SURETY TODAY PRESENTATION
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Baltimore, MD
August 14, 2017

Limitations Provisions

Our topic today is Limitations. I'm not going to go around the country and tell you what limitations are state by state, rather, I want to talk today about some of the issues that can arise when you are attempting to determine what the statute of limitations is.

So, let's say you have a claim that has come in against a bond (it could be a commercial bond or a construction bond), and you want to determine whether the claim is timely, or you might have a potential salvage claim and you want to figure out what the limitations period is on asserting that salvage claim. In these scenarios you will need to determine what the applicable limitations period is in the applicable jurisdiction.

This presentation has arisen out of our handling of several large bankruptcy cases where there are hundreds of bonds all across the country and we had to figure out what the limitation periods were for these bonds in all of these various jurisdictions. So, in the course of doing that analysis on all of those cases, we became pretty adept at determining the limitations period, and also learned quite a lot about some of the issues, pitfalls and complications that can arise when you are attempting to determine the limitations. You would think that it is pretty straight forward, and sometimes it is, but other times it can be very, very complicated and we'll talk about that today.

First, we will start with a little background. As everyone knows, statutes of limitations set a prescribed time in which a plaintiff must file a complaint after a cause of action accrues. If a plaintiff does not file a complaint within the limitations time period, the complaint may be dismissed and the claim is lost, regardless of the underlying merits of the case. I say "may be dismissed" because asserting the statute of limitations is an affirmative defense that must be raised by the defendant, so if you don't raise it, courts won't necessary throw it out.

POLICY REASONS FOR STATUTES OF LIMITATIONS

There are three generally recognized policy reasons underlying statutes of limitations. The first reason is to protect defendants from stale claims. Statutes of limitations are said to provide defendants with security in their business and planning by allowing them to rest assured that after a certain period of time, they cannot have liability for acts committed in the past. Statutes of limitations serve to protect defendants by insuring that they will not be disadvantaged by the effect of the passage of time on their ability to defend themselves. It is recognized that defendants will not be able to produce evidence to absolve themselves if memories have faded, witnesses have died or disappeared, and/or evidence has been lost. So, that's one of the policy reasons behind having statutes of limitations.

The second policy consideration is to protect the courts from having to hear stale claims when their time could be better spent on more recent, and thus presumably more important disputes. Limitations periods allow the court to clear dockets of the stale older claims, thereby increasing judicial efficiency and limiting the misuse of time.

The third policy justification for statutes of limitation is to punish plaintiffs who 'sleep on their rights' for an inexcusably long time. Thus, a plaintiff who delays a suit beyond the limitations period brings the punishment upon themselves and deserves to be penalized for allowing their claims to go stale. As one court put it – "a plaintiff's knowing delay in filing suit increases the chances that justice will be frustrated by the loss of evidence and cripples the defendant with fear of perpetual liability." As a result, the punishment of dismissal on limitations grounds gives a plaintiff an incentive to file suit in a timely fashion. As a result of these various policy considerations every jurisdiction has enacted legislation establishing various limitations statues.

WHAT LIMITATIONS PROVISION APPLIES

When you are trying to determine the applicable limitations period, there are three general places you will need to look. First, check to see if there is a limitations period in any authorizing statute for the bond or claim at issue. Second, check the language of the bond or contract itself for any contractual limitations provisions. Third, check the general statute of limitations provisions if you haven't found anything in the first two places.

AUTHORIZING STATUTE

The first place to look for a limitations period on a bond is in the authorizing statute, if there is one. For example, if a state statutory scheme requires the posting of a bond to secure the issuance of a permit, or a contractor's license or to secure a warranty or other type of service, then you should check that authorizing statute to determine if there is a limitations period applicable to claims against the bond required by the statute. Such specific limitations periods will control over any other more general limitations periods that might exist elsewhere in the law and might otherwise apply to a bond. That's because of a general rule of statutory construction that the more specific statute will control over the more general statute.

