FOURTEENTH ANNUAL NORTHEAST SURETY AND FIDELITY CLAIMS CONFERENCE

SEPTEMBER 18-19, 2003

"DON'T BE ESTOPPED –WHAT YOU SHOULD (AND SHOULD NOT) SAY TO THE CLAIMANT DURING YOUR INVESTIGATION OF A SURETY OR FIDELITY BOND CLAIM."

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Introduction

The American author and humorist Mark Twain allegedly once remarked that it is "better to keep your mouth shut and appear stupid than to open it and remove all doubt." [1] Twain probably did not have surety and fidelity claims handlers in mind when he made this statement. Nonetheless, Twain's remark might be considered by surety and fidelity claims professionals in connection with the issue of equitable estoppel, the topic of this paper. Indeed, at its core the concept of estoppel as applied against a surety or fidelity insurer usually involves something said – or not said – by the agent or representative of the surety or insurer to the claimant.[2]

This paper has two primary objectives. First, it seeks to provide the surety and fidelity claims professional with a basic overview of the law of estoppel, through a discussion of both the general principles relating to estoppel, as well as the cases which have addressed the issue of estoppel within the context of surety and fidelity bond claims. Second, in light of these cases, this paper seeks to provide some practical advice to the claims handler on claims handling strategies which might reduce the likelihood of a successful estoppel argument against the surety.

Surprisingly, there are a substantial number of cases discussing the doctrine of equitable estoppel as applied to sureties. These cases will be discussed in greater detail later in this paper. Most of these involve the same general fact pattern. Usually the claimant on the bond has sent a demand for payment to the surety before the expiration of the applicable statute of limitations. The surety thereafter investigates the claim and contacts the claimant. In some instances there are negotiations between the claimant and the surety, which do not lead to a settlement, or which lead only to a partial payment on the claim. In other instances the surety assumes that the principal has taken care of the claim and so advises the claimant. In still other instances the surety sends a denial of the claim but only after the statute of limitations has expired. Finally in some cases there is an initial communication from the surety seeking information from the claimant, but no follow up. In all cases the claimant, in supposed reliance on the statements, actions or inactions of the surety, does not file suit against the surety within the time period required by the applicable statute of limitations.

Once suit is filed, the surety contends that the suit should be dismissed because of the claimant's failure to file the action within the time required by the statute of limitations. Typically the claimant argues that the surety should be estopped (or legally precluded) from asserting the statute of limitations defense because of its conduct in handling the claim before the statute of limitations period expired. Often the claimant will argue that it deferred filing suit

[1] Though commonly attributed to Twain, there is some dispute as to whether Twain ever uttered or wrote these words. See Kim A. McDonald, "Many of Mark Twain's Famed Humorous Sayings Are Found to Have Been Misattributed to Him," *Chronicle of Higher Education* (Sept. 4, 1991), A8. Indeed, this saying – and variants of it – have also been attributed to several others, including Abraham Lincoln, the 19th century English writer George Eliot, Groucho Marx, Albert Einstein and Anonymous.

[2] This paper does not address the separate issue of the surety's right to assert estoppel *against* a payment bond claimant based on the inequitable conduct of the claimant.

on the bond because it was lulled into thinking that the surety would pay the claim. The claimant may also contend that it did not file a timely suit because it believed that negotiations with the surety regarding the claim were ongoing. The claimant may also argue that it was deliberately misled by the claims handler. Given these arguments, the Court must apply the legal rules governing estoppel and then consider whether the surety's actions are such that it should be precluded from relying on the statute of limitations defense.

It is important to note at the outset that each estoppel case is unique and will be judged based on the specific facts in that case. However, in any estoppel situation there will be two key areas of inquiry. First, the Court will examine the statements and actions of the surety or insurer. This inquiry will focus on the actions of the in-house claims handler, as well as the conduct of any other agent or representative of the surety (including consultants, attorneys, local agents, and – in the appropriate case – the principal acting with the apparent authority of the surety). What did the claims handler say to the claimant? Did he/she acknowledge liability for the claim? Did the claims handler make assurances to the claimant that the claim would be paid? Were these assurances made before or after the limitations period had expired? Did the claims handler knowingly – or even inadvertently – mislead the claimant into believing that the claim would be paid? Was a settlement offer made during the limitations period? If so, was the statute of limitations defense expressly reserved? Did the claims handler assure the claimant that the principal would take care of the claim? Did the claims handler engage in a course of conduct of misleading statements or, instead, is the estoppel claim based on a single statement or correspondence? Were there valid defenses to the claim other than the statute of limitations and, if so, were these defenses asserted or reserved by the claims handler? Did the surety promise to get back to the claimant but then fail to follow through? Did the claims handler ask or suggest to the claimant that suit not be filed so that settlement negotiations could proceed? The answers to some or all of these questions will affect the Court's determination as to whether the surety may be estopped from asserting the statute of limitations as a defense.

The second area of the inquiry in any estoppel case will be the actions of the claimant. Was the claimant genuinely misled by the surety? Did the claimant actually rely on anything that the surety said (or did not say)? Was the claimant's failure to file the suit due to the claimant's lack of diligence rather than the surety's actions? Did the claimant have an attorney during the applicable limitations period? If so, was the attorney aware of the limitations period? How long did the claimant wait until it finally filed its action on the bond? Was the claimant's delay in filing the suit so extensive as to indicate that its actions were unreasonable or that it did not actually rely on the surety's assurances? The answers to some or all of these questions will also affect the Court's determination regarding the viability of the estoppel claim.

<u>The Legal Concept of Equitable Estoppel</u>

Any surety or fidelity insurer faced with a claim of estoppel should first consult the controlling law of the jurisdiction in which the case is pending, since there is no universally accepted definition or standard for equitable estoppel. Nonetheless, based on a review of cases from various jurisdictions one can discern the following general points. Equitable estoppel is generally a common law doctrine which is available to "aid a party who, in good

faith, has relied, to his detriment, upon the representations of another." United States ex rel. Bobby Currin & Sons v. J & W Builders, 17 F.Supp.2d 462 (M.D.N.C. 1996).

