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**FALLOUT FROM FRAUD--FORGED AND UNAUTHORIZED
BONDS**

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INTRODUCTION

The surety claims department rarely becomes involved in a principal's affairs before inception of the first claim, but that moment merely starts the process of looking back. On the performance side, the claims handler looks back to the time of bidding, negotiating, and letting of the bonded contract, right on through performance by the principal, and up to the time of default and notice of claim. On the payment side, the surety investigates the inception of the subcontract or supply contract, the claimant's performance, the point at which principal and claimant began to disagree, and disputes up to the present. Occasionally, though, surety claims must look back even further--for instance, when the bond presented by the claimant varies from the copy in underwriting's file or perhaps is not in the file at all.

Surety bonds have been issued by individuals with no actual authority and beyond the agent's limited or special authority in terms and amount. Powers of attorney have been exceeded, ignored, and mis-matched in attempts to create the appearance of authority. Authorized bonds have been altered, and third parties thereafter changed their positions in detrimental reliance on those forged bonds. Signatures have been omitted entirely without anyone's recognition of a problem (until too late). As with all financial matters, Murphy's Law and the power of human ingenuity know no bounds.

The instances described above do not often lead to reported decisions, so much of our guidance from the courts is dated. Commentators likewise have not attempted to pull together the principles and doctrines applying to forged and unauthorized bonds.¹ What follows are some key questions a surety claims handler should ask when confronted by claims based on documents that vary from the authorized undertaking of the surety.

1. **Where is the writing signed by the surety or its authorized agent?**

Every jurisdiction has some form of the Statute of Frauds, one provision of which usually requires that a promise to answer for the debt of another must be in a writing signed by the party to be charged.² A surety generally cannot be bound without a written instrument bearing the signature of its authorized officer or, more commonly, its agent with power of attorney.

In *United States v. Ferguson*,³ the forfeited bail bond reflected that Ferguson was the principal and "A Bonding Company" by John S. Wilson was the surety. Attached to the bond was a power of attorney from Bankers Fire & Casualty Insurance Co. to John S. Wilson as attorney-in-fact, to "execute, seal and deliver for it . . . as surety . . . a bail bond only." Bankers defended the bond claim on the ground that John Wilson, not Bankers, was the named surety.

Even though Bankers did not appear on the face of the bond, had not signed the bond directly through an officer, and had not even signed by an express attorney-in-fact, the district

judge held Bankers bound as surety. First, Wilson had actual authority via power of attorney to issue the bail bond, and he had done so at least four other times in exactly the same manner. The court noted this custom or practice without ascribing any particular legal impact to it, but the appearance of regularity started the ball rolling against Bankers.

Second, and most important for the court, Wilson had sent a copy of the bail bond to Bankers along with remittance of the proper amount of bond premium. Bankers kept the premium and never repudiated the bond until claim was made. The court referred to the principle of ratification without ever expressly invoking it. Also, to have let Bankers go untouched would have left Wilson personally liable for the entire bond although he had remitted the premium.

When faced with Bankers' retention of the premium with knowledge of the bond, the court could not accept Bankers' argument that those facts, "legally speaking, amounted to nothing at all."⁴ Instead, the court concluded that "Bankers expected to be bound as surety on the bond and . . . expectation is, in the eyes of the law, transposed into realization."⁵

Only temporary omission of the authorized signature led to the opposite result in *Cullinan v. Bowker*.⁶ The Ætna Company vested its resident assistant secretary, Channell, with authority to countersign liquor tax bonds. That power of attorney was on file with the county treasurer charged with accepting such bonds and issuing the liquor tax certificates that the bonds supported. Channell left town but authorized his clerk to issue bonds without his signature and agreed that he would sign any such bonds when he returned.

On behalf of an applicant named Bowker, the clerk issued an unsigned bond to the treasurer and told him of Channell's agreement to sign upon his return. The treasurer accepted the bond and issued the certificate. Before Channell could make it back into town, Bowker was convicted "upon a charge of having violated the Liquor Tax Law in the sale of liquor to Indians."⁷ Without knowledge of Bowker's conviction, Channell returned, went to the treasurer's office, and signed the bond. Ætna did not know that the treasurer had accepted the bond without Channell's signature.

Ætna had lost at a bench trial, but the appellate division had reversed. Three justices of the Court of Appeals of New York disagreed, considering Channell's authority broad enough to encompass delegating his power to his clerk, but four justices affirmed the reversal for Ætna. The important factors for the majority were that Ætna did not know about the unsigned bond until after claim (presumably meaning Ætna never received any premium for it) and that the treasurer had actual knowledge of the limitation on Channell's power (who was required to countersign any bonds himself). Unlike *United States v. Ferguson*, the court was not concerned that Channell intended to issue the bond and Ætna expected to be bound by Channell's actions. Absence of the required signature, even temporarily, was enough.

On the other hand, where neither the surety nor its authorized agent ever signed the bond, the court still held the surety liable based on the doctrine of ratification in *Kadota Fig Association of Producers v. Case-Swayne Co.*⁸ California statute required that a supersedeas, or "stay," bond, be filed within five days of the appeal. The appellant/principal obtained the

authorized agent's agreement to issue the bond, but the agent left town (sound familiar?) without signing the bond. Being diligent and knowing the judge, the agent called and asked that the judge sign the bond for the agent, which the judge did and promptly accepted the bond.

The surety in fact filed with the court a ratification of the bond. The principal was the party who opposed the surety's liability on the bond based on lack of the agent's signature and the timing of the ratification after the five-day deadline. The court held that the agent was authorized to delegate the purely ministerial act of signing his name, since no discretion or judgment was involved. Further, the ratification related back to issuance of the bond, which therefore was timely and enforceable.⁹ While the surety's position may make this result seem foregone, the appellate court was reversing the trial court's decision to quash the bond.

