

**The ARecords® Condition
of First Party Property Policies
A Little Used Fraud Fighting Tool**

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Many first party property policies, and almost all inland marine policies, contain a records clause or warranty that require that the insured maintain sufficient records to prove the amount of his loss. All records clauses are called Airon safe clauses® because they originally required that the records be locked in a Afire proof iron safe.® The requirement for an Airon safe® is disappearing because of the ability to store records electronically off site.

A common form of iron safe clause will provide:

A 1. The insured will take a complete itemized inventory of stock on hand at least once in each calendar year and, unless such inventory has been taken within twelve calendar months prior to the date of this policy, one shall be taken in detail within 30 days of issuance of this policy, or this policy shall be null and void from such date, and upon demand of the insured the unearned premium from such date shall be returned.

A2. The insured will keep a set of books, which shall clearly and plainly present a complete record of business transacted, including all purchases, sales and shipments, both for cash and credit, from date of inventory, as provided for in first section of this

clause, and during the continuance of this policy

A 3. The insured will keep such books and inventory, and also the last preceding inventory, if such has been taken, securely locked in a fireproof safe at night, and

at all times when the building mentioned in this policy is not actually open for business; or, failing in this, the insured will keep such books and inventories in some place not exposed to a fire which would destroy the aforesaid building.

AIn the event of failure to produce such set of books and inventories for the inspection of this Company, this policy shall become null and void, and such failure shall constitute a perpetual bar to any recovery thereon.@ [As quoted in *Burchfield V. United States Fidelity & Guaranty Co.*, 238 Miss. 416 (Miss.03/14/1960)]

The Mississippi Supreme Court held, since the records required we not protected in a fire proof iron safe:

The destruction or theft of books and papers required by a policy of insurance to be kept or produced will excuse a noncompliance with requirement if due to no fault or design of the insured. If, however, *the*

destruction of such papers is due to the negligent failure of the insured to preserve them as required by the policy, his failure to produce them in accordance with the requirement of the policy will preclude any recovery thereon. >In the footnote to this statement there is again cited the said case of *Joffe v. Niagara Fire Insurance Company, supra.* >Furthermore, if no such books and inventories are kept as are required by a fire insurance policy, the loss of those which were kept will not excuse the failure of the insured to meet the requirement.=

The Supreme Court of Washington found that A[T]he requirement [to maintain an inventory and books and records] as a matter of law is not fulfilled when the books present a record of values only that are added and taken away. The object of having an itemized inventory and of keeping in the course of business a record of property added and taken away 'was not to ascertain the gross value of the property insured, but to ascertain the different articles which went to make up the stock in order that the insurance company might test the correctness of the claim' of the assured.@ [*Georgian House of Interiors Inc. v. Glens Falls Insurance Co.*, 21 Wash. 2d 470, 151 P.2d 598 (Wa. 09/07/1944)]

In Kentucky the Court of Appeal, even though it found a waiver of the condition, held:

When we resort to the decisions of other jurisdictions, however, we find that virtually every

court, state or federal, that has considered this precise question has decided almost without exception that the books and records themselves must accurately supply the necessary information without the aid of oral testimony except to explain the method of keeping them. We could cite many cases on this well established rule of law but, for the sake of brevity, we refer to the Annotations of 39 A.L.R., p. 1457, 62 A.L.R., p. 636 and 125 A.L.R., p. 358, for a collation of cases on this point. Appleman's Insurance Law and Practice, Vol. 5, Sec. 3024, p. 105, interprets the iron safe clause applicable to the issue here as follows: 'Under such a warranty, (the iron safe clause), the books themselves must generally provide the data desired without the need of resorting to extraneous sources. *It is not considered desirable that such information be supplemented by the memory of an interested party, so that the insured's testimony is generally not considered admissible thereon.* And it is also the rule that parol testimony will not be allowed for any purpose other than to explain the manner or system of keeping such records although the assistance of those understanding the system will not, of course, be spurned for the purpose mentioned.'