The objective of a Court applying equitable estoppel is to promote fairness and equity. The United States Supreme Court stated this principle in an early case as follows:

> The principle is that where one party has by his conduct induced the other party to a transaction to give him an advantage which it would be against equity and good conscience for him to assert, he would not in a court of justice be permitted to avail himself of that advantage. And although the cases to which this principle is to be applied are not as well defined as could be wished, the general doctrine is well understood and is applied by courts of law as well as equity where the technical advantage thus obtained is set up and relied on to defeat the ends of justice or establish a dishonest claim.

Union Mutual Life Insurance Company v. Wilkinson, 80 U.S. 222, 233 (1872) as quoted in Glus v. Brooklyn Eastern District Terminal, 359 U.S. 231, 234 (1959).

In most jurisdictions estoppel will require "representation, reliance, change of position and detriment." Millgard Corporation v. White Oak Corporation, 224 F.Supp.2d 425, 431 (D.Conn. 2002) quoting United States ex rel. Humble Oil & Refining Company v. Fidelity & Casualty Company of New York, 402 F.2d 893, 898 (4th Cir. 1968). Thus a prima facie claim of equitable estoppel requires a showing that (1) the surety, or someone acting on the surety's behalf, made a representation to the claimant (2) which is relied upon by the claimant, (3) such reliance must lead to a change of position by the claimant, and (4) the claimant must thereafter be harmed as a result of its change in position.

The Fourth Circuit Court of Appeals defined estoppel in the surety claims context as follows:

> 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, if, after investigation, the claim were found just, but when, after the time for suit has passed, breaks off negotiations and denies liability and refuses to pay.

United States ex rel. Humble Oil & Refining Company v. Fidelity & Casualty Company of New York, 402 F.2d 893, 897 (4th Cir. 1968). This definition, which remains widely quoted in even the most recent estoppel cases in the surety context, was derived from the Tenth Circuit Court of Appeal's decision in McWaters and Bartlett v. United States, 272 F.2d 291 (10th Cir. 1959), which appears to be the seminal decision regarding the claim of equitable estoppel in the context of a Miller Act payment bond suit.

The United States District Court for the District of Connecticut has defined estoppel more broadly:

> [t]here are two essential elements to estoppel: the party [i.e., the surety] must do or say something which is intended or calculated to induce another to believe in the existence of certain facts and to act upon that belief; and the other party, influenced thereby, must actually change his position or do something to his injury which he otherwise would not have done. Estoppel rests on the misleading conduct of one party to the prejudice of another. In the absence of prejudice, estoppel does not exist.

Millgard Corporation v. White Oak Corporation, 224 F.Supp.2d 425, 431 (D.Conn. 2002).

The Eighth Circuit Court of Appeals provided yet another variation on the elements of equitable estoppel:

> (1) lack of knowledge and of the means of knowledge of the truth as to the facts in question; (2) reliance, in good faith, upon the misleading conduct or false representations of the party to be estopped; and (3) change in position based thereon to his injury, detriment or prejudice.

United States v. Aetna Casualty & Surety Co., 480 F.2d 1095 (8th Cir. 1973).

While the basic concepts of estoppel (representation, reliance, change of position and detriment) are generally the same in each jurisdiction, counsel must take care to identify and confirm the controlling law applicable to each case, since each jurisdiction's definition of estoppel may vary slightly. For example, in North Dakota the doctrine of equitable estoppel has been codified into a statute; see N.D.Cent. Code § 31-11-06; and under the statute a party claiming estoppel must show "1) conduct which constitutes a false representation, 2). the intention to cause another person to rely on that conduct, and 3). that the party having made the false representation had knowledge of the true facts. A party claiming estoppel must have lacked knowledge of the true facts and must have relied on the false representation to his or her injury." Farmers Union Central Exchange v. Reliance Insurance Company, 626 F. Supp. 583, 588 (D.N.D. 1985). Estoppel claims under the Miller Act are governed by federal common law and not state law. See Garfield v. J.C. Nichols Estate, 57 F.3d 662 (8th Cir. 1995).

Regardless of the jurisdiction, courts generally agree that it is not necessary for the claimant to show that the surety or insurer engaged in fraud, deliberate misconduct, or deliberate intention to mislead the claimant:

> It is not necessary that the representations and conduct should be labeled as fraudulent in a strict legal sense or that they were made or carried on with an intention to mislead the plaintiff … [T]he focus is not on any particular factor, but rather on the totality of the circumstances. Therefore it is not dispositive that the Plaintiff may have been represented by counsel before limitations ran, or that no express promise to waive the statute

> of limitations was made, or that some form of intentional deception cannot be proven[.]

United States ex rel. Bobby Currin & Sons v. J & W Builders, 17 F.Supp.2d 462, 465 (M.D.N.C. 1996). Once again counsel must be sure to identify the controlling law of the jurisdiction on this issue to identify any nuances which may be unique to that jurisdiction. Compare McWaters and Bartlett v. United States, 272 F.2d 291, 296 (10th Cir. 1959) ("to constitute estoppel there must be deception relied upon by the other to his detriment"); with United States ex rel. Humble Oil & Refining Company v. Fidelity & Casualty Company of New York, 402 F.2d 893, 898 (4th Cir. 1968) ("[i]t is not necessary that the representations and conduct should be labeled as fraudulent in a strict legal sense of that they were made or carried on with an intention to mislead the plaintiff"); with Farmers Union Central Exchange v. Reliance Insurance Company, 626 F. Supp. 583, 587 (D.N.D. 1985) (party invoking estoppel under North Dakota law must prove that the surety made a false representation).

