

**EIGHTH ANNUAL
NORTHEAST SURETY AND FIDELITY CLAIMS
CONFERENCE
NOVEMBER 6TH - 7TH, 1997**

***THE SURETY'S RIGHTS AND REMEDIES AGAINST
THIRD PARTIES FOR NONAUTHENTIC SIGNATURES
ON THE AGREEMENT OF INDEMNITY***

PRESENTED BY:

JAMES J. ROSS, ESQ.
Wolff & Samson, P.A.
280 Corporate Center
5 Becker Farm Road
Roseland, New Jersey 07068
(973) 740-0500

THE SURETY'S RIGHTS AND REMEDIES AGAINST THIRD PARTIES FOR NONAUTHENTIC SIGNATURES ON THE AGREEMENT OF INDEMNITY

I. INTRODUCTION

Most surety attorneys are familiar with the defenses raised by indemnitors in response to an action initiated by the surety to enforce the terms of the Agreement of Indemnity. Typical defenses include the surety's failure to properly investigate a claim, its failure to mitigate damages, payment of a claim or completion of a bonded project over the principal's objection and the generic "bad faith" defense. Each of these "defenses" can usually be overcome by the surety. There is, however, a potentially "bulletproof" defense to the indemnitor's liability which arises with disappointing frequency, which is, "That's not my signature on the Agreement of Indemnity and I don't know how it got there." This paper will address the rights and remedies of the surety and the procedures which should be followed in response to this defense to an indemnity action.

Consider the following hypothetical scenario. The principal defaults on bonds issued by the surety and the surety expends a considerable sum of money to remedy the performance bond default and to satisfy payment bond claims. Having had no response to its request for cooperation from the defaulted principal, much less its demands for exoneration and indemnification, the surety initiates an indemnity action to recover its losses. The Agreement of Indemnity, contains the signatures of three indemnitors, each of which appears to be properly witnessed and notarized. The summons and complaint are served upon all three parties executing the Agreement of Indemnity, including the contractor/principal, and the president of the company and his wife, individually. In her answer to the surety's complaint, the indemnitor wife denies that she ever executed the Agreement of Indemnity. A forensic document examiner retained by the surety confirms that the signature of the indemnitor-wife on the Agreement of Indemnity is, in fact, a forgery. Unfortunately, the wife has sufficient assets to indemnify the surety for the losses incurred on the defaulted bonds. However, the surety has no remedy against her. As a result, the surety is able to obtain judgments only against the defunct contractor/principal and against the president, individually, who is without assets sufficient to satisfy the judgment.

The surety counsel's investigation of the facts surrounding the execution of the Agreement of Indemnity reveals the following. The executed Agreement of Indemnity was provided to the surety by its broker. The surety briefly reviewed the three signatures on the Agreement of Indemnity, each of which appeared to be properly executed, witnessed and notarized, and believed them to be authentic. In reliance upon the authenticity of the signatures on the Agreement of Indemnity, the surety issued the bonds upon which it suffered the losses described above. The broker recalls preparing the Agreement of Indemnity for execution, that is, the broker typed in the names of each of the intended indemnitors in the appropriate location and completed all other information required in the document. The broker then gave the "prepared" Agreement of Indemnity to a third person with instructions to obtain the signatures of the three indemnitors and to have those signatures properly witnessed and notarized. That third person was a "bond producer," that is, someone who is not an employee of the broker but who referred the principal to the broker. The broker maintains that he never met the indemnitors. The bond producer secured the appropriate signatures on the Agreement of Indemnity and returned the executed document to the broker. The broker reviewed the

executed document and, like the surety, believed all of the indemnitor signatures to be authentic, since each was witnessed by the bond producer and each was also notarized. The broker then transmitted the executed Agreement of Indemnity to the surety.

The bond producer recalls witnessing the signatures of only two of the parties on the Agreement of Indemnity, those being the principal/contractor and the president, individually. He denies executing the Agreement of Indemnity as a witness for the wife's signature. He maintains that when he received the document from the broker, it was prepared for execution by only two parties, the principal/contractor and the president, individually. He claims that he obtained those signatures, witnessed them and returned the document to the broker with only those two witnessed signatures. The bond producer has no idea how the signature of the third indemnitor was obtained on the Agreement of Indemnity, maintaining that his signature witnessing the wife's signature is a forgery. The bond producer cannot recall whether the two signatures which he witnessed were notarized before he sent the document to the broker.

The notary cannot recall anything about notarizing this particular document. She confirms that her notary stamp and signature for each of the three indemnitor signatures on the document is authentic. She concedes that she has never been to Cape May County, New Jersey, the location where the document was executed according to the notary certification. However, she maintains that she never notarizes a signature unless the document is executed in her presence. She also claims that she always requires the signer to present her with proper identification.

Based upon the above investigation, the surety's attorney amends his pleadings to include claims against the broker, the notary and the bond producer. The remainder of this paper will address the surety's rights and remedies with respect to those parties.

II. INVESTIGATION OF THE GENUINENESS OF THE SIGNATURE IN QUESTION

Once a surety is confronted with an indemnitor's claim that their signature on the Agreement of Indemnity is not authentic, the proper investigation must be conducted to ascertain the truth of that claim. The first step in that process is to retain a recognized and objective "forensic document examiner," that is, an expert in the field of comparative handwriting analysis.

Courts in most states accept expert testimony in the field of forensic document examination. However, one should be wary of pretenders in this field of expertise, since there are no degree granting institutions in the United States offering courses of study in this subject area. Nor are any licenses or certifications required to hold one's self out as an expert in the field.¹ Therefore, it is important to obtain the appropriate background information on the proposed expert in order to ensure that he or she will not only be qualified as an expert witness, capable of testifying at trial, but also that his or her testimony will be given the appropriate weight by the jury.