2. Who dealt with the forged/unauthorized undertaking?

Apparent authority is a basic concept in the law of agency and simply means that the principal will be bound by the acts of an agent if the principal leads a reasonable person to believe the agent is authorized. Restrictions on the agent's authority are of no effect on third parties unless communicated to them. The principal controls the agent's authority, and the agent cannot affect the scope of that authority, but any risk of misunderstanding rests with the principal.¹⁰

In *Maryland Casualty Co. v. Moon*,¹¹ the surety gave its agent apparent authority by applying for a certificate from the state insurance commissioner describing the surety's authority to transact business in the state and ending with delegation of all such authority to a named resident agent. That resident agent had a large sign hanging on his office wall likewise proclaiming all of the lines that Maryland Casualty could write. The resident agent issued a performance bond without actual authority, never even collected any premium (much less remitted to the surety), and did not report the bond. Maryland Casualty lost its appeal of the declaratory judgment against it based on the agent's apparent authority.

In *In re Liquidation of National Surety Co.*,¹² the surety let a non-agent named Schlesinger get so close that the public was warranted in accepting a forged bond as genuine. Schlesinger worked out of the surety's offices and shared its telephone switchboard, had actual authority to deliver its bonds and collect the initial premiums, and had access to the surety's letterhead, forms, seal, and fully executed authenticating certificates. The court had no problem holding that the surety's negligence clothed Schlesinger with apparent authority but further stated,

[i]f the signatures to the bond upon which the present claim is based had been forged and the bond delivered by a *stranger* to the surety company, the latter's negligence in permitting fully executed forms by which its bonds and undertakings are customarily authenticated to lie about in its offices would be insufficient basis for holding it liable.¹³

Presumably, the degree to which the surety joins the obligee as a victim of fraud influences the likelihood that the court will find apparent authority.

Qualifying the law of apparent authority in some jurisdictions is the “equal dignities” rule. Under this common law principle, where an instrument or act is required to be performed with certain formality (e.g. suretyship in writing), the authority to perform it must be evidenced with the same formality (e.g. written power of attorney).¹⁴ This requirement negates an agent’s apparent authority in the absence of adequately formal proof. If surety bonds must be in writing, then the attorney-in-fact who signs them must have written evidence of the authority to do so; other indicia of that authority would lack equal dignity and be insufficient.

An example of the application of this rule is *Continental Insurance Co. v. Gazaway*.¹⁵ The guardian obtained from a former agent an unauthorized \$52,000 bond, but no power of attorney was attached at the time of delivery to the probate court. The agent’s power of attorney had been revoked by Continental two months earlier, and Continental had retrieved all of the agent’s powers. The surety did not attempt to notify every potential obligee of the revocation because of the logistical impossibility, so the probate court was unaware of the revocation. Likewise, the surety was unaware of the bond.

The probate court clerk knew of the agent based on many prior bonds he had issued. Rather than request that the agent provide a power, the clerk simply pulled one of the prior bonds from the court files, made a copy, and attached it to the bond. Inexplicably, though, the clerk happened to copy and attach to the Continental bond a power issued to the agent by Transamerica Insurance Co. Naturally, the guardian wasted all of the estate’s assets, was removed, and together with Continental was required to show cause regarding her failure to account for the assets. The former agent had died, Continental discovered the unauthorized issuance of the bond, and it denied liability. The probate judge ruled that Continental was liable on the bond.

The court of appeals reversed, although three judges dissented. The dissent focused on the agent’s apparent authority based on Continental’s holding him out as an authorized agent, providing him with powers of attorney that had no expiration date and would have covered this bond, and failing to notify “all obligees” that the power of attorney had been revoked.¹⁶ The court held, however, that an obligee is bound to inspect the written power of attorney without which an attorney-in-fact is not either actually or apparently authorized to issue instruments that must be in writing, such as bonds.

The equal dignity rule, codified in O.C.G.A. § 10-6-2, provides that where the act to be performed by the agent must be executed with certain formalities, the creation of the agency must be executed with those same formalities. . . . As a result, Robinson’s authority to issue the bond could not be mere apparent authority; his authority was required to be shown by a writing: a power of attorney from Continental.¹⁷

Fortunately, the court of appeals also held that retrieving the revoked powers was sufficient diligence by the surety; notification of all the world was not required.¹⁸

3. Was the forged/unauthorized bond delivered?

An essential element of any surety undertaking is delivery to the obligee. This element

rarely becomes an issue in the average case, but the question may arise more frequently with unauthorized bonds.

Delivery is, of course, essential to [the bond's] validity. In order to bind a surety or guarantor, his contract must be delivered, and it takes effect from the time of its delivery. 1 Brandt, Sur. (2d Ed.) § 25. When there is conflicting evidence as to the delivery, it is a question for the jury. Formal delivery, however, need not be proved by direct evidence, but it may be inferred from the acts of the parties.¹⁹

The courts have treated delivery less as a question of action than as one of intent. Even if the surety can prove that the original instrument never reached the obligee's hands, liability will be enforced if the surety relinquished control of the bond with the intent that the obligee eventually receive and rely on it. The requirement that the obligee accept the bonds likewise appears to involve a very low threshold of proof.

In *Tanco, Inc. v. Houston General Insurance Co.*,²⁰ the agent for the subcontractor's surety obtained home-office authority, prepared the bonds, and was ready to mail them to the principal for signature when the obligee's agent offered to hand-carry them to the subcontractor. When he did so, the subcontractor sent him to its parent company for countersignature, where the bonds sat unsigned for two weeks. In the process, the obligee's agent reviewed and approved the bonds.

Before either the subcontractor or its parent signed the bonds or forwarded them to the obligee, the surety had a change of heart and telegraphed its revocation to the obligee. Shortly thereafter, the subcontractor defaulted. The trial court found that the bonds never were delivered to or accepted by the obligee, but the court of appeals reversed. Delivery to the principal with the intent that they be signed and sent to the obligee was the equivalent of delivery to the obligee, regardless of whether the obligee ever received possession. The court went further and held that the obligee's intent (stated only after default) to accept the bonds upon signature by the principal was effective as "implied acceptance" even though the principal never signed at all.²¹ The surety's attempted revocation was held ineffective because the bonds were delivered, though never received, and accepted, though the principal never signed.²²

At the other end of the spectrum, a bond that actually was placed into the obligee's hands was held not to have been delivered in *Fidelity Mutual Life-Insurance Co. v. Johnson*.²³ The obligee's form of bond required two sureties, and Mrs. Johnson signed expressly in reliance on the written promise of a second surety, Craig, to be bound. Craig (who also was an agent of the obligee) broke his promise to sign the bond but forwarded it to the obligee anyway. The obligee rejected the bond, insisted on two sureties, but then held the bond anyway pending satisfaction of its demand.