As noted above, in most instances estoppel is invoked against a surety where the surety seeks to dismiss the claimant's suit on the bond based on the statute of limitations. In any such case counsel must also evaluate the controlling law of the jurisdiction for the purpose of confirming that in fact estoppel is available as a defense. For example, the Second Circuit Court of Appeals has held that estoppel is not available to a claimant seeking to preclude the assertion of a statute of limitations defense under Connecticut's Little Miller Act. See Fischer Skylights, Inc. v. CFC Construction Limited Partnership, 79 F.3d 9 (2d Cir. 1996). The Court's rationale is that the timely filing of suit under Connecticut's payment bond statute constitutes an absolute condition precedent to maintaining an action on the bond, and "this substantive requirement cannot be avoided by waiver or estoppel." Id. at 12. While some earlier cases suggest that the Miller Act limitations period is also a condition precedent to maintaining suit against the surety, the modern – and clear majority – view is that a Miller Act surety can be estopped from asserting the statute of limitations defense in the appropriate case. See United States v. Continental Casualty Company, 357 F.Supp. 795, 798-99 (E.D.La. 1973) (citing cases).

The Caselaw

a. Cases Finding Surety Estopped

The seminal case finding estoppel against a payment bond surety was United States ex. rel. Humble Oil & Refining Company v. Fidelity and Casualty Company of New York, 402 F.2d 893 (4th Cir. 1968) (hereinafter "Humble Oil"). This was a claim on a Miller Act payment bond by a supplier of asphalt and petroleum products. The claimant last supplied materials to the project on December 6, 1963, thus triggering the Miller Act's one-year deadline to commence suit. The claimant advised the surety of the fact of non-payment, and asked the surety to intervene. In response the surety sought and received a proof of claim. The surety then directed the principal to contact the claimant and make arrangements to settle the claim directly. When the principal failed to take this step, the claimant again contacted the surety. The surety advised the claimant at this time that it was sending a representative to the principal's offices to investigate the principal's financial situation, and the surety would contact the claimant once this review had been completed.

The surety apparently conducted the financial investigation but failed to get back to the claimant as it had promised. Dissatisfied with the surety's lack of response, the claimant hired counsel to pursue the claim. Meanwhile, the surety and the principal participated in a meeting to discuss, among other things, the principal's deteriorating finances, and its unpaid bills. They discussed specifically the claimant's unpaid invoices. At this conference, the surety told the principal that (1) the surety would pay all of the principal's unpaid bills, including specifically the claimant's bills, as long as they were supported by invoices; (2) the surety would meet the payroll obligations of the principal; and (3) the surety would pay a consulting fee to one of the principal's "co-partners" in consideration for his agreement to work with the surety in the completion of the bonded jobs.

The claimant received word of this arrangement not from the surety, but from the principal's co-partner, who told the claimant's attorney of the surety's promise to pay the claimant's bills. This information was received by the claimant before the expiration of the one-year suit limitations period. Six days before the expiration of the statute of limitations period, the claimant sent its invoices to the principal, and advised the principal that it would defer further action while the parties worked to resolve the payment issues.

Some two weeks after the expiration of the limitations period, the principal forwarded the unpaid invoices to the surety. In response, the surety sent a letter directly to the claimant, asking for additional proofs of claim. Four months later, the surety for the first time advised the claimant that its claim was time barred under the Miller Act.

The Fourth Circuit Court of Appeals concluded that the surety's conduct with respect to its handling of the claim estopped it from denying the claim on statute of limitations grounds. The Court found that the following facts were critical to the finding of estoppel: (1) the surety had acknowledged its liability for the claimant's claim (although the Court admits that the precise amount of liability had never been agreed upon); (2) the surety explicitly promised the principal that it would satisfy the claimant's claim (although this promise was not expressed by the surety directly to the claimant but instead by the surety to the principal); (3) the surety and the principal had established a "procedure" for the verification of claims; (4) lengthy negotiations had taken place between and among the surety, the principal and the claimant regarding the claim *before* the statute of limitations expired; and (5) the decision of the claimant to defer any suit on the bond, pending a voluntary settlement of the claim by the surety.

The surety argued that it should not be estopped because the surety itself made no representations to the claimant regarding payment of the invoices, and the surety should not be estopped based solely on the representations of its principal. The Court rejected this argument on two grounds. First, the Court concluded that the principal was acting as the surety's agent when he made the representations. This agency relationship arose because of the surety's control over the principal's operations, coupled with the fact that the principal's co-partner was being paid a consulting fee by the surety to assist in the completion of the bonded projects. Even if the principal was not acting as the surety's agent, the Court concluded that the surety should reasonably have expected that its representations to the principal regarding payment of the claims would have been repeated to the claimant by the principal.

The Court also rejected the surety's contention that estoppel was not available because the claimant had retained counsel before the limitations period had expired. The Court concluded that an attorney can be lulled into a false sense of security regarding payment of the claim to the same extent as his client. The fact that the claimant's attorney may have been unaware of the Miller Act's one-year limitations period was also deemed of no significance by the Court.

The Fourth Circuit's decision in Humble Oil upholding the estoppel claim is, in some respects, a cautionary tale for sureties. The case suggests that a surety can be subject to estoppel even if the surety makes no direct representations to the claimant regarding the claim. More significantly, the Court's decision suggests that a financing surety – or a surety with even less involvement with the principal – can be bound by statements made by the principal to third party claimants.[3] For these reasons, the decision in Humble Oil is potentially problematic for sureties. That said, it is apparent that the surety in Humble Oil could have engaged in better, and more proactive, claims handling practices. For example, the surety failed to follow up with the claimant on the status of its financial investigation, and delayed in responding to claimant's notices. The claimant's estoppel arguments may have fared differently had the surety followed through and been more responsive.