Perhaps the best and most well known example of such an authorizing statute in the surety industry is the Miller Act and the Little Miller Act. The Miller Acts provide a specific limitations period for a claim on the bond and that limitations period will govern and control over any other general limitations period. Of course, in the Miller Act and Little Miller Act situations, the limitations period in the Acts only apply to the bonds issued by the general contractor and its surety to the public owner. Even though the project may be a federal project or a state project, the limitations period for a claim by a supplier or sub-subcontractor against a subcontractor's payment bond is not governed by the Miller Act or Little Miller Act. In that scenario, you've got to look for other limitations provisions.

GENERAL STATUTES OF LIMITATIONS

If there is no authorizing statutory limitations period, then you need to review the general statute of limitations provisions of the jurisdiction. Some states have specific limitations periods for claims against bonds. For example, in Maryland there is a limitations statute that provides that claims against bonds must be filed within 12 years. If there is no statute applicable specifically to bonds, such as we have in Maryland, bonds are generally considered to be a written agreement or written contract, and the states' limitations period for those types of documents would apply. In some jurisdictions there may be a limitations period for what's known as "specialties" and, at common law, bonds were considered to be specialties, so if there is a limitations provision in a particular jurisdiction relating to specialties, then that might apply to a bond claim.

Sometimes, it can get tricky. For example, recently I handled a case where a claim was being made by a County against a surety on a permit bond. There was no limitations provision in the authorizing County Code or in the bond itself dealing with limitations, so I was looking at the general limitations provisions of the State of Maryland. In Maryland there is a general statute of limitation applicable to breach of contract actions, which is three years. A bond is considered in Maryland to be a contract, so that provision would apply. However, as I noted a moment ago, in Maryland there is also a specific statute that provides limitations of 12 years on claims against bonds, so that would be the provision you would look to. But, the permit bond in question was also a forfeiture bond because the County could make demand on the bond even if it had no damages once the permit provisions were violated by the principal. In addition, the County Code referred to the bond as a forfeiture obligation. Maryland has a specific statute of limitation for forfeiture claims, which is one year. The provision provides that "a prosecution or suit for a fine, penalty, or forfeiture shall be instituted within one year after the offense was committed." I argued in that case that the forfeiture limitations period applied to the County's claim and that the principal's violations of the grading laws was an offense under the statute, and further, because the forfeiture statute is more specific than the general claim against the bond statute and that the one year limitations statute would apply.

Another example of how convoluted the analysis of what limitations provision applies can become is found in Arizona, and I am not picking on Arizona, because it can get convoluted in many states. For this discussion let's assume we have a claim against a Utility Bond. The Bond secures payment for utility services like electric, water, gas, etc., and states that if the principal fails to pay for the services, the surety will be obligated to pay. Under Arizona law there is a three year limitations period for claims on "open accounts." Arguably, the bonded agreement between the principal and the utility company is an open account. However, under Arizona law, the statute of limitations applicable to the underlying debt is not necessarily applicable to the guaranty of the debt, and that is true in most states – Louisiana is one exception. The Arizona courts have held that a guaranty contract is a separate contract pursuant to which the guarantor warrants that the principal shall perform rather than agreeing to perform jointly with the principal, and such guaranty contract is separately enforceable and independent of the obligation of the principal debtor. Accordingly, Arizona courts have applied a six year statute of limitations for contracts to claims against bonds as opposed to going with the underlying limitations period. However, Arizona courts have also recognized that guarantees are not automatically subject to the limitations period for contracts and that a determination must be made on a case-by-case basis according to the terms of the guaranty and the nature of the underlying obligation. So right there, you're just looking for what the limitations period is and now you have a situation where you have to deal on a case-by-case basis and try to figure out if there has been any prior case law dealing with the type of bond you have. Moreover, although a Utility Bond is a written agreement, the six year statute of limitations for a contract in writing under Arizona law may not apply because Arizona makes a distinction between contracts executed in the State of Arizona – which is the six year period, and contracts executed outside of the State of Arizona, which are subject to a four year statute of limitations.

So as these examples demonstrate the analysis of what limitations provision would apply can be complicated by the wide variety of limitations periods under various state laws, the nature of the obligation at issue and even the facts and circumstances of how or where the obligation was entered into.