When the principal defaulted, the obligee sued Mrs. Johnson. The court noted that the obligee, "although treating the bond as in nowise binding on it, coolly insisted on its binding force as to Mrs. Johnson."²⁴ This opening foreshadowed the result, in which the court

reversed directed verdict for the surety and directed its own verdict for Mrs. Johnson. The court held that the bond was neither delivered nor accepted. The holding on delivery was based on Craig's presumed knowledge that Mrs. Johnson relied on his promise to sign and treated that promise as a condition precedent to her authority for delivery. As in *Tanco*, the surety's intent when it relinquished control of the bond was the key; in *Johnson*, though, that intent relieved the surety of liability.

4. Should the obligee have been on notice of defects/suspicious facts?

A third person dealing with a known agent may not act negligently with regard to the extent of the agent's authority or blindly trust the agent's statements in such respect. Rather, he must use reasonable diligence and prudence to ascertain whether the agent is acting and dealing with him within the scope of his powers. The mere opinion of an agent as to the extent of his powers, or his mere assumption of authority without foundation, will not bind the principal; and a third person dealing with a known agent must bear the burden of determining for himself, by the exercise of reasonable diligence and prudence, the existence or nonexistence of the agent's authority to act in the premises.²⁵

This hornbook statement highlights the burden placed on an obligee who relies on apparent authority to bind the surety. Negligence by the obligee can negate the reliance required to hold the surety beyond its agent's actual authority. Facial defects or variances in the bond or the power of attorney, or between them, can place the obligee on notice that further inquiry is necessary.

In *Blanton v. Commonwealth*,²⁶ the county treasurer's bond listed eight sureties, but only seven signed. The court held the bond to be a nullity because of the material variance on its face. The county was authorized to accept the bond only with all eight signatures, and each of the sureties had the right to insist upon that limitation. Although the court presumed the county only negligently failed to require the eighth signature, the burden of that negligence was imposed on the purported obligee, not the innocent sureties.

Similarly, one co-surety's signature was erased at his behest after all had signed but without the knowledge and consent of the others in *Smith v. United States*.²⁷ The Supreme Court held that the burden was on the propounder of the bond to show either that any alteration did not prejudice the sureties or that they had ratified the bond after knowledge of the alteration. The government could not bear that burden.

General rule is, that where any suspicion is raised as to the genuineness of an altered instrument, whether it be apparent upon inspection, or is made so by extraneous evidence, the party producing the instrument and claiming under it, is bound to remove the suspicion by accounting for the alteration.

....

. . . [T]he rule is universal that the alteration of an instrument in a material point by the party claiming under it, as by inserting or striking out names without the authority or consent of the other parties concerned, renders the instrument void, unless subsequently approved or ratified.²⁸

The obligee knew of the alteration, so the court's decision was easy. Where omission of a surety was not known to the obligee and not facially apparent from the bond, the decision similarly was easy although against the surety. *Township of Crystal Lake v. Hill*.²⁹ The body of the bond did not list the sureties but merely had signature lines in blank at the bottom. The agent had promised the sureties that he would not deliver the bond to the obligee until the last surety (his brother) signed, but he broke his promise and delivered the bond without that signature. The court held that "the bond in its structure does not apprise" the obligee that it is incomplete.³⁰

The bond may be challenged or the obligee may be put on inquiry by facts extraneous to the bond. In *Great American Insurance Co. v. Sharpstown State Bank*,³¹ the jury decided for the surety on the issue of apparent authority, the court of appeals found no evidence to support the verdict, but the supreme court reversed. A complex financial deal was based in large part on obtaining a surety bond securing a bank loan. The bank president, McLean, was requested to make the loan to third parties who would use the funds to buy out the bank owner's interest in certain stock. The president knew the use of a surety bond in this way was unusual, and he was suspicious of almost every aspect of the bonding transaction.

Still, when the fateful day came, the bond was in the form approved by the bank's attorney, the surety's corporate seal was impressed through the attorney-in-fact's signature, and a regular power of attorney was attached giving full authority to the attorney-in-fact, whose signature was notarized by one attesting personal knowledge of him. The documents even included a copy of the surety's by-laws and corporate resolutions providing for the granting of such powers and a certificate from the day before that the power had not been revoked, all impressed with the company seal. Although the attorney-in-fact was not present, McLean accepted the documentation as authentic and made the \$300,000 loan.

Naturally, the attorney-in-fact had no actual authority to issue the bond and the one delivering it, Bartling, had no actual authority to do so. The jury concluded that the attorney-in-fact had apparent authority based on the documentation, but Bartling had no apparent authority to deliver. The bank president did not know Bartling, who had not been held out by the surety as having any authority whatsoever. McLean made no inquiry into Bartling's authority, and Bartling had no evidence of any. The court went on to state,

[m]oreover, the transaction as presented to McLean involved, to his admitted knowledge, substantial departures from the usual methods of conducting business, and the circumstances leading up to it were sufficiently suspicious to arouse in McLean admitted fears of forgery. Specifically, he doubted the capacity to act in some respects of those with whom he was dealing, and he so testified. In these circumstances, the jury's conclusion that Bartling's apparent authority was not established was supported by some

evidence.³²

What suspicious circumstances will require an inquiry by the obligee or negate apparent authority depends on the facts and the court's attitude toward sureties. In *Independence Indemnity Co. v. Industrial Realty Co.*,³³ both were unfavorable. Two unauthorized bonds were issued by two agents whose powers had been revoked without the obligee's knowledge. The power of attorney previously in force and that was used in the fraud was a broad form authorizing issuance of bonds and undertakings up to \$50,000.

