

Formula 419: Cleaning Up Fidelity Bond Claims Arising from the “Nigerian Scam”

Gail D. Spielberger
Adam P. Friedman*

I. Introduction

The “Nigerian 419” scam, also known as the “advance fee transfer scam,” the “Nigerian money transfer fraud,” the “Nigerian letter scam,” and the “Nigerian counterfeit check scam,” was responsible for the highest median dollar losses from internet crime last year.¹ The 419 has been around since the 1980s. According to the Federal Trade Commission (“FTC”), it now is occurring in “epidemic proportions.”² The FTC reported that it received more than 55,000 complaints of 419 scams or attempted scams in 2005 alone, which is almost six times the number of complaints it received in 2001.³ The Secret Service estimates that 419 scammers gross hundreds of millions of dollars a year.⁴

The basic premise of the 419 is that the “victim” pays money to the scammer in anticipation of receipt of a much larger sum, which never materializes. The 419 is said to have originated from the Spanish Prisoner Letter scam, which dates back to the sixteenth century.⁵

The 419 scams became associated with Nigeria in the mid-1980s, as a result of severe economic distress resulting from a collapse in oil prices.⁶ The scam is now commonly referred to as the “419,” after the section of the Nigerian Penal Code that applies to this type of crime. While it is referred to as a “Nigerian” scam because most communication originates in Nigeria,⁷ scammers also work out of places such as Ghana, the Ivory Coast, South Africa, and other West African states, as well as the Netherlands, the United Kingdom, Spain, and Canada.⁸

II. How the 419 Works

There are several different variations of the 419, but they all generally involve an unsolicited e-mail from a stranger requesting that the victim facilitate a supposed

* Gail D. Spielberger is a member of Whiteford, Taylor & Preston, LLP, in Baltimore, Maryland. Adam P. Friedman is a member of Wolff & Samson PC in New York, New York.

¹ <http://www.fbi.gov/pressrel/pressrel06/internetcrimereport.htm>.

² <http://www.ftc.gov/bcp/online/pubs/alerts/nigeralt.htm>.

³ http://blogs.usatoday.com/techspace/2006/05/what_a_fool_bel.html.

⁴ Mitchell Zukoff, *The Perfect Mark*, THE NEW YORKER, May 15, 2006, available at http://www.newyorker.com/fact/content/articles/060515fa_fact.

⁵ *Id.* In the Spanish Prisoner Letter scam, scammers wrote to English gentry and asked for help in freeing a wealthy countryman who was imprisoned in Spain.

⁶ *Id.*

⁷ Nigeria – The 419 Coalition Website, <http://home.rica.net/alphae/419>.

⁸ The NetHerald.com, http://www.thenetherald.com/Acu-to-Aim/Advance_fee_fraud.php.

transaction by allowing a large sum to be transferred into the victim's bank account, generally by check.

The communications often purport to be from Nigerian government committees, dignitaries, or Nigerian royalty.⁹ To add credibility, the factual context of the communications often changes in accordance with world events. Most recently, for example, scammers were sending e-mails asking for assistance in retrieving money hidden from Saddam Hussein.¹⁰ The communication gives some type of explanation as to why the "victim's" assistance is required, usually in a manner that attempts to evoke sympathy. A typical example follows:

Dear Sir/Madam,

Compliments of the season. Grace and peace and love from this part of the Atlantic to you. I hope my letter does not cause you too much embarrassment as i write to you in good faith based on the contact address given to me by a friend who works at the Nigerian embassy in your country. Please excuse my intrusion into your private life.

I am Barrister Akini Abbey, I represent Mohammed Abacha, son of the late Gen. Sani Abacha, who was the former military head of state in Nigeria. He died in 1998. Since his death, the family has been losing a lot of money due to vindictive government officials who are bent on dealing with the family. Based on this therefore, the family has asked me to seek for a foreign partner who can work with us as to move out the total sum of us\$75,000,000.00 (seventy five million United States dollars), presently in their possession. This money was of course, acquired by the late president and is now kept secretly by the family. The Swiss government has already frozen all the accounts of the family in Switzerland, and some other countries would soon follow to do the same. This bid by some government officials to deal with this family has made it necessary that we seek your assistance in receiving this money and in investing it on behalf of the family.

This must be a joint venture transaction and we must all work together. Since this money is still cash, extra security measures have been taken to protect it from theft or seizure, pending when agreement is reached on when and how to

⁹ Polly Samuels McLean & Michael Young, *Phishing and Pharming and Trojans – Oh My!*, UTAH B.J. 28, 30 (Mar./Apr. 2006).