DOCUMENTS UNDER SEAL

Another potential wild card in the limitations analysis is whether the bond or contract is under seal. Sealing a document is an ancient practice that originally involved pressing a person's seal or family crest into hot wax on a document. When a document is executed "under seal" it establishes that the contract was made for consideration, and by applying a "seal" thereto, the signor is confirming the consideration and further authenticating his or her intent to carry out the contract. A "seal" can take many forms. It can be in the form of a stamp, impression, a scroll, or even just the word "seal" or "L.S." after a person's signature. The bond or contract can also recite that the parties intending to be bound "hereby set their hands and seals," etc. In some states the effect of sealing a document has been abolished, but in other states it is still alive and well.

One effect of sealing a document is that it may extend the limitations period. For example, in Maryland as I noted a moment ago the general period of limitations on a written contract is three years, but if the contract is under seal, the limitations period becomes 12 years. Under Massachusetts and South Carolina law, for example, the limitations period applicable to a document under seal is 20 years.

So check for a seal on the bond or other instrument that you are dealing with and then check to see if there is a separate limitations provision for documents under seal in the applicable jurisdiction.

CONTRACTUAL LIMITATIONS PERIOD

Many bond forms contain a provision with a limitations period within which a claim on the bond must be made – these are referred to as contractual limitations provisions. For example, the ConsensusDocs 260 performance bond's contractual limitations period is "two years after default of the Contractor or Substantial Completion of the Work, whichever occurs first." The AIA A312 (2010) version of the Performance Bond provides that "[a]ny proceeding, legal or equitable, under this Bond . . . shall be instituted within two years after Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under the Bond, whichever occurs first."

It appears that the vast majority of jurisdictions generally hold that contractual limitations periods are enforceable. However, there may be a few restrictions on the general rule. Most states hold that contractual limitations periods will be upheld, but only if they are reasonable and the provision is clearly set forth in the agreement. As one court explained, "the contractual limitations period must be reasonable under the circumstances of the particular case and sufficient to allow a plaintiff to file a claim after the alleged damage has been ascertained." Whether a contract limitations period is reasonable may be determined by considering the provisions of the contract and the circumstances of its performance and enforcement.

I have a case pending now on appeal in the District of Columbia where I obtained summary judgment on behalf of the surety based on a one year contractual limitations provision in the bond. The District of Columbia enforces contractual limitations provisions and we argued that the provision was clearly reasonable in our case because it was the same one year period as the limitations provision under the Miller Act and Little Miller Act. If a one year limitations period was reasonable for purposes of public policy in the Miller Acts, it clearly is reasonable in the bond, so we'll see what the DC appellate court has to say about that.

In some cases a contractual limitations period may not be enforceable if the court determines that the limitations period violates public policy – such as a contractual limitation on an important statutory right. Finally, a contractual limitation period may be prohibited by statute. For example, in Maryland, the Maryland Code prohibits limitations periods in an insurance policy or surety bond if the limitations period is shorter than the statutory limitations period. Of course, in Maryland, we have 12 year statute of limitations on bond in general. It's hard to imagine that any contract would have a provision that is longer than that, so most limitations provisions involved in Maryland are going to be unenforceable. Similarly, in Florida the Florida Code provides that any provision in a contract setting the period of limitations on an action arising out of contract for less than that provided by the applicable statute is void.

So you need to be careful when dealing with contractual limitations periods and determine whether such provisions are valid in the applicable jurisdiction and whether such provisions are reasonable.

WHEN LIMITATIONS DO NOT APPLY

What about a situation where limitations do not apply? This is another wild card in the limitations analysis and it's a question of who is making the claim. There are several states that still apply the doctrine of *nullum tempus occurrit regi* or, in English, time does not run against the king. Pursuant to this doctrine, a limitations period will not prevent a governmental body from bringing a claim against the bond after the limitations period has expired. The theory that no time runs against the sovereign is generally followed in regard to ordinary statutes of limitation, unless the state is expressly or by necessary implication included within the operation of the statute.