Courts in most jurisdictions are liberal in qualifying expert witnesses and in permitting expert testimony at trial. By way of example, the New Jersey Rules of Evidence, which parallel

¹ Wilson R. Harrison, Suspect Documents, Their Scientific Examination, Praeger (1958)

the Federal Rules of Evidence, provide that a "witness qualified as an expert by knowledge, skill, experience, training, or education may testify . . . in the form of an opinion or otherwise . . . if scientific, technical or other specialized knowledge will assist the trier-of-fact to understand the evidence or determine a fact in issue." N.J.R.E. 702. The Supreme Court of the State of New Jersey has ruled that an expert witness must "be suitably qualified and possessed of sufficient specialized knowledge to be able to express (an expert opinion) and to explain the basis of that opinion." State v. Moore, 122 N.J. 420, 458-459 (1991); State v. Odem, 116 N.J. 65, 71 (1989).

Further, the proposed expert witness must satisfy the court that they have certain skills, knowledge or training in a technical area or one that is not common to the world. Hake v. Manchester Tp., 98 N.J. 302, 314 (1985); State v. Frost, 242 N.J. Super 601, 615 (App.Div. 1990), certif. den. 127 N.J. 321 (1992).

Although the trial court has discretion to reject expert testimony, the New Jersey Supreme Court has admonished that this discretion should be used with great caution in light of a strong policy in favor of admission of all relevant evidence. German v. Matris, 55 N.J. 93 (1970); State v. Briley, 53 N.J. 498. Accordingly, New Jersey courts are inclined to entrust the jury with the responsibility of weighing any deficiencies in the qualifications of an expert, since it is within the jury's province "to determine the credibility, weight and probative value" of the testimony of the expert witness rather than excluding the expert testimony. Rubanick v. Witco Chemical Corp., 242 N.J. Super 36, 48 (App.Div. 1990), mod. on oth. grds. 125 N.J. 421 (1991); Higgins v. Owens-Corning Fiberglas, 282 N.J. Super 600, 614 (App.Div. 1995).

Therefore, it is important to select a forensic document examiner who possesses the highest credentials and reputation in the field because although his testimony may be admitted at trial, any deficiencies in his qualifications may result in the jury attaching less weight and credibility to his testimony. The quality of your expert witness' credentials is also critical to prevailing in the "battle of the experts" since your adversary will almost certainly retain an expert witness to testify with a contrary opinion.

Once the forensic document examiner has been retained, the second step in the investigation of the authenticity of a signature is to assemble the appropriate type and number of handwriting samples for comparison with the questioned or disputed signature. The expert should be provided with the original questioned document for examination because photocopies tend to hide or distort evidence having an important bearing on the identification. One of the more complicating factors in handwriting identification is the fact that no one signs his name or writes any combination of words in exactly the same way twice. Therefore, the expert witness must identify certain "natural variations" in the handwriting samples obtained for comparison and must compare those with the "known writing." There is no hard and fast rule for the number of signatures which constitute an adequate sample of signatures for comparison. With some signatures, ten or twenty comparison signatures should be adequate, but there are certain cases which may require thirty, forty or even more samples in order to accurately reveal the writer's habits, ability and range of natural variations.²

It is also important to obtain signature samples that are written under circumstances

² Ordway Hilton, Scientific Examination of Questioned Documents, Revised Edition, Elsevier, 1982

similar to the questioned signature. Some writers, for example, have two or more distinctive styles for different purposes. For example, a writer may use one style for checks and legal documents and a second for correspondence. Therefore, there may be serious divergences between signatures contained on formal documents such as deeds, contracts and wills and somewhat lesser important signatures such as those used to sign correspondence or delivery receipts. Accordingly, signatures should be collected which were written under similar circumstances as the questioned signature. For example, if a signature on an Agreement of Indemnity is called into question, signatures on similar formal business documents such as contracts, wills and deeds should be used for comparison if possible. Additionally, it is important that signature samples are taken from time periods which are close to the date when the questioned signature was written. At the very least, effort should be made to obtain signature samples which precede the date of the litigation or some other date when the writer may know that the authenticity of his signature is being called into question. Not only can handwriting change over the years, but also, obviously if a person is aware that his handwriting samples are being produced for comparison with a questioned signature, he or she would have the ability to alter his handwriting.

Once the forensic handwriting examiner has made his conclusions with respect to the authenticity of the signature in question, the attorney is in a position to evaluate his case and determine whether parties, other than the indemnitors, should be named as defendants in the litigation.

III. THE AGREEMENT OF INDEMNITY

Since judges and juries (and often opposing counsel) may be unfamiliar with the concept of suretyship, much less the nuances of surety law, it is incumbent on the counsel for the surety to provide those parties with a clear understanding of basic suretyship principles. One of the first hurdles that the surety counsel must overcome is the general misconception that suretyship is the same as insurance. The distinction becomes especially difficult to explain when the name of your surety client is the "ABC Insurance Company." Therefore, it is absolutely essential that the function of the Agreement of Indemnity and the surety's reliance on the enforceability of that document are clearly and concisely explained to the judge and jury. This becomes especially critical when the authenticity of one or more of the signatures on the document is called into question.

As practitioners in the field well know, the cornerstone of the surety/principal relationship is the Agreement of Indemnity. It is a fundamental principle of suretyship that a compensated surety is induced to write bonds on behalf of its principal in reliance upon a valid and enforceable Agreement of Indemnity. The existence of and reliance upon the Agreement of Indemnity by the surety is a critical difference between suretyship and insurance. Relying upon the validity and enforceability of the Agreement of Indemnity, the surety assumes that it will incur no loss and computes its premium on that basis. Accordingly, the surety's premium is not actuarially or experience based. Rather, it represents a fee for the extension of credit by the surety to the principal.

The heart of the surety/principal relationship is the intention of the parties, clearly and unequivocally set forth in the Agreement of Indemnity, that the surety will sustain no uncompensated liability or loss in connection with the bonds and, further, that it will be fully indemnified against any loss as soon as liability is asserted against it as the result of any

alleged default by its principal. The fundamental bargain made between the surety and principal then is that the principal will receive bonds which it must provide in order to be awarded construction contracts and, in return, the principal and certain named indemnitors agree that if the surety is either faced with potential losses or forced to incur any actual losses or expenses as a result of the principal's defaults, the indemnitors will fully indemnify and save harmless the surety for those losses and expenses.