¹⁰ *Hussein's Millions Up For Grabs in Nigerian-Style Scam*, TECHWEB, Feb. 18, 2005, available at <http://www.techweb.com/wire/security/60402148>.

move it into any of your nominated bank accounts. I have personally worked out all modalities for the peaceful conclusion of this transaction. The transaction definitely would be handled in phases and the first phase will involve the moving of US\$25,000,000.00 (twenty five million United States Dollars).

My clients are willing to give you a reasonable percentage of this money as soon as the transaction is concluded. I will, however, based on the grounds that you are willing to work with us and also all contentious issues discussed before the commencement of this transaction. You may also discuss your percentage before we start to work. As soon as I hear from you, I will give you all necessary details as to how we intend to carry out the whole transaction.

Please, do not entertain any fears, as all necessary modalities are in place, and I assure you of all success and safety in this transaction.

Please, this transaction requires absolute confidentiality and you would be expected to treat it as such until the funds are moved out of this country.

Please, you will also ignore this letter and respect our trust in you by not exposing this transaction, even if you are not interested.

I look forward to working with you.

Thank you.

Truly yours,

Akini Abbey Esq.¹¹

For fidelity insurance purposes, the most important version of the 419 is where the scammer requests that the “victim”¹² deposit a check (typically a cashier’s check) into his/her bank account and return a portion of the check’s proceeds to the scammer as soon as the check “clears.” In this version of the 419, the scammer explains the background of the payment, laying the foundation for the “victim” to believe that he/she is legitimately receiving a check in a substantial sum. The “victim” is given some reason

¹¹ http://www.419fraud.com/akini_abbey.htm. This e-mail is reprinted with all spelling and grammatical errors included.

¹² The word “victim” is in quotations because one can reasonably dispute whether someone who claims to have fallen for the 419 is truly a “victim.”

why the check cannot be negotiated by the scammer. The scammer tells the victim to keep a meaningful portion of the proceeds of the check as payment for his assistance and to return the remainder of the proceeds to a designated account or address (typically overseas). After the transfer is complete, however, the “victim” is informed that the check he/she deposited was fraudulent and that he/she is now liable to the bank for the amount of the check.

This version of the 419 takes advantage of the fact that most people are not aware of the how the banking industry operates. Many “victims” of the 419 admit that they were suspicious when they received the check but were reassured when they found that the check had “cleared.” What they did not know, however, is that when a bank says a check has “cleared,” the bank means simply that the amount of the check has been provisionally credited to the “victim’s” account.¹³ If the check is a cashier’s check, as in many cases, or if the “victim” has excellent credit, the proceeds of the check might be credited to his/her account immediately, with a revocation of the credit coming several days later, after the bank on which the check is drawn refuses to pay it.¹⁴

The increasing use of cashier’s checks, as opposed to personal or business checks, lends the appearance of authenticity to the scam. While most people would be suspicious of a personal check made out for a large amount, cashier’s checks are considered safer than personal checks because the bank, as opposed to an individual or small business, is purportedly standing behind the check. For this reason, cashier’s checks circulate as the equivalent of cash.¹⁵ Many scammers use “cashier’s” checks for this reason.

III. Fidelity Bond Coverage Analysis for Losses Arising from the 419 Scheme

While the 419 scheme involves uniquely wild, seemingly implausible circumstances, its net somehow ensnares old and young, professional and unemployed, cosmopolitan and rural. Despite the ever-changing and unfamiliar circumstances 419 scams present, however, in the fidelity insurance context, these schemes generally should not present novel coverage issues. For the fidelity insurer, the most pertinent aspect of 419 schemes is the use of bogus checks (particularly cashier’s checks), sent to “victims” to be deposited and/or cashed, with a portion of the proceeds then to be sent back to the scammer or to a third party.

¹³ *The Nigerian Counterfeit Check Fraud: Ruining Lives by the Thousands*, http://fraudaid.com/scamSpeak/Nigerian/counterfeit_check_fraud/counterfeit_check_03.htm. On this point, UCC § 4-214 (a) provides, in pertinent part: "If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the items if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts."

¹⁴ *Id.*

¹⁵ See, e.g., 9 C.J.S. Banks and Banking § 453 (2006).

Under these circumstances, a bank's loss from the 419 typically results where the "victim" deposits the illegitimate check and withdraws the funds as soon as his account is provisionally credited, which tends to happen quickly in the case of a document purporting to be a cashier's check. When the check is returned to the insured bank unpaid, the bank seeks to recover the funds from the "victim" account holder, but the "victim's" account does not contain sufficient funding to repay the bank. The "victim" typically already has sent a significant portion of the proceeds to the scammer and may have squandered the remainder.

