bank is liable for loss or damage caused by its own negligence. *Goldbaum v. Bank Leumi Trust Co. of New York*, 545 F.Supp. 1008 (S.D.N.Y. 1982) states:

Bank Leumi is responsible to the plaintiff for any negligent loss or damage to the contents of the safety deposit boxes unless the parties agree upon an alternative standard of liability.

The customer establishes a *prima facie* case by showing that he or she placed the property in the safe deposit box and that the Bank has failed to return it or has returned it in a damaged condition. The Bank has to explain the cause of the damage or disappearance. The customer then must show that the cause was through the fault or negligence of the Bank. *Sun You Ko v. Lincoln Savings Bank*, 473 N.Y.S. 2d 397 (App.Div. 1984).

The Courts articulate the test to determine whether the Bank was negligent in three ways. Some require that the Bank exercise the same degree of care which an ordinary, prudent person would use to safeguard his or her own property. Others look to the safeguards used by comparable banks to protect customers' property. Other cases examine whether the Bank has protected the customer's property with the same degree of care that is used to protect its own property. If the safe deposit box rental contract establishes a reasonable standard, the Court will generally employ it.

The use of these tests to determine negligence is illustrated by a comparison of four cases in which burglars broke into the Bank's vault and stole customers' property from safe deposit boxes. In *C.D. Morgan v. The Citizens Bank of Spring Hope*, 129 S.E. 585 (N.C. 1925) the burglars blew the door off the Bank's vault with high explosives. The vault was reinforced concrete with a steel door and combination locks, and it was properly locked up for the night.

The Court affirmed a judgment for the Bank at the close of all the evidence and stated:

There was also evidence that the equipment used by defendant was of recognized standard make, and reasonably safe, in the

opinion of expert bankers; that said equipment was the same used by banks in towns of like population as Spring Hope; that the safety deposit boxes of defendant were of standard make and similar to those used in banks located in larger towns.

There was no evidence to the contrary. The facts established by all the evidence are undisputed. The inference of negligence arising from the failure to return the bonds upon plaintiff's demand is rebutted. The only inference to be drawn from all the undisputed evidence is that the failure to return the bonds was due to the burglary, and that said burglary was not the result of the negligence of defendant.

In *Moon v. First National Bank of Benson*, 135 A. 114 (Pa. 1926) the burglars gained access by cutting an iron bar at a window and drilling a hole above the lock in the steel outer door of the vault. The Court affirmed a verdict for the customer and stated:

The safe in which the bank kept its money and securities was not disturbed, and the only valuables taken were such as were found loose in the vault and those contained in the boxes of depositors, which were forced open by the burglars.

As tending to show lack of reasonable care, plaintiff offered evidence that the bank employed no watchman; that, while the building was electrically lighted, a light was not kept burning during the night; that the building was not equipped with a burglar alarm system; that the middle door of the vault had been left unlocked; that the inner gate could be unlocked by merely reaching between the rods, and that neither door of the vault was burglar proof.

Under the conditions indicated by the foregoing testimony, the court below properly charged that defendant owed to plaintiff the duty of exercising such care as ordinarily careful and prudent persons would exercise in the same or similar business, and that if the jury found defendant failed to exercise such care, plaintiff was entitled to a verdict for the amount of his loss.

In *United Farmers Bank v. Brent*, 505 S.W. 2d 760 (Ky. 1974) the rental agreement provided that the Board would "exercise the same diligence" in protecting the safe deposit box as it used in protecting its own property but

otherwise disclaimed liability. The vault had a steel door but only brick and mortar walls. An addition at the rear of the vault had reinforced concrete walls and a steel door, although the wall between it and the vault was only brick and mortar. The burglars broke through the brick and mortar wall of the vault.

The bank kept its own property in the new addition. Although the court did not doubt that the burglars could have broken into the addition from the vault, it would have taken more time and effort. It concluded that the bank gave its own property more protection than its customers', and thus breached the contract.

Finally, in *Hill v. Austed Bank*, 123 S.E. 417 (W.Va. 1923) the bank kept its own property in a steel safe inside a vault but the customer's property outside of the safe in the non-burglar-proof vault. The court affirmed a judgment for the customer on the theory that the bank did not meet the standard of treating the customer's property with the same degree of care it used for its own similar property.

In modern cases, it is less likely that burglars will have broken into the bank's vault. Most cases involve an allegation that the bank has negligently allowed someone to access the customer's safe deposit box or negligently allowed the contents to be damaged.