The Agreement of Indemnity sets forth the surety's contractual rights which include and extend beyond common law or equitable rights of indemnification. It is only through the contractual provisions of the Agreement of Indemnity that third parties, such as indemnitors other than the principal, may be liable to the surety in the same manner as the principal which executed the bonds.

One of the most prevalent uses of the Agreement of Indemnity is to enforce the surety's rights in a legal action against the principal and the indemnitors for indemnification and reimbursement following payment of a loss by the surety. The specific terms of the surety's indemnification rights contained in the Agreement of Indemnity vary from surety to surety. However, the following language is typical of the indemnity provisions of the Agreement of Indemnity.

The Contractor and the Indemnitors shall exonerate, indemnify, and keep indemnified the Surety from and against any and all liability for losses and/or expenses of whatsoever kind or nature (including, but not limited to, interest, court costs and counsel fees) and from and against any and all such losses and/or expenses which the Surety may sustain and incur: (1) By reason of having executed or procured the execution of the Bonds, (2) By reason of the failure of the Contractor or Indemnitors to perform or comply with the covenants and conditions of this Agreement or (3) In enforcing any of the covenants and conditions of this Agreement. Payment by reason of the aforesaid causes shall be made to the Surety by the Contractor and the Indemnitors as soon as liability exists or is asserted against the Surety, whether or not the Surety shall have made any payment therefor. Such payment shall be equal to the amount of the reserve set by the Surety.

Courts have repeatedly upheld such indemnity provisions by applying the usual rules of contract interpretation and subject only to the condition that the surety's actions are not the product of bad faith.³

Therefore, once it has been determined that an indemnitor's signature on the Agreement of Indemnity is not authentic, it is the initial burden of the surety's counsel to demonstrate to the trier of fact that:

³ See, eg., United States v. Seckinger, 379 U.S. 203 (1970); Northwestern National Co. v. Donovan, 916 F.2d 372 711 Cir. 1990); International Fidelity Insurance Company v. United Construction, Inc., 1992 WL 46878 (E.D.P.A.); International Fidelity Insurance Company v. Curtis T. Bedwell & Sons, Inc., 1989 WL 55388 (E.D.P.A.); Fidelity & Deposit Co. of Md. V. Bristol Steel & Iron Works, Inc., 722 F.2d 1160, 1163 (4th Cir. 1983); Commercial Ins. Co. of Newark, N.J. v. Pacific Peru Constr. Co., 558 F.2d 948, 953 (9th Cir. 1977); Engbrock v. Federal Ins. Co., 370 F.2d 784-787 (5th Cir. 1967); Firemen's Fund Ins. Co. v. Nizdil, 709 F. Supp. 1247, 1252 (D.Or. 1989); Ins. Co. of North American v. Bath, 726 F. Supp. 975, 977 (D.Wyo. 1989).

- (a) the surety relied upon the authenticity of the signatures of all indemnitors on the Agreement of Indemnity and, therefore,
 - (1) the surety reasonably assumed that the indemnity provisions of the Agreement of Indemnity were enforceable against all indemnitors executing the agreement and, further,
 - (2) reasonably assumed that each of the named indemnitors would be jointly and severally liable to the surety in the event that the surety suffered any losses with respect to any bonds issued to the principal; and
- (b) the surety relied upon the validity and enforceability of the Agreement of Indemnity as a condition precedent to the issuance of bonds on behalf of the principal; and
- (c) the surety would not have issued any bonds to the principal absent receipt of what it reasonably believed to be an enforceable Agreement of Indemnity containing the authentic signatures of each of the named indemnitors.

IV. AGENT/BROKER LIABILITY

One of the parties potentially responsible for the presence of a nonauthentic signature on the Agreement of Indemnity is the surety's "agent" or "broker."

Sureties rely heavily upon "agents" or "brokers" to secure business on their behalf. Ordinarily, agents and brokers are responsible for providing financial and other underwriting information to the surety regarding the credit worthiness of the principal and the indemnitors. Routinely, agents and brokers are charged by the surety with the responsibility for obtaining a fully and properly executed and notarized Agreement of Indemnity. Both agents and brokers are paid commissions for all bonds issued by the surety on behalf of the principal, based upon a percentage of the premium charged by the surety. The terms "agent" and "broker" are often used interchangeably in the surety and insurance context and, therefore, are often used incorrectly. The term "agent" in the surety context implies the ability of that party to execute bonds on behalf of the surety by virtue of a power of attorney granted by the surety to the agent. "Brokers," on the other hand, do not possess the ability to issue bonds via power of attorney and, therefore, each time a principal requires a bond, the broker must obtain the bond directly from the surety, which executes the bond and issues it either directly to the principal or releases it to the broker for transmittal to the principal.

Generally, the responsibility of the agent/broker for procuring the Agreement of Indemnity is not spelled out in any written agreement with the surety. Frequently, the surety's direction to the agent/broker to procure a fully and properly executed and notarized Agreement of Indemnity as a condition precedent to its issuance of bonds on behalf of the principal, is verbal or based upon an obvious understanding between those parties. On occasion, the surety's direction to the agent/broker can be found in correspondence from the surety's underwriting department to the agent/broker, which may contain language such as: "Do not release any bonds until such time as you have provided us with the fully completed and properly signed Agreement of Indemnity."

Certainly, it would be a good practice for the surety's underwriting department to create a record with respect to the agent/broker's responsibility for securing a properly executed Agreement of Indemnity and the surety's reliance on that document. However, in the absence of such a letter or document, it is important to elicit appropriate deposition testimony from the

agent/broker with respect to his understanding of his duties and obligations to the surety. The following deposition testimony, taken from a recent case demonstrates the agent/broker's clear understanding of his obligation to the surety to obtain a properly executed, witnessed and notarized Agreement of Indemnity:

(Q) Is it your testimony, sir, that ABC Surety Company would never have issued a bond naming XYZ Company as principal had it not received an Agreement of Indemnity?

(A) It would never issue a bond without an indemnity to the best of my knowledge.

(Q) Did ABC Surety Company require receipt of an Agreement of Indemnity before it would issue bonds?

(A) Yes.

(Q) Was it your understanding, sir, that ABC Surety Company required that the indemnitors' signatures on the Agreement of Indemnity must be witnessed before it would issue bonds?