The historical justification for the doctrine is that the government cannot be expected to be as vigilant as individuals are in preserving their rights. Governments are impersonal and thus are limited to acting through agents such as state officials, who, as one court noted, "are generally few in number and fully occupied with the regular routine of official duties." Moreover, the doctrine is thought to further "the great public policy of preserving the public rights, revenues, and property from injury and loss, by the negligence of public officers."

APPLICATION OF *NULLUM TEMPUS* TO COUNTIES AND MUNICIPALITIES

There is a dispute among the various jurisdictions as to whether the doctrine of *nullum tempus* should be applied to counties or municipalities. It may apply to the state government, but when you get down into the lower levels, there is a question as to whether it applies. Some states do not extend *nullum tempus* to municipalities or counties in any circumstances and you will find examples of that in Nebraska and Alabama. *See, e.g., City of Lincoln, Neb. v. Windstream Nebraska, Inc.*, 800 F.Supp.2d 1030, 1035 (D. Neb. 2011); *Bd. Of Sch. Comm'rs of Mobile Cty v. Architects Grp.*, Inc., 752 So. 2d 489 (Ala. 1999). In other states *nullum tempus* is extended to municipalities to the same extent that those states apply the doctrine to the state government. You'll find examples of that in Mississippi. *See, e.g., Enroth v. Memorial Hosp.at Gulfport*, 566 So.2d 202, 206 (Miss. 1990). The remaining states that have addressed the issue apply *nullum tempus* to municipalities and counties in a limited fashion, using a variety of tests that all seem to center around the same theme. For example, in Iowa the *nullum tempus* doctrine does not exempt actions by municipalities and counties from the general statute of limitations unless the action involves a public or governmental activity, as opposed to a private or proprietary activity. In Illinois, *nullum tempus* applies to municipalities with regard to "public rights" and "property held for public use," but not to "contracts or mere private rights."

Pennsylvania applies the so called public/private test to the application of *nullum tempus* and held that the building of a school was a public function and thus *nullum tempus* applied and the action was not barred by the statute of limitations. Many courts have observed that the public/private test is difficult to apply. The Maryland courts have stated that many of the decisions regarding whether a function is governmental or proprietary in nature are confusing and almost impossible to reconcile. The line of demarcation between private, corporate, and ministerial, and governmental, political, and discretionary activities or functions by municipalities is difficult to discern, and even more difficult to define, and is some instances illusory in practice. So when you look at the law, you will see in some states they say that building a school is a governmental function while some states say it is not. Some states say that building roads is a governmental function while some states say it is not. It's really all over the place and as these courts themselves have noted, are sometimes difficult to apply.

One interesting result of the application of *nullum tempus* is that it can transfer to the surety. A Maryland Court held that a surety, which had paid a judgment owing to the State and thereafter sued a debtor as subrogee of the State, is entitled to stand in the State's position in reference to its claim against the debtor and enjoy the State's exemption from the operation of the statute of limitations under *nullum tempus*. *See Baltimore Cty. v. RTKL Assocs. Inc.,* 380 Md. 670, 686, 846 A.2d 433, 442–43 (2004). So, if you've got one of these old claims that you've paid and you weren't sure if you could go after somebody for salvage, if you're standing in the shoes of the State and that State recognizes *nullum tempus*, then you may be able to pursue that claim, even if a lot of time has passed.

WHEN DOES THE LIMITATIONS PERIOD BEGIN TO RUN - ACCRUAL

Once you determine what the statutory or contractual limitation period is, the next question becomes, when did the limitation begin to run? Limitations period begins to run when the cause of action at issue "accrues." Typically, a cause of action is said to have accrued when all of the elements of the cause of action exist. As a California court stated "[i]n ordinary ... actions, the statute of limitations ... begins to run upon the occurrence of the last element essential to the cause of action." For example, it is generally held that a cause of action for breach of contract ordinarily accrues and the limitations period begins to run upon a breach. A surety's obligation under a bond typically accrues when the principal breaches the underlying obligation. A surety's indemnity claim accrues when the surety incurs a loss.