If the customer's only evidence is his or her own word that the property is missing and the bank can show that it has procedures to prevent unauthorized access and that the procedures were followed, the bank should prevail. In *Hurt v. Bank One Dayton*, 718 N.E. 2d 485 (Ohio App. 1998), the court affirmed summary judgment for the bank. The Bank showed it had reasonable procedures, and the plaintiff was unable to establish any facts to support a reasonable inference that the bank did not exercise ordinary care. The court stated:

Were we to hold otherwise, the institution would clearly be in the position of an insurer of the contents of all the safe deposit boxes and open to unlimited claims based upon customers' uncorroborated claims that contents of safe deposit boxes were missing. The institution would have to be found negligent any time contents of safe deposit boxes were alleged missing, and that is not the law.

In *Paehler v. Union Planters National Bank*, *supra*, the court affirmed summary judgment for the bank because the plaintiff established no facts to support her belief that property was taken from her late husband's safe deposit box. In *Cash*

v. Minnequa Bank of Pueblo, 426 P.2d 767 (Colo. 1967), the plaintiff recovered a jury verdict and the trial court granted a new trial. The plaintiff elected not to participate in the second trial and judgment was directed against him. The issue on appeal was whether the original jury verdict should be reinstated.

The bank kept sloppy records, but there was no evidence that any of the plaintiff's property could have been stolen. The court noted that it would be an invitation to fraud to allow a box renter to recover on his uncorroborated testimony that property had disappeared without requiring proof of negligence by the bank.

On the other hand, if the bank does not have procedures to limit access to the safe deposit box, or does not follow them, it invites a finding of negligence and, hence, liability. See, for example, *Becker v. BancOhio National Bank*, 478 N.W. 2d 776 (Ohio 1985). Once the bank is found to be negligent, of course, it in many ways is a sitting duck on damages.

Two recent cases in which the authors represented banks illustrate the problems a negligent bank can expect to face. In one case, a husband and wife jointly rented a safe deposit box, and the wife separately rented another box at the same branch office. The husband and wife then returned to their own country, and the husband allegedly obtained a divorce. While the wife was outside of the United States, the husband appeared at the branch bank, signed the card for the wife's separate safe deposit box, and was allowed to open it with the box holder's key.

The wife alleged that the key was used without her permission and that over \$350,000 of jewelry was stolen from the box. She had receipts and photographs to establish that she owned a substantial amount of jewelry, but she and her former husband continued to live in the same city, and she had not attempted to recover the allegedly missing jewelry from him.

In the second case, the box holder lost her key which was found and turned in to the Bank. The Bank's employees put it in a desk drawer, and several weeks later the box holder claimed it. At that time, she said nothing was missing from the box, but several months later she alleged that a very valuable coin collection was missing. Her theory was that an unknown Bank employee had made a copy of the key.

There was no evidence to support this supposition or to corroborate the testimony of the box holder and her husband that the coins ever existed. On the other hand, the Bank had not followed procedures to safeguard the key after it was found or adequately to control access to the safe deposit boxes.

Both of these cases eventually settled. They illustrate, however, that proper procedures, carefully followed, are a Bank's only secure line of defense. Once that line is breached, the Bank and its Insurer are exposed to unknown claims which may or may not be fraudulent.

Subject to restrictions of state law, Banks can attempt to limit such exposure by contract. In *FDIC v. Carre*, 436 So.2d 227 (Fla. App. 1983) the Court enforced a partial exculpatory provision in the rental agreement which limited the Bank's liability to loss caused by its own gross negligence, fraud or bad faith. In *Eller v. NationsBank of Texas, N.A.*, 975 S.W.2d 803 (Tex.App. 1998) the Court enforced a very broad release clause as absolving the Bank from liability for its own alleged negligence. There was no proof of such negligence, however, except the uncorroborated allegation of the customer that property was missing.

The danger of placing too much reliance on a disclaimer of liability is illustrated by *Goldbaum v. Bank Leumi, supra.*, in which the customer's property was damaged by water from a malfunctioning fire sprinkler system. The rental contract disclaimed liability for water damage, and the Bank did not put on evidence explaining the sprinkler malfunction or contesting the plaintiff's valuation of the damages. The Court interpreted "water" in the context of the disclaimer clause to mean only water from natural sources. The Court found that the Bank had failed to rebut the customer's *prima facie* case of negligence by the Bank and awarded the amount claimed.

IV. CONCLUSION

A Bank's best defense to a claim for loss of or damage to the contents of a safe deposit box is to have facilities and procedures (in theory and in practice) which prevent a loss. While this will not prevent fraudulent claims, it will help to defeat them.

If a Bank's employees do permit unauthorized access to a safe deposit box, the Bank and its Insurer are exposed to unknown legitimate claims as well as to fraudulent ones. Contractual limitations are unreliable and can undermine insurance coverage pursuant to the CSD Policy. As in many other human endeavors, it is less expensive to take reasonable steps to prevent or minimize losses than to pay for them after they happen.