

In re Shamus Holdings, LLC and the Automatic Stay

Matthew Silverman, J.D. Candidate 2013

Cite as: *In re Shamus Holdings, LLC and the Automatic Stay*, 4 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 24 (2012)

Introduction

The automatic stay¹ is recognized as one of the fundamental protections provided by bankruptcy law.² The automatic stay prevents creditors from taking almost any type of formal or informal action against the debtor, including commencing or continuing foreclosure actions.³ There are, however, certain exceptions to the automatic stay, exceptions that permit the creditor to take action against the debtor despite the pendency of the bankruptcy proceeding.⁴ This memorandum focuses on one such exception, contained in section 362(b)(3) of the Code,⁵ and the effect courts have held it to have on the automatic tolling provision of the Bankruptcy Code.⁶

The focus of this memorandum is not necessarily *when* section 362(b)(3) applies but rather *how*

¹ 11 U.S.C. § 362 (2006).

² See S. REP. NO. 95-989, at 54 (1978).

³ See COLLIER ON BANKRUPTCY, ¶ 362.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), available at LEXIS, 3-362 Collier on Bankruptcy P 362.03.

⁴ See 11 U.S.C. § 362(b).

⁵ See 11 U.S.C. § 362(b)(3). “The filing of a [bankruptcy] petition . . . does not operate as a stay . . . of any act to perfect, or to maintain or continue the perfection of, an interest in property” *Id.*

⁶ “[I]f applicable nonbankruptcy law . . . fixes a period for commencing . . . a civil action in a court other than a bankruptcy court on a claim against the debtor, . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of – (1) the end of such period . . . or (2) 30 days after notice of the termination or expiration of the stay under section 362” 11 U.S.C. § 108(c) (2006).

it is applied. This distinction becomes important when the automatic stay provision is read in light of the automatic tolling provision contained in section 108(c).

Though the automatic stay is broad in scope, section 362(b)(3) contains an exception that allows a creditor to take action to perfect or maintain an interest in property of the bankruptcy estate.⁷ Tension arises when courts must decide whether creditor action excepted by the automatic stay renders the automatic tolling provision inapposite.⁸ This question turns on whether courts view creditor action that is permitted under the automatic stay as action that the creditor is *required* to take, or, alternatively, as simply action the creditor is *allowed* to take. On the one hand, some courts that have taken the position that excepted creditor action is required have held that a creditor must take the action that is excepted by section 362(b)(3) and, therefore, any underlying statute of limitations is not tolled.⁹ On the other hand, some courts that view excepted creditor action as merely allowed have held that the creditor may take such action, but regardless the underlying statute of limitations remains tolled while the debtor is under the protection of bankruptcy.¹⁰

Part I of this memorandum presents an analysis of the purpose and application of the automatic stay and automatic tolling provisions of the Bankruptcy Code. Part II discusses the bankruptcy court's treatment of the exception to the automatic stay as a mandatory provision and the resulting effect on the applicability of the automatic tolling provision. Part III contrasts the

⁷ See 11 U.S.C. § 362(b)(3).

⁸ Compare *Morton v. Nat'l Bank of N.Y.C. (In re Morton)*, 866 F.2d 561, 565 (2d Cir. 1989) (tolling limitations period to enforce statutory lien despite lienholder's ability to file extension), with *In re 201 Forest St., LLC*, 404 B.R. 6, 14 (Bankr. D. Mass. 2009) (declining to toll limitations period where creditor failed to take action it was not stayed from taking).

⁹ See *In re Worldcom, Inc.*, 362 B.R. 96, 116 n.33 (Bankr. S.D.N.Y. 2007) (“[I]f Sections 362(b)(3) . . . were applicable, Section 108(c) would not have tolled the Statute of Limitations.”).

¹⁰ *Sirtos v. Moreno (In re Sirtos)*, 221 F.3d 1079, 1081 (9th Cir. 2000) (holding time within which creditor was required to enforce lien was tolled by § 108(c) and ability of creditor to renew lien was irrelevant).

approach taken by the bankruptcy courts with the First Circuit’s interpretation in *In re Shamus Holdings*¹¹ in which the court held that the exception to the automatic stay permitted, but did not require, creditor action. Part IV addresses the policy implications of allowing creditors excepted from the automatic stay the choice of whether to take action to enforce their rights. This memorandum concludes that the First Circuit correctly interpreted the exception to the automatic stay as permissive. Characterizing the exception to the automatic stay as permissive is consonant with the long-standing precedent that the rights of creditors are fixed when the debtor files for bankruptcy and such rights do not lapse during the pendency of the proceeding.¹²

I. Purpose and Application of the Automatic Stay and Automatic Tolling Provisions

The automatic stay provides a broad grant of relief to debtors from a wide variety of creditor action.¹³ Its purpose is to “give[] debtors breathing room by stopping collection efforts in their tracks and permitting their resumption only when the stay is lifted by the bankruptcy court or dissolved by operation of law.”¹⁴ Section 362(a)(1) prevents “the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor.”¹⁵ Almost all actions a creditor may have taken against a debtor immediately prior to the debtor’s filing for bankruptcy become temporarily unenforceable once the bankruptcy petition is filed for so long as the stay remains in effect.¹⁶ This serves two purposes. It affords the debtor an

¹¹ *Shamus Holdings, LLC v. LBM Fin., LLC (In re Shamus Holdings, LLC)*, 642 F.3d 263 (1st Cir. 2011).