Accrual can also be defined in the statute or contract itself. Thus, in the example I gave earlier, in the AIA A312 (2010) Performance Bond, the contractual limitations provision provides that "[a]ny proceeding, legal or equitable, under this Bond . . . shall be instituted within two years after Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under this Bond, whichever occurs first." Thus, the accrual for the limitations period in the A312 Bond is defined as the first to occur of those various events. In the Miller Act, the limitations provision defines accrual as "one year after the day on which the last of the labor was performed or material was supplied by the person bringing the action." 40 U.S.C. § 3133(b)(4).

DISCOVERY RULE

In some cases and in some jurisdictions the general rule regarding accrual is modified by what is known as the "discovery rule." The discovery rule postpones accrual of a cause of action until the plaintiff discovers, or has reason to discover, the cause of action. The rule is generally expressed as a "knew or should have known" standard.

Under the discovery rule, a cause of action accrues, and the limitation period begins to run when a claimant knows or in the exercise of ordinary diligence should have known of the injury. A court applies the discovery rule to determine when a cause of action accrues if an element of the cause of action is not immediately apparent. Under the discovery rule, suspicion of one or more of the elements of a cause of action, coupled with knowledge of any remaining elements, will generally trigger the statute of limitations period. The rule avoids dismissing a suit on grounds of limitation when a plaintiff is blamelessly ignorant of his or her cause of action, but it does not afford protection to a plaintiff who knows about the injury but has not determined the identity or cause. Thus, the discovery rule requires only that the plaintiff be aware of an injury; it does not require the plaintiff to know the full extent of the injury.

There is a good example of the discovery rule in a Maryland case involving a religious order that built a new convent. Shortly after moving in, the Sisters noticed that there were some roof leaks. They did not know what the cause was or who was responsible, so they hired an engineer. The engineer conducted an inspection, issued a report and identified who was responsible and what the cause was. The Sisters then filed suit three years from the date the report was issued, but more than three years after the roof leaks began. The case was dismissed as barred by limitations because under the discovery rule once the Sisters became aware of the leaks, they were on notice of the claim and had a duty to investigate and the limitations then began to run. The ultimate determination of the cause and party responsible was not the triggering event.

TOLLING OF LIMITATIONS

Once limitations are running, it is possible that those limitations can be tolled. Of course, everyone is probably familiar with a tolling agreement where the parties contractually agree to suspend the running of the statute of limitations. The limitations can also be tolled by equitable grounds, and limitations can be tolled by what is known as the doctrine of equitable estoppel. Equitable estoppel is a well established concept invoked by courts to aid a party who, in good faith, has relied, to his detriment, upon the representations of another. One court in a Miller Act case stated the rule as: Estoppel arises where one, by his conduct, lulls another into a false security, and into a position he would not take only because of such conduct. Estoppel, in the event of a disputed claim, arises where one party by his words, acts, and conduct led the other to believe that it would acknowledge and pay the claim, but then, after limitations passed, refused to pay the claim and refused to negotiate any further.

There is an example of this under the Fourth Circuit of a case where the surety came in, was financing its principal and was using its principal to complete various defaulted projects, and the principal was representing to various subcontractors and suppliers that the surety take care of the claims, don’t worry about it, everything will be fine. When a supplier asserted a claim after the statute of limitations had passed the surety moved to dismiss. The Court held that under the circumstances of the case and the surety’s financial control over the principal, and the principal and surety working together to cure the default and complete projects essentially rendered the principal the surety’s agent. So the actions and the statements of the principal was then imputed to the surety and equitable estoppel was applied to that claim.

ACKNOWLEDGEMENT, PARTIAL PAYMENT

Other times, limitations can be tolled or even restarted if there’s an acknowledgment that the debt was owed or partial payment is made. Those circumstances can result in the limitations period being tolled or starting to run again. This issue came up under Louisiana law in a bankruptcy case. In Louisiana the limitations period for a claim against a surety is the same as the limitations period for the principal on the underlying obligation. Thus, events that would affect the limitations period of the principal can also affect the limitations period for a claim against the surety. Under Louisiana law, the debtor’s sworn schedules filed in a bankruptcy can constitute an acknowledgement of a debt such that the limitations period can be interrupted, which would cause the limitations period to begin to run anew from the last day of the interruption.