A bank that has sustained a loss relative to the 419 typically will assert that coverage exists under the "forgery," "alteration," or "counterfeit" provisions of the bond. While claims investigation will vary depending upon the language of the particular bond, a practical approach to the assessment of losses arising from the 419 typically will involve consideration of at least some of the following questions:

- (1) Is the check a "forgery" or does it bear an "alteration"?
- (2) Is the check a "counterfeit"?
- (3) Did the account holder intend to defraud the bank by depositing or cashing the check?
- (4) Did the insured bank's loss result *directly* from any of the foregoing?

A. *Is the check a "Forgery" or does it bear an "Alteration"?*¹⁶

Insuring Agreement (D) of Form 24 provides coverage for losses sustained by financial institutions resulting directly from the forgery and alteration of checks and certain other defined instruments. Similar coverage is found in most other bond forms, both standard and proprietary.

"Forgery" is defined in the standard form Financial Institution Bond (the "FIB") as "affixing the handwritten signature, or a reproduction of the handwritten signature, of another natural person without authorization and with intent to deceive" or "affixing the name of an organization as an endorsement to check without authority and with the intent to deceive." The definition further provides that a signature that consists in whole or in part of one's own name signed with or without authority, in any capacity, for any purpose is not a forgery.¹⁷

¹⁶ This paper is not intended to provide a detailed discussion of the definitions of "forgery," "alteration," and "counterfeit". There have been many fine papers and articles addressing these topics, and the reader is referred to them.

¹⁷ The FIB also contains twenty-two separate definitions, set forth in the Conditions and Limitations Section 1, and twenty-eight exclusions, set forth in Section 2, which impact the construction and application of this Insuring Agreement. See Section 2 of the FIB at subparts (a), (e), (g), (h), (o), and (p).

The essence of forgery consists of endeavoring to give the appearance of truth to a deceit and falsity. Thus, if a person signs his own name to a negotiable instrument, such signature is not considered a “forgery” even though he falsely pretends to represent someone that he does not in fact represent.¹⁸

The requirement that the signature be of the name of “another person” explicitly contemplates the signature of an actual living person, authorized to sign checks on the maker’s behalf. The signature of a fictional person, or even an illegible signature, does not constitute a “forgery” under the FIB definition.¹⁹ In the context of a cashier’s check used in the 419, in order for a “forgery” to exist, the check must bear the forged signature of a specific person authorized to sign checks on the maker’s behalf. Intent to deceive in such a circumstance likely can be assumed. Absent the cashier’s check bearing such a signature, the bond’s “forgery” coverage provision likely is not implicated.

“Alteration” 419 claims generally involve the interception of a cashier’s check (or other check), with the name of the original payee changed to the name of the “victim,” and perhaps an increase in the amount of the check as well.

“Alteration” is not defined in the FIB. The Uniform Commercial Code, however, defines “alteration” as an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.²⁰ The definition of “alteration” presupposes the existence of a genuine instrument that has been fraudulently changed. A change to a fake instrument is not an “alteration.”

Cases construing fidelity bond coverage involving altered instruments have consistently reasoned that in order to be covered, an alteration must materially change the contract of a party to the instrument.²¹ A material alteration can be accomplished through a fraudulent change in a genuine instrument or by the completion of an incomplete instrument by someone other than the original signer in a way that is unauthorized.²² An instrument that is fraudulent from its inception, however, cannot be considered altered within the terms of the bond because it is not based on any preexisting, genuine instrument.

¹⁸ See, e.g., *United Pac. Ins. Co. v. Idaho First Nat’l Bank*, 378 F.2d 62 (9th Cir. 1967).

¹⁹ In addition, as discussed below, any loss would not result “directly” from the “forgery” because the check should not be honored and thus should be worthless.

²⁰ See UCC § 3-407.

²¹ *St. Paul Fire & Marine Ins. Co. v. State Bank of Salem*, 412 N.E.2d 103, 113 (Ind. Ct. App. 1980) (“Logically, an alteration on the amount in figures alone should not be considered as changing the contract of the instrument or the effect thereof, and should therefore not be regarded as material...[B]y the weight of authority, the alteration of figures on a check, bill, or note, stating the amount thereof, without changing the words expressing the amount, does not constitute forgery because a change in the figures alone is not a material alteration of the instrument It is difficult to see how one could suffer a loss due to an alteration that is not material.” (citations omitted)).

²² *Charter Bank N.W. v. Evanston Ins. Co.*, 791 F.2d 379 (5th Cir. 1986).

Thus, provided the cashier's check bears a material alteration and the loss results "directly" from such alteration, as discussed in more detail below, coverage for such a loss may exist under many bond forms.

B. Is the check a "Counterfeit"?

While the FIB does not provide coverage for losses resulting from "counterfeit" checks, the marketplace offers other bond forms that do.

The typical definition of "Counterfeit," as found in the FIB, is "a Written imitation of an actual, valid Original which is intended to deceive and to be taken as the original."