[*Westchester Fire Ins. Co. v. Gray*, 240 S.W.2d 825 (Ky.App. 06/19/1951)] (Italics only)

Many jurisdictions have allocated to the insured the burden of proving compliance with a promissory warranty which gave rise to a condition precedent to recovery. In *Cooper v. Ins. Co.*, 98 W. Va. 655, 127 S.E. 511 (1925), the West Virginia Supreme Court of Appeals held that it was the insured's burden of proof to show compliance with an iron-safe clause warranty, since the insurer had specified a failure to comply with the warranty as defeating recovery. The Missouri Court of Appeals has also held that the burden is on the insured to show compliance with an iron-safe clause when the insurer's answer denies the insured's allegation of full performance of conditions precedent. [*Pruzan v. National Surety Corporation*, 223 S.W.2d 8 (Mo. App. 1949); *Johnson v. Fire Ins. Co.*, 120 Mo. App. 80, 96 S.W. 697 (1906).]

Moreover, the Delaware Supreme Court has held that a bookkeeping provision is a promissory warranty, and the insured must show at least a substantial compliance to recover under the insurance policy. [*Std. Acc. Ins. Co. v. Ponsell's Drug*, 57 Del. 485, 202 A.2d 271 (1964); *Insurance Co. vs. Rosenberg*, 23 Del. 174, 74 A. 1073 (1909); *Travelers Fire Insurance Co. v. Frady.*, 180 F.2d 339 (4th Cir. 02/25/1950); *Continental Ins. Co. v. Thrash*, 1955, 223 Miss. 344, 78 So.2d 344; *National Surety Co. v. Earl Park State Bank*, 63 F.2d 825 (7th Cir. 03/25/1933). See, also, *Rehburg v. Constitution States Ins. Co.*, 555 So. 2d 79 (Ala. 1989) (endorsement in liability policy requiring insureds' pool be fenced and locked was promissory warranty and condition precedent to recovery); *Alaska Foods, Inc. v. American Mfr.'s Mut. Ins. Co.*, 482 P.2d 842 (Alaska 1971) (monthly reporting provisions in fire insurance policy are conditions precedent to liability under policy); *Jonette Jewelry Co. v. Liberty Mutual Ins.*, 105 R.I. 308, 251 A.2d 521 (1969) (recordkeeping provision was condition precedent to liability of defendant insurer); *Damron v. Fireman's Fund Insurance Company*, 430 S.W.2d 956 (Tex. Civ. App. 1968)

(provisions in jeweler's block policy requiring itemized inventory was promissory warranty and condition precedent to recovery); *Great American Insurance Company v. Lang*, 416 S.W.2d 541 (Tex. Civ. App. 1967) (provision in theft policy requiring jewelry store owner to keep percentage of insured property in safe was promissory warranty and condition).] The Supreme Court of Nebraska found that lack of sufficient records were also found to be grounds for denial of claim in *Thomas L. Coppi v. West American Insurance*, 524 N.W.2d 804, 247 Neb. 1 (1994). Bookkeeping provisions of the iron safe clauses of fire insurance policies were found by the Tennessee Supreme Court in the case of *Hughes v. Aetna Insurance Company*, 1923, 148 Tenn. 293, 255 S.W. 363, fair and reasonable and necessary to protect the insurer against the fallibility or dishonesty of the insured; that expert bookkeeping was not required but such books should be kept as would show fairly to a man of ordinary intelligence the amount of the loss. The Tennessee Court of Appeal ruled similarly in *Mabry v. Hartford Insurance Co.* (1941), 26 Tenn. App. 463, 173 S.W.2d 169 and *Sam Joseph Sciara d/b/a v. the Fidelity & Casualty* 362 S.W.2d 935, 50 Tenn. App. 608 (1961).