The United States District Court for the District of South Carolina followed the reasoning and result of Humble Oil and held a payment bond surety estopped from asserting a statute of limitations defense in United States ex rel Bagnal Builders Supply Co. v. United States Fidelity & Guaranty, 411 F. Supp. 1333 (D.S.C. 1976) (hereinafter "Bagnal Builders"). Here the claimant supplied materials to the principal on a Miller Act job. Just prior to its last date of supply on the project, the claimant sent a letter to the surety advising it that the principal was behind in its payments. The surety sent a letter in response, which set forth the surety's understanding that it had discussed the matter with the principal, that the principal had advised the surety that the situation "was taken care of" and the surety would assume that the matter was resolved unless it heard otherwise from the claimant. See Bagnal Builders, 411 F.Supp. at 1335.

The matter was in fact not taken care of by the principal, prompting a series of calls and letters between the principal and the surety. The claimant thereafter demanded full payment from the surety. The surety wrote back that it would "check into this matter and advise you in due course." Id. One month later, the surety sent a check to the claimant, representing payment for a portion of the claimant's unpaid bills. The partial payment was not the result of a settlement agreement but instead, apparently, issued unilaterally by the surety.

Thereafter, in response to another demand for payment, the surety told the claimant that it would contact the principal and then respond. One month later the surety wrote again to the claimant, again promising that the principal would take care of the debt and suggesting that some monies which had been earmarked for the claimant had been frozen by the labor

[3] For an interesting twist on this argument, see Green Contractors v. May Electrical Contractors, 4-99-CV-90367 (S.D. Iowa 2000). Here the claimant argued that the surety was estopped by the actions of its principal not because of any agency relationship between the principal and surety, but instead because of the fact that a surety stands in the shoes of the principal, and if the principal was estopped, the surety must also be estopped. The Court agreed with this general proposition but found that the claimant had failed to provide any evidence that the principal had engaged in conduct warranting estoppel.

department. Now thoroughly frustrated by the process, the claimant hired counsel, who wrote to the surety asking for an update regarding the status of the claim. In a curious and confusing written response, the surety told the claimant that it was assuming the role of an "interested bystander" in connection with the claim, but that it had a "hold on the money" (presumably referring to principal's unpaid contract funds) and the next payment issued would be a joint check issued to the claimant and the principal. Bagnal Builders, 411 F. Supp at 1335-1336. This correspondence was issued three months prior to the expiration of the Miller Act's one-year limitation period.

No payment was made by the surety and the limitations period expired with no suit filed by the claimant. Three months after the end of the limitations period the surety wrote again to the claimant, stating that the principal had assured the surety that the principal would "take care of" the claimant's bills. One month later, with its bill still not paid, the claimant finally sued the surety and the principal. The surety moved to dismiss the complaint based on the statute of limitations. Citing the Fourth Circuit's decision in Humble Oil, the Court sustained the estoppel argument made by the claimant.

The Court characterized the surety's course of conduct as "obviously designed to lead the plaintiff to rely to its detriment upon the representations of the Surety [.]" See Bagnal Builders, 411 F. Supp. at 1338. In particular the Court noted that the surety had "acknowledged the claim, made payments thereunder, and even though it attempted to take the role of an 'interested bystander' despite its contract for suretyship, continued to correspond with the parties and to present the appearance of taking an active part in trying to secure payment." Bagnal Builders, 411 F. Supp. at 1338.

Like Humble Oil, the decision in Bagnal Builders is instructive because there was no evidence that the surety made any specific direct representation to the claimant which, on its face, induced the claimant to forbear from filing suit during the applicable limitations period. Rather, it was the surety's "course of conduct" which provided the basis for the estoppel claim. Particularly problematic for the surety was its partial payment to the claimant, which was made without any written understanding regarding the status of the remaining debt. If the surety intended to preserve its defenses with respect to the remaining claim, it should have – at a minimum – advised the claimant in writing of this position. It should also be noted that the surety had no apparent substantive defenses to the claim. Finally, the Court's opinion points to the inherent risks facing a surety when it refers the claimant to the principal and assumes the position of an "interested bystander." While a surety may be justified in deferring to its principal in some situations, the surety's luck may run out where – as in Bagnal Builders – the principal fails to follow through. This decision also points out the risk to a surety where it tells the claimant that it "assumes" the principal will take care of the claim, or that the principal has "assured" the surety that the claim will be taken care of. This type of open-ended response to a claim can often be construed (or misconstrued) as a tacit assurance by the surety that it will pay the claim if the principal does not. The better course for the surety is to make a clear, definite written statement of its intentions with respect to the claim.

A court has held a payment bond surety estopped from asserting a statute of limitations defense even where the claimant's failure to commence a timely action was caused, in part, by the failure of the claimant's counsel to understand the correct statute of limitations. See

United States ex rel. Nelson v. Reliance Insurance Company, 436 F.2d 1366 (10th Cir. 1971) (hereinafter "Nelson"). Here the claimant was a supplier to a general contractor on a Miller Act project. The claimant hired an attorney to pursue the general contractor and the surety. The attorney erroneously believed that the one-year statute of limitations commenced from the date of "final settlement" between the general contractor and the United States (as a prior version of the Miller Act provided) when in fact the limitations period ran from the last date of performance by the claimant (as the operative version of the Miller Act now provides). The claimant failed to file the lawsuit within the correct time period, and the surety asserted the statute of limitations as a defense. The claimant argued that it was lulled into delaying the filing of suit based on representations by the surety. The trial court agreed with the surety that estoppel was not applicable because, inter alia, the claimant's attorney failed to apprise himself of the correct statute of limitations.

In a questionable decision, the Tenth Circuit Court of Appeals disagreed. See Nelson, 436 F.2d at 1371. The claimant's attorney's ignorance of the correct statute of limitations was, according to the Court, not a "critical factor" in light of the surety's course of conduct, which attempted to paint a "rosey picture" of the situation and assure the claimant that its claim would be paid. See Nelson, 436 F.2d at 1371.