The surety pointed to the following unusual or suspicious facts as putting the obligee on duty of inquiry: (a) the bond form guaranteed loan repayment, which was known to the experienced obligee to be an unusual surety instrument; (b) the agents purported to amend the original bond to cover future advances, which could have taken the obligation above the amount of the power of attorney; (c) the agents failed to produce their power of attorney at the time they issued the amendatory bond; (d) the bonds were not issued on the surety's regular blank forms; (e) the bonds were executed not in the surety's office but in the obligee's; and (f) before issuance of the bonds, the surety had cancelled with the state insurance commissioner the authority of any agent on its behalf.

The obligee's officer testified that in fact his suspicions had been aroused by the circumstances but that he undertook no inquiry at all. The court of appeals had affirmed the jury verdict against the surety, and the supreme court granted certiorari to consider the legal issues. After acknowledging all of the above facts, the supreme court unanimously dismissed cert as improvidently granted: "If the [principal and surety] have suffered injury, it is plain that they were the authors of their own misfortune."³⁴ The broad power of attorney that had been granted to the unfaithful agents overcame all of the other circumstances, as far as this court was concerned.

5. Did the undertaking exceed the power of attorney?

A more specific question related to facial defects or suspicious circumstances is whether the undertaking exceeded the power of attorney in nature or amount. The courts have taken one of two approaches: either exceeding the power negates apparent authority entirely or the bond remains valid up to the amount of the power.

A trio of Georgia cases illustrates that the obligee relies at its peril on an agent's acts outside the scope of the power of attorney. In *Maddox v. Waldrop*,³⁵ the agent had broad power of attorney for the surety, Great American, but the power expressly excluded appeal bonds. Because that was the kind of bond in issue, the court correctly held that the agent lacked any authority to bind the surety. In *National Surety Co. v. Moore*,³⁶ the power authorized the agent to issue "any and all bonds, contracts of indemnity, etc." but did not mention continuation certificates, which the bonded contract required in order to extend the term beyond one year. Despite the broad scope of the power, the court held that it did not include such renewal certificates, apparently because the obligee expected the surety to issue the certificate directly and did not really rely on the agent's receipt for the continuation premium.

Finally, in *Myers v. Walker*,³⁷ the power authorized the agent to transact all business between the principal and his bank, including making notes and endorsing drafts. The agent made an accommodation indorsement as "surety" without actual authority, but the court held that "a mere power to indorse promissory notes does not confer upon the agent authority to make an indorsement" as surety.³⁸ Generally, express limitations or restrictions on the face of a power of attorney curtail the apparent authority of the limited agent, regardless of the obligee's misconceptions.

The courts are split on the effect when the bond simply exceeds the power of attorney in amount. In *Stovall v. Commonwealth*,³⁹ the surety gave power of attorney to his agent to issue an officials bond up to the amount of \$25,000, but the agent issued such a bond with a \$40,000 penal sum. The trial judge awarded the lower amount against the surety, but the supreme court reversed on the principle that, "if the agent exceeds the special and limited authority conferred on him, the principal is not bound by his acts, but they become mere nullities, so far as he is concerned."⁴⁰

In *Parsons v. Federal Realty Co.*,⁴¹ an overly optimistic agent issued a bond to guarantee payment of two promissory notes totalling \$100,000. He had warned the obligee that he would have to obtain authorization from the surety's home office, but he expected such approval imminently. When the moment of truth came, and the agent feared losing the deal, he proceeded even though he did not have authority and his request to the surety shortly was denied. Worse, his power of attorney was valid only up to \$50,000.

The obligee tried to avoid the lack of actual and apparent authority by relying on a Florida statute that made an agent out of every person who represents a surety so far as to receive bond applications from principals or to receive from sureties bonds for delivery. The court held that the statute was akin to a similar insurance statute and merely created a presumption, rebutted in cases where an obligee has actual knowledge of limitations on the

agent's authority. Therefore, the power of attorney and the other circumstances put the obligee on notice that the agent lacked authority, and the bench verdict for the surety was affirmed.⁴²

Stacking of bonds is one way an unscrupulous agent can try to get around the limitations in his power of attorney. Where the surety anticipated that ploy, the agent was not allowed to multiply her authority by 10 in *Hill v. State*.⁴³ To issue a \$50,000 bail bond, the agent stacked 10 \$5,000 powers, even though each stated on its face, in bold type, "void if used with other powers." The court to which the bond had been submitted allowed stacking of powers and had not received any separate notice from the surety that the practice was not allowed. The trial court disregarded the limitation in the powers, but the court of appeals reversed. Had the surety not been so careful in the pre-printed powers, the result probably would have gone the other way.⁴⁴

Exceeding the power of attorney in fact did not provide a defense to the surety up to the amount of the power in *DeBoer Construction, Inc. v. Reliance Insurance Co.*⁴⁵ The agent schemed with a contractor to supply payment and performance bonds without notifying Reliance or remitting premiums. The bonds at issue were almost double the amount of the agent's power of attorney provided to the obligee, who testified that they checked for the power but did not read it.

The court of appeals started out well by acknowledging that the dollar amount of the power limited any apparent authority on which the obligee could rely. The court disagreed with the trial court's finding that the construction industry's ordinary reliance on bonding agents relieved the obligee of reading the power. The court likewise refused to impute the agent's fraud to Reliance, since the power of attorney limited the agent's apparent authority and thus the obligee's reasonable reliance. Also, the court overruled the trial judge's finding of estoppel based on an alleged misrepresentation by Reliance's representative during negotiations.⁴⁶

The court then considered whether Reliance should be absolved or held up to the amount of the power of attorney. As a case of first impression in Oklahoma, the court looked to the Restatement of Agency without finding specific guidance. Normally, the rule is that a contract made in excess of authority is valid up to the authorized amount; this rule expressly does not apply, however, when the agent's fraud is involved.⁴⁷ Because the general rule is a departure from contract law and relies on equitable principles, the court felt at liberty to fashion what it considered an equitable compromise rule. Balancing the obligee's duty of inquiry against the surety's duty to supervise its agent prudently, the court decided on the facts to hold Reliance up to the limit in the agent's power (\$500,000). Fortunately, the court at least recognized what it was doing and limited its ruling to the facts of the case.⁴⁸

This type of balancing, whether express as in *DeBoer* or implied in similar results, devalues the principle of imposing the risk of loss on the party best able to avoid or prevent it. In the real world, a surety cannot dole out its powers of attorney on a bond-by-bond basis; principals and obligees would never put up with the slow pace and inflexibility of such a system. Those very obligees, though, can read the bond and power and confirm that they are facially regular. If so, the surety takes the risk under apparent authority; if not, a simple inquiry by the obligee avoids any fraud. The cost of this rule is negligible as compared to imposing

a duty of constant, commerce-suffocating vigilance on the surety.