The US Supreme Court analyzed an iron safe clause as follows:

Turning now to the words of the policies in suit, what is the better and more reasonable interpretation of those provisions so far as they relate to the issues in this case? The convenient and agreement 'to keep a set of books showing a complete record of business transacted, including all purchases and sales, both for cash and credit, together with the last inventory of said business,' should not be interpreted to mean

such books as would be kept by an expert bookkeeper or accountant in a large business house in a great city. That provision is satisfied if the books kept were such as would fairly show, to a man of ordinary intelligence, 'all purchases and sales, both for cash and credit.' [*Liverpool & London & Globe Insurance Co. v. Kearney*, 180 U.S. 132, 21 S. Ct. 326, 45 L. Ed. 460.]

Where an insured is in business in a little country town in Florida, and his books, kept in most primitive style, were far from being what a good accountant would consider a complete set of books, if the insured kept a set of books which were as good as ordinarily kept in such a store and business, and exercised good faith in the matter, his policy was not avoided merely by the fact that the books were not what an expert would consider a complete set of books. When the insured's books are kept in the manner customary with merchants like the insured, and as elaborate and complete as is usually the case in stores of like character, it is sufficient.

In the encyclopedia, *Corpus Juris Secundum* at 45 C.J.S., Insurance, ' 658, p. 577, we find: **A**It is sufficient if the books and records are such that, with the assistance of those who kept them, or understood the system, the amount of the loss can be ascertained, or if a jury, as practical men, can determine the loss from the books and accounts. **@**

'Such a provision must be given a reasonable interpretation, consistent with its design to protect insurer against fraudulent and excessive claims, and

in view of the character of the business and the circumstances connected with it. A substantial compliance therewith is sufficient. No particular form of books is required; the requirement is satisfied if the books and records produced are sufficient to show the real state of facts and to enable insurer to determine with reasonable accuracy the amount of its liability, and the books need not be such as to enable insurer to ascertain the exact articles stolen and the price thereof. Absolute accuracy, or such a system of bookkeeping as would satisfy an expert accountant, is not required; yet there must be sufficient written evidence to enable a person of ordinary intelligence familiar with accounts, to determine with accuracy the extent of the liability, without the supplying of essential details from the memory of an interested party. It is sufficient if the books and records are such that, with the assistance of those who kept them, or understood the system, the amount of the loss can be ascertained, or if a jury, as practical men, can determine the loss from the books and accounts.' [*Joseph Pelitsie D/b/a Joe's Pin up Bar v. National Surety Corporation of New York et al.*, 76 N.W.2d 327, 272 Wis. 423 (04/03/56)]

The Supreme Court of North Dakota found clear a charge to a jury explaining the effect of the breach of an iron safe clause. It stated:

Appellant says the court erred in instructing the jury as to some of the conditions of the insurance, when the court read the provisions to the jury, particularly the provisions requiring the taking of an inventory at least once every twelve months, and the keeping of a set of books, etc., in an iron safe. The court charged the jury that the plaintiff had to comply with these provisions, and the policy would be void in case she did not. ... The court proceeded to instruct the jury as to what constituted forfeiture, and that the forfeiture provisions were for the benefit of the insurer, and could be waived. The court also instructed as to waiver of the non-waiver agreement and the waiving of the stringent requirements, regarding the notice of loss, proof of loss. ... After reading the whole charge we find that the court fairly and fully presented such features to the jury, and that the verdict has support in the evidence. [*F. R. Griffin v. Implement Dealers Mutual*, 250 N.W. 780, 64 N.D. 146 (1933)]

The Supreme Court of Virginia stated:

We need not go afield for the construction of this provision. In *Hartford Fire Ins. Co. v. Farris*, 116 Va. 880, 83 S.E. 377, 379, the court said: 'The iron safe clause' has been over and over again dealt with and approved in the decisions of this court as fair

both to the insurer and the insured, and it has been held that the former has the right to insist on a compliance with this provision of the policy, for the reason that the insured contracted to do so, and that the conditions are reasonable and if the assured were not. [*Continental Insurance Co. v. Peed*, 178 S.E. 800, 164 Va. 69 (Va. 03/14/1935)]