The surety's problems in this case began with the first communication between the claimant and the surety's local agent. In that discussion the agent assured the claimant's attorney that "You don't need to worry" about the surety making payment, and that the surety would "even pay the interest" if the principal failed to make good on the obligation. Nelson, 436 F.2d at 1368. Not satisfied with the local agent's response, the claimant's attorney then sent a demand directly to the surety's home office. The surety responded that it would investigate. Meanwhile, the surety learned that the principal was in no position to meet the claimant's demands and would be left with no choice but to let the surety take care of things. The surety's local agent again wrote to the claimant, advising it that the surety's home office was investigating.

The claimant did nothing to pursue its claim for several months following this initial exchange of correspondence, apparently under the belief that the surety was taking steps with its principal to resolve the claim. In fact nothing was happening with the claim, which prompted the claimant's attorney to make another written demand and threaten suit against the surety. In response the surety's local agent advised the claimant that the principal was in negotiations with the owner regarding final settlement of the project, that upon completion of these discussions the principal would address resolution of the claims. The surety recommended that the claimant "Diary you file ahead for a period of time, keeping in contact with us," until the project was closed out. See Nelson, 436 F.2d at 1369. All of these communications took place before the expiration of the one-year limitations period. The claimant heard nothing further from the surety until suit was filed some four months after the expiration of the Miller Act's limitations period.

In finding that the surety was estopped from asserting the statute of limitations defense, the Court found that the surety had engaged in a course of contact designed to lead the claimant to the conclusion that "an amicable settlement was just around the corner." Nelson Brothers, 436 F.2d at 1371. In particular, the surety's actions were designed to convey the

impression that the claimant's claims would be satisfied once the principal's contract with the owner was settled. The Court noted that the surety's actions were taken toward the claimant at a time when the surety knew that the principal's financial condition was perilous and unlikely to lead to settlement of the claimant's account. The Court further noted the surety's *internal* communications (which suggested that litigation would likely be required and that the claim would not be taken care of by the principal) was directly at odds with the surety's *external* communications with the principal (which suggested that litigation would not be needed because the principal was capable of resolving the claim). Finally, the fact that the surety did not actually misrepresent the statute of limitations to the claimant did not prevent the claimant from succeeding on its estoppel claim.

The decision in Nelson Brothers is notable in several respects. As discussed above, it suggests that a surety can be estopped even where the claimant's delay in filing timely suit is caused by the claimant's attorney's failure to understand the statute of limitations. Moreover, the decision demonstrates the risks involved in repeatedly assuring a claimant that the principal will take care of the claim. A surety making such statements opens itself up to a potential estoppel argument, especially where – as in Nelson Brothers – the surety makes these statements with knowledge that in fact the principal's financial state is precarious. This decision also stands for another more practical point: beware of the actions of the surety's local agents or affiliated brokers. Generally not trained as claims handlers, surety bond producers can interject themselves into the claims handling process and make statements and representations which are no less binding on the surety than the statements of in-house claims handlers. The local agent in Nelson Brothers contributed to the surety's estoppel problems by repeatedly telling the claimant that the principal would take care of the claim while at the same time writing the home office and telling it that the principal was in no position to deal with the claim. In short, a surety cannot "string along" a claimant with representations regarding the principal's claims paying ability when the surety well knows that the principal is in reality broke.

In another instance of a surety's representative making repeated assurances that a claim would be resolved, the United States District Court for the Eastern District of Louisiana held that a surety was estopped from raising the statute of limitations defense in United States ex rel Atlas Erection Company v. Continental Casualty Company, 357 F. Supp. 795 (E.D.La. 1973) (hereinafter "Atlas Erection"). In this Miller Act case the surety hired a consultant to respond to payment bond claims. The claimant was instructed to send its claim documentation to the surety's consultant. The surety sent an initial small check in partial settlement of the claim, and then agreed to issue a second check, again as partial payment. The consultant issued this check with a representation that it would continue with its efforts to resolve the claim. Later a third partial payment was issued by the consultant, along with another letter promising that the consultant's investigation would continue. Coincidentally (apparently) this third partial payment was received by the claimant just one day before the claimant's one-year period for filing suit had expired. Of course the claimant did not file suit during the applicable period. Instead, the claimant and the surety's consultant pursued settlement negotiations on the balance of the claim. Nearly eight months after the expiration of the statute of limitations the consultant sent a final written offer to the claimant. The claimant rejected the proposal and made a counter-offer. The surety found this proposal to be unacceptable and sent a letter to the claimant denying the claim based on the expiration of the statute of limitations. See Atlas Erection, 357 F. Supp. at 797.

The claimant contended, and the Court agreed, that the surety was estopped from arguing that the claimant's action was barred by the statute of limitations. The Court based its conclusion on the pattern of conduct which arose between the surety, its consultant and the claimant, pursuant to which the surety made partial payments, represented that its investigation was ongoing, and continued to negotiate with the claimant until after the Miller Act limitations period had expired. The Court characterized the actions of the surety's consultant as "paint[ing] a rose colored and confident picture" to the claimant with respect to the claimant's recovery on its claims. See Atlas Erection, 357 F. Supp. at 800. The surety had thus succeeded in "staving off the litigious intentions of [the claimant] until the termination of the Miller Act filing period through partial payments, continuing correspondence and settlement offers." See Atlas Erection, 357 F. Supp. at 800.