6. Did agent, obligee, or stranger commit fraud on the surety?

The surety is defrauded whenever the undertaking asserted varies from what was authorized and intended. Whether the agent merely issues bonds exceeding the power of attorney, the obligee makes misrepresentations to induce issuance of bonds, or a stranger or unknown third party alters instruments, the surety is the immediate victim. Because others rely on the fraudulent bonds, though, courts sometimes overlook the surety's position in an attempt to rescue obligees. The outcome does not depend entirely on who committed the fraud; even misrepresentation by the obligee may not release the surety.

For example, in *Armstrong Transfer & Storage Co., Inc. v. Mann Construction, Inc.*,⁴⁹ the obligee and principal submitted to the surety's underwriter an unsigned draft of the contract to be bonded. In reliance on that document, the surety issued its bond. Subsequently, the obligee and principal "amended" the contract so that the executed version named a job superintendent as "joint general contractor." The surety contended that this unconsented substitution of a different contract was a misrepresentation by the obligee that discharged the surety.

The trial court directed verdict against the surety on this defense, and the court of appeals affirmed. The court accepted testimony that the superintendent really was not a joint contractor, even though that is what the contract said. The court also concluded that the differences between the contract as submitted and the one asserted as having been bonded were not material; in other words, the obligee misrepresented the undertaking to the surety, but "no harm, no foul." Finally, even if the obligee's misrepresentations were material, the surety "cannot reasonably rely upon an unsigned document as the true representation of the contractual relationship of the parties,"⁵⁰ even though that is what the obligee represented.

A case that presented a mixed bag for the surety, but with a happy ending, was *Rachman Bag Co. v. Liberty Mutual Insurance Co.*⁵¹ The principal's president, Halpern, had stolen from and agreed to repay the obligee, Rachman Bag, by turning over profits from a bonded contract with the obligee. The obligee and principal both knew all of the pertinent facts, but the surety knew nothing. The surety agreed to issue the bond while the agreement still was in the oral stage, with the written contract to follow.

Communications between obligee and surety during this formative period were in dispute, but the evidence was that Rachman Bag withheld from the surety all of the material background on Halpern's theft and plan to repay. The written contract that was attached to the bond and that the surety's agent incorporated (by altering the reference on the bond) did not contain any of that background. The surety's representatives testified that the surety would not have issued the bond if this background information had been disclosed.

The trial court granted summary judgment to the surety on fraudulent concealment by Rachman Bag. The court of appeals reversed and held that the obligee's duty to disclose, an element of the surety's defense, must be found by the jury on these facts. Fortunately, the jury concluded that the obligee's communications with the surety affirmatively created a

misimpression that the contract was straightforward, instead of one which involved underlying fraud by the principal's president. The jury also found that Rachman Bag had unique access to material information (since Halpern never admitted his theft) and therefore had a duty to disclose that information to the surety. These findings resulted in a verdict for the surety on its fraudulent concealment defense.⁵²

Where the obligee's agent misrepresented that another had signed as surety when in fact that signature was forged, the co-sureties were discharged in *W.T. Rawleigh Co. v. Kelly*.⁵³ The evidence did not implicate the obligee or his agent in forging the one surety's signature but was adequate to establish that the agent knew about the forgery. While the agent's authority did not extend to making misrepresentations about the bond, and his misrepresentation could not be imputed to the obligee for affirmative recovery, the obligee could not assert the bond "and at the same time be relieved of the agent's fraudulent conduct in procuring it."⁵⁴ The court did not discuss whether the co-sureties' reliance was reasonable.

Forgery by the agent also leads to varying results. In *Board of Trustees, Tarrant County Junior College v. National Indemnity Co.*,⁵⁵ the surety entrusted its power of attorney to an agency who knowingly employed an unfaithful agent with a history of forging bonds. The head of the agency requested a bond for a customer who could not meet the surety's conditions. The unfaithful agent, undeterred by the surety's refusal, forged the attorney-in-fact's signature to the required bond, affixed the surety's seal, and delivered the package to the principal.

The obligee apparently did not assert the agent's apparent authority, since the agent did not sign his own name or purport to be acting under any authority himself. Instead, the obligee claimed the surety was negligent in entrusting its binding documents to the agency without more investigation and supervision. The court of appeals could not tell whether the judgment for the surety was based on judgment notwithstanding the verdict or on a finding of contributory negligence by the obligee but affirmed in any case. The court stated that merely "leaving supplies, seals, Powers-of-Attorney, etc., with an agent" is not negligence "unless there be notice of some condition or circumstance specially existent causing such to be dangerous itself."⁵⁶ The court went on to rule as follows:

The jury finding that National Indemnity Company was negligent in its supervision (or lack thereof) of Stevens [the agency] as its local recording agent, which negligence amounted to a proximate cause of the damages sustained by TCJC [the obligee], was without support by evidence both as to negligence and proximate cause.⁵⁷

The surety also was not bound by the agent's forgery in *Auto Rental & Leasing, Inc. v. Blizzard*,⁵⁸ even though the head of the agency was the forger. Blizzard wanted to lease trucks but lacked the net worth to persuade the lessor. His brother-in-law, Walderman, was president of a bonding agency and suggested performance bonds to back up Blizzard's financial responsibility. No doubt because of Blizzard's lack of credit-worthiness, Walderman did not bother asking the surety for approval of the bonds. Instead, he issued bonds in the amounts of \$84,000, \$50,000, and \$2,500 in Georgia (where he was not authorized), using a forged version of the surety's power of attorney and seal, and neither disclosed the bonds nor

remitted any premium to either his own agency or the surety.