(A) It is my understanding that the indemnitors' signatures must be witnessed.

(Q) Is it your understanding that ABC Surety required that the indemnitors' signatures be notarized before ABC Surety would issue a bond?

(A) Yes.

(Q) Did ABC Surety go out and get the signatures of the indemnitors?

(A) No.

(Q) Someone else did it?

(A) The agents and brokers are responsible to send out a completed submission. A submission is inclusive of a fully executed, witnessed and notarized indemnity agreement.

The witness in the above case claimed that he could not recall whether the surety had specifically charged his company (a broker), with the responsibility for obtaining the indemnitors' signatures on the Agreement of Indemnity in question. However, the above testimony, clearly evidences the broker's understanding that it is the obligation of the surety's agents and brokers to obtain a fully and properly executed Agreement of Indemnity and that the surety would not issue any bonds until it had received the executed Agreement of Indemnity.

When the agent/broker assumes the responsibility for obtaining the proper signatures on the Agreement of Indemnity, he becomes the surety's agent. Agency is defined under the

law as the relationship which results from the consent by one person, the principal, that another, the agent, act on his behalf. See RESTATEMENT (SECOND) OF AGENCY 2d §1 (1958).⁴ It is well settled as a matter of law that when a person undertakes to act as an agent, he assumes the obligations of a fiduciary. Manna v. Pirozzi, 44 N.J. Super. 227, 229 (App.Div. 1957); see also RESTATEMENT (SECOND) OF AGENCY 2d §13, cmt. (1958).⁵ As a consequence of such obligation, the agent is charged with a duty to be careful, skillful and diligent in the performance of his principal's business, for his failure to so act will subject himself to liability to his principal. Campagna v. United States, 474 F. Supp. 573, 585 (D.N.J. 1958); Marchitto v. Central R. Co., 9 N.J. 456, 466 (1952); F. Male v. Acme Markets, Inc., 110 N.J. Super. 9, 11 (App.Div. 1970); see also RESTATEMENT (SECOND) OF AGENCY 2d, §§379(1), 401, 402 (1958). Therefore, once it can be established that the surety charged the agent/broker with the affirmative obligation of procuring a fully executed and properly witnessed and/or notarized Agreement of Indemnity, and once it establishes the formalities of the execution mandated on that document, i.e., execution by the named indemnitors before a witness and notary public, the agent/broker is charged with the duty to be "careful, skillful and diligent" in the performance of those duties.

Sometimes the defendant "broker" will claim that he is not bound by agency principles since he was not an "agent" but a "broker," in an obvious attempt to muddle the issues. However, in determining the agency status of a broker, the dispositive factor is not whether the broker is labeled a "broker," but whether the broker's role in a particular transaction is consistent with the agency relationship between the parties. Sears Mortg. Corp. v. Rose, 134 N.J. 326, 337 (1993); AT&T Winback & Conserve Program, 851 F. Supp. 617, 625 (D.N.J. 1994). The determination will rest on a factual analysis of the conduct of the parties regardless

⁴ Section 1 of the Restatement of Agency provides, in pertinent part, as follows:

§1. **Agency; Principal; Agent**

- (1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.
- (2) The one for whom the action is taken is the principal.
- (3) The one who is to act is the agent.

⁵ Section 13 of the Restatement of Agency, and the accompanying comments thereto, provide, in pertinent part, as follows:

§1 3. **Agent as Fiduciary**

An agent is a fiduciary with respect to matters within the scope of his agency.

Comment:

- a. Existence and effect of fiduciary duties.

The agreement to act on behalf of the principal causes the agent to be a fiduciary, that is, a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking.

RESTATEMENT (SECOND) OF AGENCY 2d §1 3, cmt. (a) (1 958).

of the terms the parties ascribe to the relationship. Sears, 134 N.J. at 337; Winback, 851 F. Supp. at 625. There need not be an agreement between parties specifying an agency relationship; rather, "the law will look at their conduct and not to their intent or their words as between themselves but to their factual relations." Sears, 134 N.J. at 337 (citing Henningsen v. Bloomfield Motors, 32 N.J. 358 (1960); Winback, 851 F. Supp. at 625).

Despite the recognized distinction between the terms "broker" and "agent," there is precedent for disregarding these labels when they fail to reflect the realities of a particular situation. See, e.g., Sands v. Granite Mutual Life Insurance Company, 232 Pa. Super. 70, 76, 331 A.2d 711, 714 (1974); Diplomat Homes, Inc. v. Commercial Standard Ins. Co., 394 F. Supp. 558, 564-65 (W.D. Mo. 1975). In any given transaction, a broker may act as the agent of both the insurer and the insured. Diplomat Homes, 394 F. Supp. at 564-65.

Further, the broker's role as agent may change in the course of a transaction so that during some stages he represents the insured and during others he represents the insurer. See, e.g., Transamerica Interway, Inc. v. Commercial Union Assur. Co. of South Africa, 97 F.R.D. 419, 421 (S.D.N.Y. 1983); see also B.J. Tiner v. Aetna Life Insurance Company, 291 So.2d 774, 777 (La. 1974). In Tiner, the Louisiana Supreme Court held that a broker who procures insurance which is accepted and issued by an insurance company pursuant to application forms furnished to the broker by the company is considered the agent of such company in the issuance of the policy. Id. at 777. In dismissing the broker's argument that it was not an "agent" of the insurer in the procurement of the policy, the court rejected the broker's reliance on the formalistic labels of "broker" and "agent." Id. There, the court distinguished the term "agent" in the insurance context, from its application under the principles of general agency law. Specifically, the court opined

:

The error in this reasoning is that, while the statutory definitions of agent, broker, or solicitor, [citations omitted] may determine what sort of license, prerequisites, or examination is required, [citations] it is not determinative of whether, in a given instance, a broker or solicitor may not also serve as an agent of the insurer. As noted, [citations omitted], the clear weight of authority is that statutes regulating licensing and defining agents, brokers, and solicitors are not intended to change or to exclude the general laws of agency: 'these regulatory statutes do not prevent the court from finding that an agency relationship exists in fact, outside the scope of the statutes.' [citations omitted]

Id. (citing Mathews v. Marquette Casualty Co., 152 So.2d 577 (La.App. 1963), cert. Denied, 244 La. 662, 153 So.2d 880 (1963)) (emphasis supplied).