In order for a document to be a "Counterfeit," there must be an "original" document in existence that the "Counterfeit" imitates. In the case of a check, this means that there must be an original check with the same payee and the same amount in existence, and the "counterfeit" must imitate the check precisely.²³

It would be difficult to conclude that a 419 check constituted a "Counterfeit" for purposes of fidelity coverage, for reasons that may be obvious: typically there will not be a legitimate check payable to the "victim" accountholder, the imitation of which has been received from the scammer. Cases involving checks bearing forgeries or alterations will be more prevalent.

C. Did the accountholder intend to defraud the bank?

This consideration comes into play with bond forms that provide coverage such as "fraudulent deposit", covering losses resulting directly from an accountholder's deposit of a fraudulent item with intent to deceive.

The question of intent will undoubtedly prove to be more factual than legal. By reviewing the accountholder's actions and interviewing the accountholder (who may be anxious to defend himself/herself), one may be able to discern his/her motives. Was he/she simply young, naïve, and/or foolish enough to believe that he/she was getting "free money" for helping out an African princess? Or was he/she well-educated, savvy, and professional, who most likely had to know that the check he/she received, and the deal with which he/she was presented, was dubious at best? Should he/she have known that there was something suspect about the check he/she received? Did he/she withdraw most of the proceeds of the check from his/her account as soon the account was credited, arguably indicating fraudulent intent? Or did the funds remain in the account for any length of time before they were withdrawn?

²³ See, e.g., *First Fed. Sav. Bank v. Continental Cas. Co.*, 768 F. Supp. 1449 (D. Kan. 1991) (discussing "Counterfeit" in the context of checks).

D. Did the loss result **directly** from a “Forgery,” “Alteration,” or “Counterfeit” check?

Bond forms universally require that a loss resulting from a “forgery,” “alteration,” or “counterfeit” document result “directly” from the fact that the document contains a forgery or alteration, or that the document is a counterfeit.²⁴ While the issue discussed in the preceding section presents primarily a factual question, this issue is distinctly legal. The case law that has interpreted fidelity bonds demonstrates that, if the insured would have sustained the loss had the check not contained a forgery or alteration, or had not been counterfeit, then the bank’s loss is not a “direct” loss.

Various courts have employed different interpretations of the phrase “direct loss.” A discussion of these interpretations has been the subject of many excellent papers and is beyond the scope of this article. For purposes of this article, it is sufficient that the reader recall that the prevailing view is that the loss is a “direct loss” if it would not have been sustained “but for” the forgery or lack of authenticity of the check.²⁵ In other words, if the loss would have been sustained irrespective of whether the signature on the check was authentic, or if the document itself was authentic, then the loss is not a “direct” loss.

For purposes of the 419, then, the analysis focuses on whether the insured bank would have sustained a loss even if, for example, the signature on the check was genuine. If the check was written on a fictional account, or if the forged signature is of a person not authorized to sign checks on the maker’s behalf, such that the paying bank would not have honored the check had the signature been authentic, then the insured likely would have sustained the loss irrespective of the forgery and the loss cannot be considered to be a “direct” loss.

IV. Conclusion

The notoriety of the Nigerian 419 scam is widespread. Victims have been duped by sham Nigerian business deals since the early 1980s. The Google search engine identifies over 5,640,000 relevant web pages relating to the 419.

Coverage analysis may initially appear to present a challenge to the claims professional or practitioner due to the fact that these are non-traditional claims, and 419 scam losses may not have been within the contemplation of either party during the

²⁴ The phrase “resulting directly from” a specified peril, in order to be covered, has been present in every Insuring Agreement since at least 1980. See William T. Bogaert & Andrew F. Caplan, *Loss and Causation Under the Financial Institution Bond*, in FINANCIAL INSTITUTION BONDS, Ch. 11 (Duncan L. Clore ed. 2d ed. 1998).

²⁵ See, e.g., Gary J. Valeriano, *Handling Forgery Claims and Articles 3 and 4 of the Uniform Commercial Code*, in HANDLING FIDELITY BONDS 223, 231 (Michael Keeley & Sean Duffy eds., 2005) (“If the forgery which is the basis of the claim was on a document which was worthless in any event, there is no causal relationship between the loss and the forgery”) The other, less restrictive view of “direct loss” is to consider whether the forgery or counterfeit nature of the document was a “proximate cause” of the loss. See, e.g., *Resolution Trust Corp. v. Fidelity & Deposit Co.*, 205 F.3d 615, 654-56 (3d Cir. 2000).

underwriting process. 419 losses do not generally, however, present novel issues, and these claims can be addressed within the framework set forth above. As in most other types of claims, the scope of the claim evaluation will be dictated by the peculiar facts surrounding the loss, and the rights and respective liabilities of the parties will be governed by the express language of the fidelity contract.