A payment bond surety was deemed estopped from relying upon the statute of limitations where the claimant's failure to commence a timely suit under the bond was due to the surety's false statement that it had not issued a valid payment bond for the project. See York Excavating v. Employers Insurance of Wausau, 834 F.Supp. 733 (M.D.Pa. 1993) (hereinafter "York"). In York the surety had issued a payment bond for a private project in Pennsylvania. The claimant made written demand on the surety for payment on its claim. In response, the surety sent a written denial of the claim which stated that the surety had not issued a bond for the project. In fact, a bond had been issued and signed by the surety's agent, although the surety contended that the agent lacked authority to issue the bond. In reliance on the surety's denial letter, the claimant did not file suit. After the limitations period had expired the claimant learned that in fact a bond had been signed and issued by the surety's agent. It then promptly filed suit on the bond. The York Court concluded that the surety was estopped from relying on the statute of limitations defense because of its statement in the denial letter that no bond had been issued for the project. See York, 834 F.Supp. at 739.

b. Cases Finding Surety Not Estopped

In some instances an unreasonably long delay from the end of the limitations period to the filing of suit will preclude a claimant from relying on equitable estoppel. Such was the case in United States ex rel J. Bobby Currin & Sons v. J & W Builders, 17 F.Supp.2d 462 (M.D.N.C. 1996) (hereinafter "J & W Builders") in which the Court found that the claimant's six-year delay in filing suit could not be excused on the basis of equitable estoppel. In this Miller Act case the claimant began negotiations with the surety just prior to the claimant's last performance of work. The surety's in-house claims handler wrote to the claimant and stated that the claimant "was going to be paid for the work" and that it would "receive fair treatment." See J & W Builders, 17 F.Supp.2d at 464.

The claimant thereafter retained an attorney, who began negotiations with the surety. The negotiations included discussions regarding two claims: one claim for work performed under the original subcontract and a second claim for extra work which the claimant performed due to certain material errors in the contract documents as prepared by the owner. Six months before the expiration of the limitations period the surety issued a payment to the claimant, apparently in partial settlement of the claim for additional work. The check stub described the

check as issued “on account – pending resolution of” the claim for additional work performed. See J &W Builders, 17 F.Supp.2d at 464.

Some three months before the expiration of the statute of limitations, the surety sent a release to the claimant regarding its claims under the original contract. The statute of limitations then expired with no suit filed by the claimant. One month after the limitations period had expired the surety sent to the claimant a check in settlement of the claim for the work performed under the original subcontract.

Notwithstanding these payments from the surety, the claimant believed that it was owed an additional $310,000 for additional work performed on the project due to the design errors. However, the claimant’s attorney was apparently unaware of the Miller Act’s one-year statue of limitations, and also believed that the owner was primarily responsible to reimburse his client. The claimant pursued the owner and eventually received $30,000 for its troubles. Not satisfied with this recovery, the claimant turned its attention back to the surety, and filed a Miller Act suit some six years after it had completed work on the project.

The surety successfully argued that the claimant’s action was barred and, contrary to the claimant’s assertions, equitable estoppel did not preclude the surety from relying on the statute’s limitations period. The Court focused extensively on the claimant’s conduct. It found no evidence that the claimant intended to bring an action against the surety during the applicable limitations period. Indeed, the evidence demonstrated that the claimant believed the owner, and not the surety, was liable for its delay claims. The Court also found as significant that the claimant had retained counsel during the limitations period and that counsel had the means to determine its rights as against the surety and “should have backed up its position by timely filing against” the surety. J & W Builders, 17 F.Supp.2d at 466.

The Court further found that the actions of the surety were appropriate and not misleading. Indeed, all correspondences between the parties “were nothing more than those one would expect in a typical commercial context involving a disputed claim and the potential liability of a surety.” See J & W Builders, 17 F.Supp.2d at 466. The surety made no direct representations to the claimant which should have engendered a reasonable belief that the claimant should defer from filing suit.

The decision in J & W Builders is a significant one for sureties in several respects. First, it recognizes that protracted settlement discussions and partial settlement payments are typical and customary in the surety claims handling environment. Thus the fact that a surety makes a settlement offer or partial payment should not, standing alone, open the surety up to an estoppel claim. J & W Builders is also significant because of the Court’s focus on the actions of the claimant. It is the claimant’s obligation to know the statute of limitations and also to understand the full extent of its rights as against the surety. This is especially so where the claimant has legal counsel who is directly involved in the negotiations. Absent a deliberate effort by the surety to deceive the claimant (or the claimant’s attorney) the surety should not be held responsible for the attorney’s negligence. As the J &W Builders Court recognized, it is up to the claimant to know and understand its rights, and where suit is delayed through no fault of the surety, the claimant must bear the responsibility. Finally, the decision in J & W Builders is significant in that it demonstrates that the length of delay in filing suit can often

provide the most compelling evidence of the unreasonableness of the claimant's position. Here the claimant did not bring suit for some six years after the expiration of the limitations period. A delay of this magnitude is presumptively unreasonable and, in this author's opinion, cannot be justified or explained away under virtually any circumstance.[4]

The fact that the surety's claims consultant schedules a meeting with the claimant to discuss the claim is not sufficient to sustain an estoppel argument against the surety, according to the court in United States ex rel B & B Welding v. Reliance Insurance Company of New York, 743 F.Supp. 129 (E.D.N.Y. 1990) (hereinafter "B & B Welding"). Here the plaintiff was a subcontractor on a Miller Act project. The surety's claims consultant arranged for a meeting between the surety and the claimant at the project site. While there was some dispute as to the claimant's last date of work, the Court assumed that the meeting took place six weeks prior to the expiration of the Miller Act's one-year limitations period. See B & B Welding, 743 F.Supp. at 132. The consultant told the claimant to bring someone to the meeting with authority to sign on behalf of the claimant, "since checks would be issued at that time in settlement of existing claims." B & B Welding, 743 F.Supp. at 131. The meeting was held, but no settlement was reached and no checks were issued. The claimant advised its attorney the day after the meeting that its claim had not been paid. The following day the claimant's attorney spoke with the surety's in-house claims attorney. The surety's attorney suggested that the claimant file a formal claim on the bond. Approximately three weeks later (and still some three weeks before the expiration of the limitations period) the claimant's counsel sent notice of claim to the surety. The surety sent a written response to this letter three weeks later. This response was dated two days after the date on which the Miller Act limitations period expired. In its letter the surety requested supporting documents from the claimant, and also advised the claimant that it was "reserving any and all rights available under the provisions of the Miller Act relating to suit limitations." See B & B Welding, 743 F. Supp. at 131. The surety wrote letters twice to the claimant in the following three months. In both letters the surety set forth its position that the claimant's action was time barred under the Miller Act. The claimant did not commence suit against the surety until five months after the surety first wrote to the claimant and advised it that the Miler Act limitations period had expired.