V. LIABILITY OF NOTARY PUBLIC

Virtually all forms of Agreements of Indemnity provide for notarization of the signatures of the intended indemnitors. Therefore, the notary who executes and affixes their notary stamp or seal to the document can potentially be responsible for a nonauthentic indemnitor signature

on the Agreement of Indemnity.

Notaries public of the State of New Jersey are appointed by the Secretary of State and hold their respective "offices" for a term of five years, pursuant to the Notaries Public Act of 1979, N.J.S.A. 52:7-10. Pursuant to N.J.S.A. 52:7-19, each notary must subscribe his "autograph signature to any jurat upon the administration of any oath or the taking of any acknowledgment or proof."

It is well settled in the State of New Jersey that notaries are public officers charged with a duty to the public to discharge their functions with diligence. Immerman v. Ostertag, 83 N.J. Super 364, 369 (Law Div. 1964). Stated simply, a notary has a duty to "use ordinary or reasonable care" in the performance of his functions. With respect to the identities of signers, the law requires nothing more of the notary than the use of "reasonable care to satisfy himself or, in other words, to become satisfied in his own conscience that the signers are the persons they purport to be." (citations omitted) *Id.* at 370.

In the Immerman case, the court determined that the notary was not negligent in notarizing signatures of a set of "imposters" who appeared before the notary and executed the document in question. In that case, a lender bank required a mortgage executed by the borrower's parents on certain real estate owned by them as security for a loan. The attorney for the borrower drafted the mortgage documents and gave the documents to the borrower with instructions to have them executed by his parents in the presence of a notary public. Thereafter, the borrower, accompanied by a man and a woman appeared before a notary with a man and a woman who he represented to be his parents. The borrower was known to the notary but the man and woman were "strangers to" the notary. The man and woman signed the documents in the notary's presence. The certificate of acknowledgment and the jurat on the mortgage were "in the usual form." In the certificate, the notary represented, among other things, that the parties "personally appeared" before him and that he was "satisfied" that they were the mortgagors mentioned in the mortgage.

Given the above set of circumstances, the court ruled the defendant notary met the requisite standard of care when ascertaining the identities of the documents signers. The court justified its decision by holding that it is a "common practice" for people "in both social and business contacts, to learn the identities of strangers through the introductions by mutual acquaintances. Such introductions are accepted without question. Acknowledgment - taking officers are held to no higher standard than that of ordinary mankind." *Id.* at 371. However, the court did find that the notary was "guilty of negligence" on other grounds. Specifically, the court determined the assertion on the notary's jurat that the document in question had been "sworn to" before the notary was "patently false." *Id.* at 373-374.

In determining that there must be a "causal relation" between the notary's negligence and plaintiff's loss, the Immerman court found that the bank "had a right to rely, and did in fact rely, upon defendant's (notary's) certification when making the loan. If the acknowledgment certificate had not been executed by the defendant, plaintiff would not have disbursed the loan funds." *Id.* at 370. The Immerman case is also significant since it holds that the duty owed by the notary is owed not only to the person with whom he has privity, but also to any member of the public who in reasonable contemplation might rely upon the officer's certification. *Id.* at 369.

Therefore, by extension, a notary who certifies the signatures of the indemnitors to an Agreement of Indemnity owes a duty to the surety, who will reasonably "rely upon" the notary's certification. Accordingly, following the blueprint set forth in the Immerman case, the surety can take the position that the notary had a duty to the surety and the surety had a right to rely and did rely upon the notary's certification that the signatures of the indemnitors on the Agreement of Indemnity were authentic. Like the bank in the Immerman case, the surety would not have extended its surety credit by issuing bonds absent the notary's certification on the Agreement of Indemnity.

Recently, in Villanueva v. Brown, 103, Fed. 3d 1128, 1137 (3d Cir. 1997), the Third Circuit Court of Appeals held that a notary, who notarized a document without witnessing the execution of the signatures on it, "breached her duty as a notary in so doing." Specifically, the court held that a notary who affixed her seal to a document only as a "favor" to the party requesting her to do so without taking any steps "reasonably calculated to ensure the genuineness of the signature," and without actually witnessing the signatures, was negligent. With respect to the standard of care to be imposed on the notary, the Third Circuit held that the law "requires nothing more of a notary than the use of reasonable care to satisfy himself or, in other words, to become satisfied in his own conscience that the signers are the persons they purported to be." Id. at 1137. Citing Immerman, the Third Circuit also confirmed that the notary's duty is owed "not only to persons with whom he has privity but also to any member of the public who, in reasonable contemplation, might rely on the officer's certification." Id. at 1137.

Following Immerman's mandate, the Third Circuit remanded the issue to the District Court for a "factual determination" of whether there was a "causal relation" between the negligence and the loss or damage. The document in question in the Villanueva case was a power of attorney giving certain parties the right to make investments for the signators. The Third Circuit determined that even if the signature on the power of attorney was a forgery, if the person in question "ratified disbursements" from the investment account, the notary's negligence would be of "no consequence," thereby breaking the "causal relationship" between the negligence and the loss. Id. at 1138.

In summary, under New Jersey law, a notary is not an "insurer" of the genuineness of a signature of an indemnitor on an Agreement of Indemnity but can and will be held liable for his or her negligence in permitting a nonauthentic signature to appear on the document. The notary must use reasonable care to satisfy himself or herself that the signers of the document are the persons that they represent themselves to be. Specifically, New Jersey courts have held that a notary is not to be liable when an "impostor" is presented to the notary and executes the document in the notary's presence, provided that notary uses reasonable care to ascertain the identity of the signer. (Immerman) However, courts have found notaries to be negligent when they affix their notary seal without witnessing the execution of the document and without taking steps reasonably calculated to ensure the genuineness of the signature. (Villanueva) The notary's duty runs to the surety which, in reasonable contemplation, will rely upon the notary's certification on an Agreement of Indemnity. However, the surety must demonstrate a "causal relationship" between the notary's negligence and its loss to recover any damages from the notary.