Blizzard's dreams crumbled into bankruptcy when his overhead consistently exceeded his revenues. The jury found against Walderman but in favor of the agency and surety, and the court of appeals affirmed. Distinguishing from the simpler case of undisclosed revocation of otherwise adequate powers of attorney, the court considered the combination of a forged power and a bond not within any current or former valid power to be "radically different."⁵⁹ The court highlighted the facts that the obligee knew Walderman's relation to Blizzard and Blizzard's dependence on Walderman for financial backing, combined with the obligee's complete failure to investigate Walderman's authority. The agency and surety's complete ignorance (and failure to receive any premium) also were factors in the favorable result.

On the other hand, the Sixth Circuit reversed summary judgment for the surety victimized by a forging agent in *Aetna Casualty & Surety Co. v. Federal Deposit Insurance Corp.*⁶⁰ A contractor/developer was required to obtain \$3.2 million in payment and performance bonds as a condition to receiving a \$3.5 million construction loan. The bond identified the lender as the owner, although the principal was both owner and contractor, and referred to a written construction contract that never existed. The attorney-in-fact whose name was on the bond had not signed it, was not employed at that time by Aetna, and had nothing to do with issuance or delivery. The principal only remitted to the agency part of the lender/obligee's premium payment, none of which went to Aetna.

Near the end of the project, the obligee called Aetna to discuss the principal's request for release of the bonds. The surety's representative, Deal, told the obligee that Aetna was having some trouble locating the bond. The obligee faxed Deal a copy, and Deal inquired of Aetna's local office. The immediate response was that the signature of the attorney-in-fact appeared to have been forged. Deal then asked the obligee where the principal was located but did not mention Aetna's suspicion that the bonds were forged. Deal called the principal and learned of the agent's involvement. The next business day, the agent obtained from the obligee a letter releasing the bonds and the original of the bonds themselves. "A few days later . . . Deal told [the obligee] that the bond was a forgery. In spite of receiving this information, [the obligee] took no steps to retract the release."⁶¹ Upon default, Aetna denied the claim and was sued.

The trial court ruled that the obligee's release of the bonds was enforceable so that Aetna had no liability. The Sixth Circuit disagreed and reversed. First, the court examined the validity of the bonds. Although the agent had no actual authority or power of attorney, which Aetna had revoked, his partner in the agency still had power of attorney and the agent himself was allowed to solicit business and issue bonds for Aetna with specific authorization. Those restrictions were not known to the obligee, but neither does the opinion reflect that the obligee knew *any* of the facts cited as support for apparent authority. The court still concluded that the jury must decide whether the agent had apparent authority to bind Aetna.

The court also applied Tennessee's broad view of the scope of agency when holding a principal liable for an agent's fraud. Worse, the court without explanation imputed to Aetna the agent's conduct in procuring release of the bonds. That conduct had begun before Aetna even knew who the agent was, and Aetna had no involvement whatsoever in it; the

explanation may be that Aetna was asserting the release and had to take it with the baggage of the agent's misconduct. Worst of all, the court held Aetna exposed to a jury trial on fraudulent concealment for having delayed by less than six business days in telling the obligee about the suspected forgery. The court viewed the surety's duty to share what it only suspects (in the face of inquiry by the obligee) as requiring disclosure virtually at the moment of suspicion.⁶²

Finally, two cases decided in June, but 104 years apart, illustrate the variability of the surety's fate even when a stranger forges the bonds. In *City of Orlando v. C.T. Gooding*,⁶³ a multiple-surety bond had been altered to add that the sureties were jointly and severally liable. A witness to the sureties' signatures apparently added this language at the principal's request between signature and delivery to the obligee. Because the obligee had no knowledge of the alteration's origin, the court held that the obligee could presume the bond had been altered before execution. The court focused entirely on the obligee's ignorance and placed the risk of forgery by a stranger entirely on the surety.

In *American Insurance Co. v. Donatelli Construction Co., Inc.*,⁶⁴ the surety sought declaratory judgment that its payment and performance bonds were not enforceable. Among others, a steel supplier opposed that claim and sought to recover under the payment bond. Attached to the bond, with its forged agent's signature, was a photostatic copy of a power of attorney. The claimant accused the surety of negligently having left powers in the hands of a former agent when authority was revoked. No one could identify the source of the photocopied power of attorney, though, and the claimant did not even call the principal to explain how it came to submit the forged documents to the obligee.

Both the trial court and the supreme court agreed that the surety could not be bound by the forgeries. Without addressing apparent authority, which presumably was negated by the photocopied power, the courts both focused on the "glaring gap" that prevented the claimant from linking the forged documents with any power of attorney negligently left with the former agent. The forger was unknown. Any number of sources could have provided an original from which to make a photocopy of the power used to defraud the parties. Without proof of causation connected to the surety's alleged negligence, the court easily granted summary judgment for the surety.

CONCLUSION

Sureties surely do not intend to be bound by the unauthorized acts of their agents or by forged or fraudulent bonds. Placing powers of attorney or other form of authorization in the stream of commerce, though, is essential to keep the stream flowing. The accompanying risk of unintended undertakings must be allocated between sureties and those who rely on surety instruments. The courts apportion that risk as they consider appropriate under the facts, without necessarily worrying about consistency of rationale or predictability of result.

Sureties can address these risks up front by the way actual and apparent authority is granted. For the claims handler who receives the file too late to affect that granting of power,

the most important rule is to investigate and disclose promptly and candidly what can be learned about the unauthorized or fraudulent acts. When asking a court to weigh the surety's place in the risk-allocation process, the surety must be able to demonstrate the cleanest of hands and the highest claim to equity. Otherwise, the surety may find itself a target that the court cannot miss.