Breach of the iron safe warranties precludes any right to recover under a policy of insurance. *Central Manufacturers Mut. Ins. Co. v. Rosenblum*, 180 Miss. 485, 177 So. 909; *Gershon v. North River Ins. Co.* (La.), 148 So. 10; *Hartford Fire Ins. Co. v. Adams* (Tex.), 158 S.W. 231; *Lewis v. National Fire Ins. Underwriters*, 136 Miss. 576, 101 So. 296; *National Fire Ins. Co. v. Patridge*, 162 Miss. 62, 139 So. 876; *Pennsylvania Fire Ins. Co. v. Malone* (Miss.), 115 So. 156, 56 A.L.R. 1075; *Phenix Ins. Co. v. Dorsey*, 102 Miss. 81, 58 So. 778; *Phoenix Ins. Co. of Hartford v. Bourgeois*, 105 Miss. 698, 63 So. 212; *World Fire & Marine Ins. Co. v. King*, 187 Miss. 699, 191 So. 655; *Wright v. Union Ins. Co. of Indiana*, 13 Fed. 2d 612; Anno. 56 A.L.R. 1086.

The United States Supreme Court explained that the Airon safe@ clause must be read in practical reality and not literally. Although an inventory required by the policy was not produced after the fire, coverage was found for the insured because of the following facts: Aa fire accidentally broke out in a livery stable in the town of Ardmore, which was about three hundred yards distant from the plaintiffs' place of business. Efforts to arrest the progress of the conflagration failed, and when it had approached so near to the plaintiffs' place of business that the windows of their store were cracking from the heat and the building was about to take fire, one of the plaintiffs

entered the building for the purpose of removing the books of the firm to a safer place, thinking that it would be better to remove them than to take the chances of their being destroyed by fire. He opened an iron safe in the store, in which they had been deposited for the night, which was called a fireproof safe, and took them there from, and to his residence some distance away. The books consisted of a ledger, a cash book, a day book or blotter, and a small paper-covered book containing an inventory that the firm had taken of their stock on or about January 1, 1895. In the hurry and confusion incident to the removal of the books, the inventory was either left in the safe and was destroyed, or was otherwise lost, and could not be produced after the fire. The other books, however, were saved, and were exhibited to the insurer after the fire, and were subsequently produced as exhibits on the trial. There was neither plea nor proof that the loss of the inventory was due to fraud or bad faith on the part of plaintiffs, or either of them.® The Supreme Court, faced with such facts, provided the rule for all future interpretations of Airon safe® clauses, when it held:

If, in selecting a place in which to keep their books and last inventory, the insured acted in good faith and with such care as prudent men ought to exercise under like circumstances, it could not be reasonably said that the terms of the policy relating to that matter were violated. Indeed, upon the facts stated, the plaintiffs were under a duty to the insurance company to remove their books and inventory from the iron safe, and thereby avoid the possibility of their being destroyed in the fire that was sweeping towards their store, provided the circumstances reasonably

indicated that such a course on their part would more certainly protect the books and inventory from destruction than to allow them to remain in the safe. If they believed, from the circumstances, that the books and inventory would be destroyed by the fire if left in the safe, and, if, under such circumstances, they had not removed them to some other place and the books or inventory had been burned while in the safe, the company might well have claimed that the inability of the insured to produce the books and inventory was the result of design or negligence, and precluded any recovery upon the policies. We are of opinion that the failure to produce the books and inventory, referred to in the policy, means a failure to produce them if they are in existence when called for, or if they have been lost or destroyed by the fault, negligence or design of the insured. [*Liverpool and London and Globe Insurance Company v. Kearney*. (01/07/01) 1901.SCT.40005, 180 U.S. 132, 45 L. Ed. 460, 21 S. Ct. 326]

It is settled law in West Virginia that only substantial compliance with the Airon safe@ clause is required, that the provisions requiring an inventory and the keeping of a set of books should be construed together, and that these provisions are satisfied when records are kept from which the extent of the loss by fire can be determined with reasonable certainty, without resort to parol evidence except for the purpose of explaining the entries or the manner in which the records have been kept.[*Kelmenson v. British America Assurance*