VI. LIABILITY OF OTHER THIRD PARTIES TO THE SURETY

At various times, agents or brokers may delegate the responsibility for obtaining the appropriate signatures on the Agreement of Indemnity to certain third parties. For example, insurance agents representing an insured with respect to their general liability insurance, automobile insurance and other insurance needs, may not have the ability to obtain surety bonds for their clients. Therefore, those parties often solicit a surety broker or agent to obtain bonds for their insurance clients. Those parties, generally known as "bond producers," may receive a percentage of the agent/broker's commission when bonds are issued. In many cases, the surety agent or broker may have no direct contact with the potential new principal, and may delegate to the "bond producer" much of his responsibility for obtaining financial information from the principals as well as the responsibility for obtaining the appropriate signatures on the Agreement of Indemnity.

When the agent/broker delegates his responsibility for providing a properly executed Agreement of Indemnity to the bond producer, the standard of care of the "bond producer" for obtaining the proper signatures on the Agreement of Indemnity parallels that of the agent. It is a fundamental tenet of agency law that one who agrees with the agent to act for the principal in a transaction becomes a subagent, and owes to the principal all the duties of a fiduciary to a beneficiary. See RESTATEMENT (SECOND) OF AGENCY 2d §428, cmt. A. (1958); see also United State v. Tianello, 860 F.2d 1521, 1524 (M.D.Fla. 1994). If he undertakes to act in the principal's affairs, and because of reliance upon his performance by the principal or the agent, the principal suffers a loss because of his failure to perform, he is subject to liability to the principal as well as the agent. See, RESTATEMENT (SECOND) OF AGENCY 2d §428, cmt. a. (1958); see also Sannini v. Cascells, 1975 WL 806 (Del.Ch. 1975).

The subagent is subject to a duty, as is the agent, not to act contrary to what he knows to be the principal's orders. See RESTATEMENT (SECOND) OF AGENCY 2d §428, cmt. b. (1958). Although he has a duty of loyalty and obedience to the agent who is his immediate principal, the subagent is subject to liability to the ultimate principal for participating in a breach of duty by the agent to the principal. Therefore, in the event that the subagent or producer fails to obtain the appropriate signatures on the Agreement of Indemnity, he becomes directly liable to the surety for his negligence.

The question then becomes whether the bond producer's negligence absolves the agent/broker of any liability to the surety. For example, the agent may take the position that he obtained what appeared to him to be a properly executed, witnessed and notarized Agreement of Indemnity from the bond producer. He had no reason to believe that there were any nonauthentic signatures on the Agreement of Indemnity and submitted that document to the surety, who also had no reason to believe that the document contained any nonauthentic signatures. The agent/broker's argument then becomes "How can you, the surety, claim that I am negligent when you also could not determine that the signatures were nonauthentic?"

The answer to that question is that as a matter of law, the agent/broker cannot exculpate itself from liability through the delegation of its fiduciary obligation to the bond producer. To the contrary, it is blackletter law that an agent is responsible to his principal for the conduct of a subservant to whom he has delegated his principal's affairs. See,

RESTATEMENT (SECOND) OF AGENCY 2D, §406 cmt. b (1958).⁶ Therefore, the agent/broker is liable to the surety for harm to the surety's property or business occasioned by the subagent's negligence or intentional wrongs.

VII. CAUSATION AND DAMAGES

A. Compensatory Damages

This paper will not attempt to present a complete tort law analysis of causation and damage issues. However, a few fundamental principles should be considered.

Once the surety establishes that the agent/broker, notary or some other third party deviated from the appropriate "standard of care" in permitting the nonauthentic signatures to appear on the Agreement of Indemnity, the surety must demonstrate the "proximate causation" between that negligence and the surety's injury as well as the amount of its damages. This concept is simply stated in Immerman, 83 N.J. Super at 372, as establishing the "causal relation" between the wrongful act and the loss. Additionally, the surety must also demonstrate that the damages arising out of the defendant's negligence were "foreseeable," applying the ancient but still applicable principles of Hadley v. Baxendale.

It should be the surety's position that it is entitled to full recovery from the wrongdoer of all of the losses which it sustained as a result of the principal's default on the bond in question since those losses were both reasonably foreseeable and proximately caused by defendant's negligence. Specifically, the surety's entitlement to full recovery of its loss is based upon the premise that it issued the bond in reliance upon the authenticity of all of the signatures on the Agreement of Indemnity and the enforceability of its indemnity rights against all indemnitors who executed the document both jointly and severally. Simply stated, had the surety not received a fully executed and properly notarized Agreement of Indemnity, it would not have issued the bond to the principal and would not have incurred any losses.

⁶ Section 406 of the Restatement of Agency, and the accompanying comments thereto, provide, in pertinent part, as follows:

§406. Liability for Conduct of Subagent

...an agent is responsible to the principal for the conduct of a subservient or other subagent with reference to the principal's affairs entrusted to the subagent, as the agent is for his own conduct ...

Comment:

a. ... a subservient or other subagent is a person to whom the agent delegates, as his agent, the performance of an act for the principal ...

b. An agent who employs a subagent is the latter's principal and is responsible both to third persons and to his principal for the subagent's derelictions. Thus the agent is subject to liability to the principal for harm to the principal's property or business caused by the subagent's negligence or other wrong to the principal's interests.

RESTATEMENT (SECOND) OF AGENCY 2D §406, cmts. (a), (b) (1958)

The surety's position that it is entitled to full recovery of the loss incurred on the defaulted bond is especially effective where, as in the hypothetical situation presented in this paper, the only indemnitor with any assets is the party whose signature is not authentic. In that case, the surety's argument that the defendant's negligence deprived it of its ability to recover against the only indemnitor capable of indemnifying the surety is particularly compelling. Clearly, in that case, the negligence of the agent/broker and/or the notary "proximately caused" the surety's loss, i.e. its inability to recover against the indemnitor for its loss.