The District Court rejected the claim that the surety's actions in dealing with the claimant estopped it from relying on the statute of limitations. The Court had "difficulty in accepting" the claimant's contention that the surety's request for a meeting with someone with signature authority was tantamount to a promise to pay the claim. See B & B Welding, 743 F. Supp. at 133. Even if the claimant was somehow misled by this statement, it should have been disabused of any misunderstanding by the subsequent communications from the surety, each of which made clear the surety's position that the claim would not be paid. In particular, the Court noted that two days after the meeting the surety suggested to the claimant that it file a formal claim on the bond. Moreover the surety sent several letters to the claimant reserving its defenses in general and its right to assert the statute of limitations defense in particular.

[4] For another instance in which the claimant's unreasonable delay in filing suit precluded any argument that the surety was estopped from asserting the statute of limitations defense, see McWaters and Bartlett v. United States, 272 F.2d 291 (10th Cir. 1959). There the claimant received written notice of the surety's denial of the claim some eleven months prior to the deadline for filing suit, and failed to file the suit until two years after the limitations period had expired.

Faced with these statements, it was unreasonable for the claimant to assume that it could continue to defer the filing of an action on the bond.

The surety's claims representative has no obligation to inform the claimant – or the claimant's counsel – of the existence of the limitations period. This was the holding of the United States District Court for the District of North Dakota in Farmer's Union Central Exchange v. Reliance Insurance Company, 626 F. Supp. 583 (D.N.D 1985) (hereinafter "Farmer's Union"). This was a consolidated action under the North Dakota payment bond statute pursuant to which two claimants sought reimbursement for materials supplied to the same principal in connection with two road construction projects. On the first claim, the claimant first gave written notice to the surety approximately four months after its last date of performance. Four months later the surety's in-house claims manager contacted the claimant's counsel and told him that (1) the surety would take no action until the principal was formally declared in default; (2) the surety "expected to be involved" once a default was declared; and (3) the surety "would make payment on the bonded projects," subject to the surety's right to challenge the allocation of materials between the bonded and non-bonded jobs. One month later the claimant's attorney spoke again with the surety, and was told that the principal had in fact been defaulted on the job, the surety would send out proof of claim forms to the claimant, and the surety was "working hyperactive" on the claim. Farmer's Union, 636 F.Supp. at 584-85. The surety thereafter sent several letters to the claimant requesting additional information and reserving the surety's rights and defenses under applicable law.

Approximately one week prior to the expiration of the statute of limitations, the claimant provided written affidavits to the surety in support of the claim. Two months later (and after the limitations period had expired) the surety advised the claimant that it would be making an offer within a month. No offer was made. Three months later the surety advised the claimant that its claims were barred by the statute of limitations.

The surety's handling of the second claim followed a similar pattern. The surety received the claimant's proof of claim form just before the expiration of the statute of limitations. The surety's in-house claims handler advised the claimant's in-house counsel that the surety was investigating the claims and would contact the claimant once the investigation was concluded. The limitations period then expired. Still having heard nothing from the surety, the claimant's counsel called the surety several months later, and was told that the limitations period on the claim had expired. The claimant thereafter filed suit.

The Court concluded that both claims were barred by the applicable limitations period, and the surety's conduct in handling the claims did not give rise to a claim of equitable estoppel. In support of its position the claimant argued that the surety's claims handler had an affirmative obligation to advise the claimant's counsel of the applicable statute of limitations, and the surety's failure to do so constituted not only estoppel but also a violation of the state's unfair insurance claim practice statute. The Court rejected this argument, reasoning that "knowledge of the existence of the statute was accessible to all parties" and the surety has "no legal or equitable obligation" to communicate its understanding of the limitations period to the claimant. Moreover, the other statements attributed to the surety's claims handler were not, as a matter of law, sufficiently misleading or deceptive so as to constitute a basis for estoppel. Specifically, the surety's statement that it "would be involved" and would pay documented

claims could not have justified the claimant in refraining from filing suit, since the surety made it clear in its correspondence and communications that it was reserving the right to assert defenses relating to the proper allocation of materials between the bonded and non-bonded jobs.

In the most recent reported decision addressing the invocation of estoppel by a surety, the United States District Court for the District of Connecticut held that a surety was not estopped to assert the defense of late notice based on purportedly misleading conduct of its principal. See Millgard Corporation v. White Oak Corporation, 224 F.Supp.2d 425, 431 (D.Conn. 2002) (hereinafter "Millgard"). In this case the claimant brought suit against the surety and the principal under Connecticut's payment bond statute. The surety asserted inter alia that the claimant had failed to provide written notice to the surety within 180 days of the last performance of work on the project, as required by the version of the Connecticut payment bond statute in effect at the time of the claim. In response, the claimant acknowledged that it failed to provide notice within the 180-day time period. However the claimant argued that the surety was estopped from relying on the late notice defense because it was misled by statements of the principal "acting in concert" with the surety. Specifically, the claimant contended that the principal "continually assured" the claimant that disputes over payment would be resolved and that the claimant "should return to work and expect to be paid." Millgard, 224 F.Supp.2d at 429-30. The claimant further argued that, in reliance upon these representations, the claimant remained on "standby", prepared to return to the job site, and if it had done so the surety could not have relied upon late notice as a defense. Id.