Co., 114 W.Va. 379, 171 S.E. 904; *Ruffner Bros. v. Dutchess Ins. Co.*, 59 W.Va. 432, 53 S.E. 943, 115 Am.St.Rep. 924, 8 Ann.Cas. 866.] But it is also well settled that the clause is a reasonable provision of the insurance contract and must be substantially complied with [*Fisher v. Sun Ins. Co. of London*, 74 W.Va. 694, 83 S.E. 729, L.R.A. 1915C, 619, *Scottish Union & Nat. Ins. Co. v. Virginia Shirt Co.*, 113 Va. 353, 74 S.E. 228], and that the insurer has a right to such a compliance with its terms as will inform him during the life of the policy, fairly and intelligently, as to the stock of merchandise carried by the insured, and, in case of loss by fire, as to the stock of merchandise burned and the fair cash value thereof.@ [*Phoenix Ins. Co. v. Sherman*, 110 Va. 435, 66 S.E. 81]

The Fourth Circuit found the iron safe clause violated and affirmed judgment for the insurance company because there only existed a record of a single sale, other records were inaccurate. Since there was not substantial compliance with the requirement the plaintiff did not recover:

In the case of *Lumbermen's Mut. Ins. Co. v. Johnson Lumber Co.*, supra, [53 F.2d 941], the other case particularly relied on by plaintiff, the question held to be for the jury was whether the records presented constituted all the records that insured had and whether they presented, in substantially complete form, evidence from which the state of plaintiff's business could be fairly determined.@ The records presented consisted of invoices and were held to satisfy the general requirements of the rule as to the character which such records should have@. The

court emphasized, however, that the records must be of such character as to furnish a basis for the computation of loss, quoting with approval the following passage from the opinion in *Aetna Ins. Co. v. Johnson*, 127 Ga. 491, 56 S.E. 643, 9 L.R.A., N.S., 667, 9 Ann.Cas. 461: "The purpose of the requirement was that in case of loss or damage the assured would have kept such book accounts of his invoices, purchases, and sales as would show the amount of goods on hand at the time of the fire, and thus furnish data from which to make a reasonable estimate of the loss or damage." As stated above, no records were offered here from which a reasonably correct estimate of the loss or damage could be computed; and as reasonable men could not differ as to this essential fact, a clear case for direction of verdict was presented under the well settled rule with regard thereto.

[*Dickerson v. Franklin Nat. Ins. Co.*, 130 F.2d 35 (4th Cir. 08/18/1942)]

The Eighth Circuit, in *Noland v. Buffalo Ins. Co.*, 181 F.2d 735 (8th Cir. 05/02/1950) upheld the factual finding of the District Court that the records produced by the insured were not sufficiently reliable to comply with the "iron safe" clause and affirmed judgment for the insurance company.

In Louisiana, substantial compliance with the iron safe clause is sufficient, but if that is lacking the policy is defeated. [*Gershon v. North River Ins. Co.*, 177 La. 148, 148 So. 10, 92 A.L.R. 368.] A proper inventory was lacking

in that case. We find no Louisiana case holding that, in a retail store where cash sales are made, a complete record of the cash so received, though it does not indicate what particular goods were sold, is not a substantial compliance as to such sales. The Airon safe@ clause does not expressly require a record which will disclose the identity or the cost of the goods sold. But the cash sales record must be complete. In *Lucille Ladies' Ready-to-Wear v. Glens Falls Ins. Co.*, 168 La. 696, 123 So. 295, 296, the sales tickets from which the books might have been posted were kept in a drawer and many were destroyed by the fire. If the books were unposted for a period of fifteen days before the fire although it appeared otherwise that the loss exceeded the insurance, it was held Athe books which were kept by the assured did not furnish a complete record of the business transacted, and it is well settled that without such record no recovery can be had on an insurance policy containing the standard iron safe clause@. In *La Hood v. National Union Fire Ins. Co.*, 179 La. 213, 153 So. 695, the bank deposit book was relied on to show the amount of cash sales, but the deposit book was held an insufficient record.