But should it matter that the indemnitor whose signature on the Agreement of Indemnity is not authentic is the only party with sufficient assets to satisfy the surety's indemnity claim? What if in the hypothetical situation presented in this paper the wife was also judgment-proof? In that case, the surety arguably has suffered no loss as a result of the negligence of the agent/broker and/or notary in permitting a nonauthentic signature to appear on the Agreement of Indemnity since the surety would not have recovered any money against that indemnitor even if the signature had been valid. However, this argument ignores the basic fact that the surety would not have issued a bond without all of the required signatures on the Agreement of Indemnity each properly authenticated. For example, if the wife in the hypothetical situation had not executed the Agreement of Indemnity or if the notary had not notarized her signature, the surety would not have issued the bond in question and, therefore, would not have suffered any loss.

Accordingly, if the facts reveal that all of the indemnitors are judgment-proof, in order to establish the "causal relationship" between the negligence and the surety's loss, the surety counsel must be consistent and persistent in maintaining his position throughout the case that the surety relied upon the authenticity of the signatures of all indemnitors on the Agreement of Indemnity and it would not have issued a bond without a fully executed and properly witnessed and/or notarized agreement. Had the agreement been incomplete, i.e., without the signatures of one of the indemnitors or without the notary's certification, for example, the surety would not have issued bonds and would not have suffered a loss. Therefore, the surety's damages are measured by the costs which it has incurred to satisfy its obligations on the bonds which it would not have issued but for the negligence of the agent/broker and/or notary.

It should be noted, however, that there are cases which go both ways in the various jurisdictions which have examined the issue of proximate cause in analogous circumstances. Thus, the issue of whether the insolvency of the party whose signature is demonstrated to have been forged will be deemed to be an intervening cause of loss absolving the notary or others responsible for the forgery from liability, will depend upon the jurisdiction whose law controls.

B. Surety's Entitlement to Attorneys' Fees and Other Costs As Damages

Ordinarily, under the "American Rule" with respect to assessment of attorneys' fees, each party to a civil litigation is responsible for its own attorneys' fees. However, it can be successfully argued that a surety which brings a claim in tort against a party who, through his negligence or fraudulent activity, has permitted nonauthentic signatures to appear on an Agreement of Indemnity, is entitled to its attorneys' fees pursuant to Restatement Torts, 2d, §914(2) 1965 (the Restatement). This applicable section of the Restatement is as follows:

§ 914. Expense of Litigation

(2) One who through the tort of another has been required to act in the protection of his interest by bringing or defending an action against a third person is entitled to recover reasonable compensation for loss of time, attorney fees and other expenditures thereby suffered or incurred in the earlier action.

New Jersey courts have recognized and applied Restatement §914(2), which is known as the "tort of another" exception to the general rule against the award of attorneys' fees. Specifically, in Dorofee v. Planning Board of the Township of Pennsauken, 187 N.J. Super. 141 (App. Div. 1982), the Appellate Division quoted from Restatement §914(2) and summarized its application in the case before it as follows:

New Jersey case law does support the proposition that, although attorneys fees are not ordinarily included as damages in a fraud action, one who is forced into litigation with a third party as a result of another's fraud may recover from the tortfeasor the expenses of that litigation, including counsel fees, as damages flowing from the tort. Id. at 144. (emphasis supplied).

In that case, the Appellate Division held that "the legal expenses reasonably incurred by the Planning Board (the wronged party) in defending the litigation which foreseeably ensued (from defendant's tortious conduct) may properly be considered as damages proximately caused by the tortious conduct." Id. at 145.

Therefore, the Restatement and the Dorofee decision opens the door for the surety's claim for attorneys' fees as a measure of its damages once it establishes that it incurred counsel fees as a result of the defendant's tortious conduct. For example, the surety can argue that the tortious conduct of the agent/broker or notary in permitting nonauthentic signatures to appear on an Agreement of Indemnity compelled the surety to "act in the protection of its interests" by initiating litigation to enforce its indemnity rights. Specifically, the tortious act, be it negligence or fraud, of the wrongdoer caused the surety to accept and rely upon an Agreement of Indemnity which it reasonably believed to contain the authentic signatures of the intended indemnitors. Simply stated, absent receipt of what the surety believed to be a fully enforceable Agreement of Indemnity, it would not have underwritten the principal's obligations under the bonds and, therefore, would not have suffered the losses, costs and expenses which it sustained as a consequence of the principal's default and would not have been compelled to initiate the indemnity action to enforce its indemnity rights. "But for" the tortious conduct of the agent/broker, the surety would not have issued bonds, would not have incurred losses and would not be compelled to "act in protection of its interests" by initiating the litigation to pursue

its rights of indemnity.

However, the Dorofee case makes it clear that the surety is entitled to recover only those attorneys' fees expended in pursuit of the claims against third parties, resulting from the tortious conduct of the wrongdoer. The surety is not entitled to attorneys' fees expended in pursuit of claims against the wrongdoer himself. Id. at 145-146. All other attorneys' fees expended by the wronged party in the prosecution or defense of the claims against third parties resulting from the tortious acts are, however, recoverable as a component of the plaintiff's damages. Therefore, for example, once the surety establishes the tortious conduct of the agent/broker, it is entitled to all reasonable attorneys' fees expended in the prosecution of its claims against the "third persons" in the litigation, including the intended indemnitors and in defense of claims against the bonds which would not have been issued but for the tortious conduct of the wrongdoer. Only, that discrete portion of the attorneys' fees which were expended by the surety in pursuit of its claims against the wrongdoer himself are precluded from recovery against that party.

It has been argued that the Dorofee case limits the entitlement of attorneys' fees only to fraudulent conduct and not negligence. However, both the court in Dorofee and the Restatement make it clear that the Rule applies to all tortious conduct, including, but not limited to, fraudulent conduct. Further support for the position that the Restatement applies to all tortious conduct, not merely fraudulent acts, can be found in 22 Am. Jur. 2d §618 which provides as follows:

A plaintiff has the right to recover attorney's fees incurred in other litigation with a third person, if he became involved in that litigation as a result of a breach of contract or tortious act by the present defendant. Usually recovery is allowed as an item of damage flowing from the present defendant's wrongful act and not specifically as an attorney's fee. Recovery is permitted if the litigation involving the third party was brought against the current plaintiff or if the present plaintiff was led by the defendant's action to take legal proceedings against the third person. (Footnotes and citations omitted, emphasis supplied)

The "elements of proof" for recovery of attorneys' fees incurred in litigation involving third parties resulting from the "tortious act by the present defendant" are clearly delineated in 22 Am. Jur. 2d §621. Specifically, the plaintiff must demonstrate that:

- (1) It had become involved in a legal dispute . . . because of defendant's tortious conduct;
- (2) The dispute was with a third party - not with the defendant . . .
- (3) the plaintiff incurred attorneys' fees connected with that dispute. . . .