ENDNOTES: FALLOUT FROM FRAUD--FORGED AND UNAUTHORIZED BONDS

1. About 20 years ago, one distinguished writer did look into the "Surety's Liability for Unauthorized Execution or Oral Promises by an Agent to Issue Surety Bond," Charles A. Meeker, Committee on Fidelity & Surety Law, Section of Insurance, Negligence, and Compensation Law, ABA Annual Meeting (August, 1979). That paper examines a number of authorities not addressed here and is recommended for further reading.
2. For a list of statutes of frauds by jurisdiction, see 23 AM. JUR. PLEADING & PRACTICE FORMS (rev. ed.), at p. 4. See also 72 AM. JUR. 2D, STATUTE OF FRAUDS, §§ 179, 388.
3. 409 F. Supp. 393 (S.D. Ga. 1975).
4. *Id.* at 398. See American Druggist Insurance Co. v. Georgia Power Co., 243 S.E.2d 319 (Ga. App. 1978) (where agency had surety's broad-form power of attorney, agency's president signed bond, and surety kept the premium paid for the bond, summary judgment for surety reversed on grounds of apparent authority). But note that the courts do not automatically put the shoe on the other foot: mere failure to receive the premium does not absolve the surety. C&F Bonding Co. v. State, 480 S.E.2d 240, 241 (Ga. App. 1997) (agent issued authorized bond but absconded with premium; surety held bound, any dispute is "between C&F and its agent and does not affect the validity of the bond").
5. *Id.* at 399. For an even clearer application of the courts' unwritten rule that the surety is liable whenever it intends to be, regardless of formalities, see Wharton v. Fidelity Mutual Life Insurance Co., 156 S.W. 539 (1913) (individual surety overlooked obligee's requirement of at least two sureties, not discharged by surety agent's failure to obtain second surety despite representation that he would do so).
6. 72 N.E. 911 (N.Y. 1904).
7. *Id.*
8. 167 P.2d 523 (Cal. App. 1946).
9. *Id.* at 526-528.
10. RESTATEMENT, AGENCY 2D, § 8, Comments a-c; 3 AM. JUR. 2D, AGENCY, §§ 73-75, 78. See Veranda Beach Club Ltd. Partnership v. Western Surety Co., 936 F.2d 1364 (1st Cir. 1991) (surety absolved by verdict; agency did not create appearance of authority on part of forging agent, despite allowing access to surety's letterhead and power of attorney, so forged bond and letter from surety did not impose liability on either agency or surety).
11. 203 N.W. 885 (Mich. 1925).
12. 294 N.Y.S. 433 (Misc. 1937).
13. *Id.* (emphasis added).
14. Of the 50 states, Puerto Rico, and the Virgin Islands, only 10 do not have some statutory form of the equal dignities rule (Kansas, Maine, Massachusetts, Puerto Rico, Tennessee, Utah, Virginia, Washington, West Virginia, and Wyoming). Twelve apply the rule generally (Alabama, California, Delaware, Georgia, Hawaii, Illinois, Mississippi, Montana, New York, North Carolina, North Dakota, and South Dakota). The rest apply a limited version of the rule, usually requiring only that an agent's power to act with reference to an interest in real estate be established in writing. The one exception of note among the limited-rule jurisdictions is Kentucky, which generally does not follow the rule except that "[n]o person shall be bound as the surety of another by the act of an agent unless the authority of the agent is in writing, signed by the principal . . . made in the presence of at least one creditable attesting witness."

K.R.S. § 371.090 (Michie 1998).

15. 453 S.E.2d 91 (Ga. App. 1995).

16. *Id.* at 93-94.

17. *Id.* at 92-93 (citations omitted). *Cf.* Hunter v. Lanier, 39 S.E.2d 79 (Ga. App. 1946) (failure to attach power of attorney to appeal bond did not nullify effect but was amendable; evidence that such power existed, in the form of a certified and authenticated copy of the power, was adequate).

18. *But see* In re Town of Ponchatoula v. National Indemnity Co., 395 So. 2d 401, 402 (La. App. 1981) (surety's publishing in *The Wall Street Journal* and various local papers "pertinent information" about the agent's forgeries held to be "reasonable steps to afford notice").

19. St. Louis Brewing Association v. Hayes, 97 F. 859 (5th Cir. 1899). How the bond got into the obligee's hands was not established, and the principal had not signed. The sureties testified that they knew the obligee had the bond and was relying on it, and the court considered that adequate evidence of delivery to render the bond enforceable.

20. 555 P.2d 1164 (Colo. App. 1976).

21. *Id.* at 1166. On the question of acceptance, see Cornell & Co., Inc. v. First Indemnity of America Insurance Co., 198 B.R. 871 (E.D. Pa. Bankr. 1996): The general contractor required that subcontract bonds be issued by an acceptable surety and rejected the surety bonds tendered by the subcontractor's "substandard" surety. Then the GC tried unsuccessfully to claim under the bond when the subcontractor defaulted before providing the required replacement surety. Even though the surety had retained the \$56,000 premium, the court rejected an estoppel argument because all parties understood that the money was to be applied to the replacement bond premium.

22. *Id.* at 1166. The absence of the principal's signature was irrelevant to the court, even though the obligee's acceptance had been conditioned on that signature. The court noted that the principal already was liable on the contract, and the bond merely made the surety jointly and severally liable with the principal. Also, the principal had signed an indemnity agreement, so the surety could protect its rights without the need of having the principal on the bond. See St. Louis Brewing Association v. Hayes, 97 F. 859 (5th Cir. 1899). This result is particularly difficult to understand with no mention of a premium paid to the surety, no reliance by the obligee on the issuance of bonds since the principal had been working for several months without bonds, and surety's notice of revocation within two weeks of issuance. Perhaps the timing of revocation and default caused the court to suspect that the surety was taking advantage of inside information about the principal.

23. 116 N.W. 404 (Mich. 1908).

24. *Id.* at 405.