The Seventh Circuit, dealing with a reporting clause that required reports of value found that the plaintiffs faithfully filed monthly reports with the defendants, and on March 30, 1967, the plaintiffs filed the report which was then due in the amount of \$528,410.41. However, the amount which should have been reported on March 30 is agreed by the parties to be \$634,507.34; the disparity is stipulated to be largely the result of an unintentional bookkeeping error not made with any intent to defraud. The defendants also stipulated that plaintiffs were following an acceptable and generally accurate procedure in filing the reports of statement of values. Refusing to do violence to an Ahonesty@ clause limiting recovery to the amount reported rather than the actual amount of loss, the Seventh Circuit stated:

In the case before us, the plaintiffs did not comply with the terms of the contract and, contra KEARNEY, this non-compliance affected not only the consideration paid by the insured to the insurer, but also the amount of risk undertaken by the insurer. In this factual setting, we do not believe the law permits us to give the "dishonesty" clause plaintiffs' construction, regardless of the innocence of plaintiffs' error. *Albert v. Home Fire & Marine Ins. Co. of Calif.*, 275 Wis. 280, 81 N.W. 2d 549 (1957); *Peters v. Great American Ins. Co.*, 177 F.2d 773 (4th Cir. 1949); *Anderson Feed & Produce Co. v. Moore*, 66 Wash. 2d 237, 401 P.2d 964 (1965). [*Standard Lumber Co. v. Travelers Indemnity Co.*, 440 F.2d 544 (7th Cir. 03/24/1971)]

The Third Circuit, faced with an insured who had no records showing the dates of purchase of some articles or the sources from which they were purchased concluded that, absent waiver, there could be no coverage:

As was stated by the trial court, absolute accuracy is not required. Nor is it necessary that the records be kept upon such a system of bookkeeping as would satisfy an expert accountant.. *Lumbermen's Mutual Insurance Co. v. Johnson Lumber Company*, 5 Cir., 53 F.2d 940; *Weinstein v. Globe Indemnity Co.*, 277 Pa. 388, 121 A. 316; *Gorson v. Aetna Accident & Liability*

Co., 283 Pa. 558, 129 A. 590. But we are constrained to the belief, none the less, that if the amount of the loss is to be determined accurately and from books or records regularly kept there must be available to the appellant such information as will permit a check of the cost price of the merchandise from sources not entirely dependent upon the good faith of the appellee. *The word "accuracy" as used in the policies is not a word of art. It possesses its usual and ordinary meaning. It signifies merely the state or quality of being accurate, freedom from mistake or error.* In the case at bar, in respect to those items of merchandise for which the appellee cannot supply the name of the vendor or a bill of lading or voucher, we think that it cannot be said that amount of loss can be ascertained with accuracy or from records regularly kept within the terms of the promissory warranty. We think that such is the meaning of the decisions in the Pennsylvania cases cited above. [*Globe Indemnity Co. v. Cohen.*, 106 F.2d 687 (3rd Cir. 06/29/1939)] (Italics added)

The Tenth Circuit, found:

The law does not require the insured to keep and produce the best possible records. It is sufficient if the insured keeps and produces a record from which the amount and value of the insured cotton destroyed can be **A**reasonably ascertained[@]. *Royal Ins. Company v.*

Scratchfield, 51 Okl. 523, 152 P. 97; Mississippi Fire
Ins. Co. v. Perdue, 217 Ala. 292, 116 So. 142, 62
A.L.R. 626. We agree with the trial court that the
proof offered in support of the loss was a substantial
compliance with the policy. [*American Eagle Fire Ins.
Co. v. Peoples Compress Co.*, 156 F.2d 663 (10th Cir.
07/10/1946)]

The iron safe clauses found in most commercial and all inland marine policies issued in the United States and across the world are important tools in the fight against insurance fraud. A person who will perpetrate a fraudulent claim or who will burn down a business to profit from an insurance policy are experts at fraud but know nothing about insurance. If the books and records of the business do not comply with the policy condition **B** and since the claims are fraudulent they seldom will **B** an effective defense without the need to accuse the insured of fraud will protect the assets of the insurer.

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