The Court rejected the claimant's contentions on several grounds. First, the Court held that estoppel requires some representation by the party to be estopped, and the surety itself made no representations to the claimant. The Court noted the holding in Humble Oil that representations of a "copartner" of the principal would be attributed to the surety for purposes of estoppel because the evidence in that case suggested that the copartner was acting as the agent of the surety. Humble Oil was distinguishable because in Millgard there was no evidence that the principal was acting as the surety's agent, or that the surety had endorsed the statements allegedly made by the principal. Moreover, even if the principal was acting as the surety's agent, there was no evidence that the claimant was prejudiced or relied to its detriment on the principal's statements, since all of the statements were made *before* the last date on which the claimant performed work on the project. See Millgard, 224 F.Supp. 2d at 431-32.

While the caselaw addressing estoppel in the surety context is much more extensive than in the fidelity context, at least one court has addressed this issue in a suit on a fidelity bond. See Star Fastener v. American Employer's Insurance Company, 326 Mass. 728, 96 N.E.2d 713 (1951). Here the fidelity insurer contended that the claimant failed to comply with a provision of the bond by not submitting a sworn proof of loss within ninety days from the original notice of claim to the insurer. The claimant contended that the insurer should have been estopped because the insurer's conduct lulled it into believing that it was not required to submit a proof of claim. The Court rejected this argument because the insurer's formal denial of the claim did not occur until after the expiration of the ninety-day period for filing the proof of claim.

Claims Handling Strategies

As is suggested by the facts of the cases discussed, estoppel arguments are in many respects the natural byproduct of the surety claims handling dynamic. In virtually every instance the claims handler finds himself/herself in direct contact with the claimant and the claimant's counsel before the statute of limitations has expired. Such contact may be for the purpose of seeking information, requesting documentation, soliciting a demand, making an offer or making a partial payment. Such contacts are often made against the backdrop of an ongoing construction project or an existing business relationship between the claimant and the principal. In many instances the surety's contacts with the claimant are made at a time when the principal is facing a cash flow crisis or payment problems on the bonded job. The surety may be reluctant to issue payment to the claimant under these circumstances because it honestly believes that the principal will "work itself out of" its financial problems and take care of the claim. All of these events are occurring against the backdrop of a statute of limitations period which is relatively short (as in, for example, the Miller Act's one year period) and which continues to run as the parties are exchanging information, documents, proofs of claim and settlement offers. Thus it is unavoidable that the surety and the claimant will have extensive contact and communications during the limitations period and, given the dynamics of the surety-principal-claimant relationship, the possibility for estoppel arguments will always be present. The fidelity insurer faces a similar risk since the handling of fidelity claims also invariably involves extensive contacts between the claims handler and the claimant before the expiration of the statute of limitations.

The above notwithstanding, there are some steps and strategies which the surety and fidelity claims professional can employ to minimize the possibility that an estoppel argument will be successfully asserted by a claimant. Some of these steps are simple and relatively obvious. For example, the claims handler should not mislead the claimant and should not make false statements to the claimant regarding any aspect of the claim. In the surety context, the claims handler should not misrepresent the status of the principal's claims paying ability to the claimant (i.e., he/she should not advise the claimant that the principal is solvent and capable of satisfying the claim when he/she knows that in reality the principal is insolvent). The claims handler also should not make general assurances to the claimant that the claim will be paid if the claims handler in fact is uncertain about the principal's ability to pay the claim (and is also uncertain about the surety's liability for the claim). These types of broad assurances – when made to the claimant while the limitations period has not yet expired – can be the basis for an estoppel claim against the surety in subsequent payment bond litigation.

A surety claims handler must also recognize that estoppel arguments against a surety are not limited to claims based on direct statements or communications from the claims handler to the claimant. The claims handler must recognize that the surety's consultant, local agent and even the principal may be deemed the agent of the surety for purposes of estoppel analysis. Thus the claims handler must take great care to monitor the actions of consultants and the principal and also keep in mind that any statements made to the principal may be repeated by the principal to the claimant. If you tell the principal that the surety will pay the claimant's bills, and if you thereafter do not pay the bill, you may find yourself estopped if the principal has told the claimant to expect payment from the surety.

Memorializing each communication with a claimant is always a sound claims handling practice. This is especially so in the context of estoppel disputes with claimants. A "he said/she said" dispute between the claimant and the surety claims handler is more often than not resolved in favor of the claimant, if for no other reason than the Court's view that the claimant should always receive the benefit of the doubt. Try to back-up any oral communications with a written letter to the claimant. Make sure that the letter includes a written reservation of rights and, in the appropriate case, specifically reserve the statute of limitations defense in the letter.

Other basic claims handling maxims apply as well. If you promise to follow up with the claimant by a certain time, do so within the time period which you promised and memorialize it in a letter. If you do not you are giving the claimant ammunition from which to argue that it was lulled into believing that a settlement offer was forthcoming and, therefore, the filing of suit was deferred indefinitely. In addition, be aware of the risks involved in responding to the claim by referring the claimant to the principal or telling the claimant that the surety assumes that the principal "will take care of it". This type of vague, open-ended and indefinite response to the claim will invariably prompt an estoppel argument if the claim is later denied as untimely. If you are going to rely on your principal, give it a date certain to satisfy the claim and provide written proof of payment. It is also a good idea to try to ascertain the statute of limitations as soon as possible after the claim has been received, initiate the investigation of the claim as soon as possible after the claim has been received and advise the claimant as soon as practicable as to the surety's defenses. The denial letter should be sent to the claimant well in advance of the expiration of the statute of limitations. The greater the delay in the surety's denial of claim, the greater the possibility that the claimant will later argue that it was misled into believing that the claim would be paid.

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