25. 3 AM. JUR. 2D, AGENCY, § 78.

26. 20 S.E. 884 (Va. 1895).

27. 69 U.S. 219, 17 L. Ed. 788, 2 Wall. 219 (1864).

28. *Id.* at 232, 234.

29. 67 N.W. 121 (Mich. 1896).

30. *Id.* See *Holloway v. City of Atlanta*, 92 S.E.2d 615 (Ga. App. 1956) (agent signed surety's name and added his own as attorney-in-fact but without power of attorney; certiorari bond held a nullity because lack of power negated suretyship).
31. 460 S.W.2d 117 (Tex. 1970).
32. *Id.* at 122. The court also cited the RESTATEMENT, AGENCY 2D, § 166, Comment (a): "Any substantial departure by an agent from the usual methods of conducting business is ordinarily a sufficient warning of lack of authorization." McLean in fact had attempted to make some inquiries, including calling the surety's local office to confirm who had power of attorney to sign bonds for it. He also had made financial inquiries about the borrower, but had received a "no comment" response from Dun & Bradstreet. The court considered these attempts at investigation to be evidence against the bank, in that McLean's suspicions confirmed the need to investigate further or decline the loan.
33. 172 S.E. 38 (Ga. 1933).
34. *Id.* at 41.
35. 4 S.E.2d 684 (Ga. App. 1939).
36. 157 S.E. 108 (Ga. App. 1931).
37. 30 S.E. 842 (Ga. 1898).
38. *Id.* at 843 (judgment for payee reversed).
39. 4 S.E. 379 (Va. 1887).
40. *Id.* The same principle is repeated in quotes from a variety of ancient sources, including Story on Agency and English authorities.
41. 143 So. 2d 912 (Fla. 1931).
42. *Id.* at 918. Although the agent kept the premium, he never remitted it to the surety. Therefore, the surety was not estopped to deny the undertaking.
43. 585 A.2d 252 (Md. App. 1991).
44. See *United States v. Gil*, 657 F.2d 712 (5th Cir. 1981) (power did not bar stacking, general bond instructions on file with the court did not prevent two agents from stacking, the surety did not otherwise notify the court that stacking was against its policies, and the practice is not illegal or so unusual that the magistrate should have inquired about it); *State of Delaware v. Edwards*, 1995 Del. Super. LEXIS 630 (1995) (stacking prohibited in power of attorney attached to each bond, but court held surety liable up to amount of power).
45. 540 F.2d 486 (10th Cir. 1976).
46. The representative allegedly told the obligee that Reliance still was considering its liability on one of the unauthorized bonds when in fact the surety already had decided to deny the claim. The obligee claimed to have relied on that representation in settling on another bond. The court found the surety's conduct "condemnable" but saw no detrimental reliance. *Id.* at 492.
47. RESTATEMENT, AGENCY 2D, § 164(2).

48. 540 F.2d at 492-494. The court's only indication of how it considered Reliance to have been derelict regarding the agent was a disapproving tone at the idea that a surety would give dollar-limited powers without some other form of check and balance. Essentially, the court was criticizing the way the entire surety industry does business. The reasoning behind the result was that sureties assume the risk of fraud, within the apparent authority of the agent under the power, because the public is unprotected in relying on the agent's power of attorney. The court failed to mention that a bond in excess of the power is facial proof that the obligee should not rely on the agent but inquire of the surety instead. Unfortunately, DeBoer has been applied by the former Fifth Circuit in *United States v. Gil*, 657 F.2d 712 (5th Cir. 1981) (court limited government's recovery when bond exceeded power).

49. 458 S.E.2d 481 (Ga. App. 1995).

50. *Id.* at 485. The court's reasoning on reliance by the surety brings to mind Bluto's response to Flounder's complaint about wrecking his brother's car in the movie *Animal House*: "Hey, you [screwed] up, you trusted us." Signed or unsigned, where else can a surety get the contract it is bonding other than from the obligee and principal? Technically, the principal cannot sign the contract until its surety commits to bond, since providing a bond is a material obligation under the contract. This court says the surety should not bond until it sees a signed contract. The court ignored this Catch-22.

51. 839 F. Supp. 998 (E.D.N.Y. 1993), *rev'd*, 46 F.3d 230 (2d Cir. 1995); *after trial*, 905 F. Supp. 95 (E.D.N.Y. 1995), *aff'd*, 101 F. 3d 1393 (2d Cir. 1996).

52. 905 F. Supp. 95 (E.D.N.Y. 1995) (*J.N.O.V.* for Rachman Bag denied; sufficient evidence to support verdict for surety). The trial court also denied the surety's claim for attorney's fees based on (a) a finding that the surety did not prove malice on the part of Rachman Bag in failing to disclose Halpern's theft and (b) the court of appeals' reversal of summary judgment for the surety.

53. 50 S.E.2d 113 (Ga. App. 1948).

54. *Id.* at 116.

55. 484 S.W.2d 399 (Tex. App. 1972).

56. *Id.* at 403.

57. *Id.* *But see* *DeBoer Construction, Inc. v. Reliance Insurance Co.*, 540 F.2d 486 (10th Cir. 1976) (merely entrusting documents to agency, without any reason for suspicion, led court to balance against the surety in deciding who should bear risk of forgery).

58. 284 S.E.2d 47 (Ga. App. 1981).

59. *Id.* at 535.

60. 927 F.2d 603 (table affirmance, citation to the Sixth Circuit restricted), *full opinion reported*, 1991 U.S. App. LEXIS 3272 (6th Cir. 1991).

61. *Id.* at *8-9.

62. To add insult to injury, the court of appeals was willing to allow the converted "premium," paid only in part to the fraudulent agent and not at all to Aetna, to be consideration for the forged bond. Moreover, the court held that a surety can bond a contract not identified in a bond that identifies a completely different contract. *Id.* at *28-32. None of the facial irregularities in the bond concerned the court, either, despite a complete lack of inquiry by the obligee.

63. 15 So. 770 (Fla. 1894).

64. 713 A.2d 237 (R.I. 1998).