- (4) the expenditure of attorney's fees was a foreseeable or necessary result of the breach or wrong;
- (5) the fees claimed are reasonable.

In summary, once the surety establishes the tortious conduct of defendants, it can claim reimbursement for attorneys' fees incurred in litigation against third parties, resulting from the defendants' tortious conduct. The surety is entitled to recovery of attorneys' fees provided that it presents the following proofs at trial:

1. The tortious conduct of the defendant (either negligence or fraud) resulted in nonauthentic signatures on the Agreement of Indemnity;
2. The surety issued bonds to the principal in reliance upon the authenticity of the signatures on the Agreement of Indemnity;
3. The surety incurred losses, including counsel fees, as a result of its issuance of bonds on behalf of the principal.
4. The surety as required to initiate litigation in order to recover losses incurred as a result of the issuance of the bond or was required to defend against litigation as a result of the issuance of the bond;
5. The expenditure of attorneys' fees was a foreseeable or necessary result of the tortious conduct of the defendant in question;
6. The surety's fees in prosecuting the litigation are reasonable.

IX. INSURANCE COVERAGE ISSUES

Insurance coverage issues play an important part in litigating and settling claims made by the surety against agent/brokers, notaries and other third parties with respect to negligence and/or fraud in permitting nonauthentic signatures to be obtained on the Agreement of Indemnity. Generally, agents and brokers carry professional liability insurance, which obligate the insurer to "pay on behalf of the insured those sums which the insured becomes legally obligated to pay as damages, because of a negligent act, error or omission in the performance of the insured's professional services." Often, the professional liability insurance maintained by the agent/broker is a "claims made" policy, which covers only those claims for damages which were made against the insured during the policy period, notwithstanding the date when the alleged negligent act, error or omission occurred.

Ordinarily, when an agent/broker is named as a defendant in litigation alleging it is responsible for a nonauthentic signature on an Agreement of Indemnity, the insured will notify the insurance carrier of the claim as required by the terms of the policy. Ordinarily, insurance carriers will defend the claim on behalf of the insured under a "reservation of rights" with respect to coverage of the claim. This section of the paper will not address all of the insurance coverage issues which are presented in a claim against the agent or broker. However, counsel for the plaintiff should be aware of the following general terms and conditions which appear in

many professional liability policies, in order to properly analyze litigation strategies. For example, the following clause is typical of the exclusions contained in the agent/broker's policy:

This insurance does not apply to any claim:

- arising out of any active and deliberate, dishonest, criminal, fraudulent, malicious or knowingly wrongful act, error or omission of any insured.

Therefore, a carrier will deny coverage in the event that the trier-of-fact determines that the fraudulent conduct of the agent/broker resulted in the nonauthentic signature on the Agreement of Indemnity. In general then, the agent/broker's negligence is covered by insurance; however, his fraudulent conduct or other intentional wrongdoing is not. Therefore, in cases where counsel for the surety is unaware of the circumstances surrounding the obtaining of the nonauthentic signature on the Agreement of Indemnity, it may be more prudent to proceed on a theory of negligence rather than fraud which if proven, would not be covered by insurance.

Moreover, insurance policies routinely provide certain notice provisions requiring the insured to provide prompt notice of the claim to the insurer. For example, professional liability policies typically include language which is similar to the following:

If the negligent act, error or omission results in a claim or suit brought against the insured, the insured must: notify the insurer as soon as practical.
(emphasis provided)

The standard language also requires that the insured must provide the insurer with copies of all pleadings as well as requiring the insured to cooperate with the investigation, settlement or defense of the claim on behalf of the insurer. However, under New Jersey law, except under claims made policies, an insurer cannot succeed on a "late notice defense" unless it can show that it suffered "appreciable prejudice" by reason of the late notice. Further the burden of demonstrating that prejudice rests with the insurer. Continental Ins. Co. v. Beecham, Inc., 8367 F.Supp. 1027 (D.N.J. 1993); Pittston Co. v. Alliance Ins. Co., 905 F.Supp. 1279 D.N.J. 1995); Sagendorf v. Selective Ins. Co., N.J. Super 81 (App.Div. 1996). For claims made policies however, no prejudice from late notice need be shown, Zuckerman v. National Union Fire Ins. Co. of Pittsburgh, Pa., 100 N.J. 304 (1985).

X. CONCLUSION

Sureties rely upon agents and brokers to secure business on their behalf. Ordinarily, the surety will delegate the responsibility for securing a properly executed and witnessed Agreement of Indemnity to the agent/broker which has produced the business for the surety. Should the agent/broker provide the surety with an Agreement of Indemnity containing non-authentic indemnitor signatures, the surety can look to the negligent broker/agent as a source of recovery in the event that the surety is unable to obtain full indemnification for any losses which it has incurred from the indemnitors. By creating a record of the agent/broker's responsibilities with respect to securing a properly executed Agreement of Indemnity and the surety's reliance upon that document, the surety will substantially increase its ability to recover losses sustained by the agent/broker's negligence. Other parties potentially responsible to the surety for their negligence in securing proper signatures on the Agreement of Indemnity include the notary and any other third party which the agent/broker may charge with the responsibility for procuring the indemnitors' signatures on the Agreement of Indemnity. Litigation by the surety against agent/brokers, notaries and other potentially responsible third parties necessarily requires the surety's attorney to educate the court and the trier of fact with respect to principles of suretyship and their application to the law of negligence. Thus, where the surety discovers that the Agreement of Indemnity upon which it has relied contains a nonauthentic signature, the prospect of recovery is not necessarily lost. Rather, the nonauthentic signature may provide other pockets from which reimbursement for both losses and expenses might be obtained.