¹² *See Isaacs v. Hobbs Tie & Limber Co.*, 282 U.S. 734, 739 (1931) (“The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of both secured and unsecured creditors.”).

¹³ *See* 11 U.S.C. § 362(a).

¹⁴ *229 Main St. Ltd. P’ship v. Mass. Dep’t of Env’tl. Prot. (In re 229 Main St. Ltd. P’ship)*, 262 F.3d 1, 3 (1st Cir. 2001).

¹⁵ 11. U.S.C. § 362(a)(1).

¹⁶ *See, e.g., Borman v. Raymark Indus., Inc.*, 946 F.2d 1031, 1036 (3d Cir. 1991) (applying automatic stay to prevent creditor from instituting action against debtor).

opportunity to rehabilitate free from creditor harassment. And, in most cases, protects creditors by preserving equality of distribution among claimants.¹⁷ Though broad in nature, the automatic stay is not absolute.¹⁸ For various policy reasons,¹⁹ Congress has provided a list of exceptions to the stay.²⁰ One such exception is section 362(b)(3) which permits acts “to perfect, or to maintain or continue the perfection of, an interest in property.”²¹

A related provision of the Code, section 108(c), is a tolling provision that extends the statute of limitations of nonbankruptcy law “for creditors who are barred by the automatic stay from taking timely action against the debtor.”²² The automatic tolling provision represents a compromise between debtors and creditors that recognizes that a debtor stands to gain an unfair advantage over the creditor by remaining under the protection of the automatic stay until the statute of limitations on a creditor’s claim has expired.²³ Courts have acknowledged that the automatic tolling provision operates to extend an applicable state law statute of limitations for creditors barred from action by the automatic stay.²⁴ However there has been disagreement over whether the automatic tolling provision applies when a creditor is not barred from taking action by the automatic stay because an exception to the automatic stay could be sought.²⁵

¹⁷ 2 NORTON BANKRUPTCY LAW AND PRACTICE § 43:4 (William L. Norton, Jr. ed., 3d ed. 2008).

¹⁸ See *In re 229 Main St. Ltd. P’ship*, 262 F.3d at 3.

¹⁹ See COLLIER ON BANKRUPTCY, ¶ 362.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), available at LEXIS, 3-362 Collier on Bankruptcy P 362.03.

²⁰ See 11 U.S.C. § 362(b).

²¹ 11 U.S.C. § 362(b)(3).

²² *Shamus Holdings, LLC v. LBM Fin., LLC (In re Shamus Holdings, LLC)*, 642 F.3d 263, 266 (1st Cir. 2011).

²³ See *Morton v. Nat’l Bank of N.Y.C. (In re Morton)*, 866 F.2d 561, 566 (2d Cir. 1989).

²⁴ See *Miner Corp. v. Hunters Run Ltd. P’ship (In re Hunters Run Ltd. P’ship)*, 875 F.2d 1425, 1427 (9th Cir. 1989).

²⁵ See *In re Shamus Holdings, LLC*, 409 B.R. 598, 605–06 (Bankr. D. Mass. 2009) (finding § 108(c) inapplicable when creditor failed to take action it was not stayed from taking); but see *LBM Fin., LLC v. 201 Forest St., LLC (In re 201 Forest St.)* 422 B.R. 888, 895 (B.A.P. 1st Cir. 2010) (holding § 108(c) applied to extend the creditors rights).

II. The Bankruptcy Courts' Treatment of Section 362(b)(3) as Compelling Creditor Action

In *In re 201 Forest Street*, the Bankruptcy Court for the District of Massachusetts considered whether the automatic tolling provision preserved a mortgagee's enforcement rights against a mortgagor despite the mortgagee's failure to take necessary action from which it was not stayed from taking.²⁶ 201 Forest, the debtor, granted LBM, the creditor, a mortgage on its real property with a stated term of one-year. Under applicable state law, LBM's failure to take action on its mortgage, either by instituting a foreclosure action or recording an extension, within five years from the expiration of the stated term results in the discharge of the mortgage as time-barred.²⁷ Prior to the expiration of the stated term, 201 Forest filed a petition under Chapter 11 of the Bankruptcy Code.²⁸ While 201 Forest was under the protection of the automatic stay, the five-year period within which LBM was required under state law to take action passed and 201 Forest sought to have the mortgage discharged.²⁹ 201 Forest argued that under a plain reading of the state law it was entitled to have the mortgage discharged since LBM did not file an extension of the mortgage, an action LBM was not barred from taking under the exception to the automatic stay.³⁰ LBM countered that the automatic tolling provision of section 108(c) suspended its right

²⁶ *In re 201 Forest St., LLC*, 404 B.R. 6, 9 (Bankr. D. Mass. 2009), *rev'd*, 422 B.R. 888 (B.A.P. 1st Cir. 2010). In its opinion reversing the decision of the Bankruptcy Court, the B.A.P. of the First Circuit noted that it is unclear whether the action required of the mortgagee in *In re 201 Forest Street* was in fact excepted from the automatic stay by section 362(b)(3). For purposes of this memorandum we proceed under the assumption that the mortgagee's act of recording an extension falls under the exception in section 362(b)(3) for acts to "perfect, or to maintain . . . an interest in property." See *In re 201 Forest St.*, 422 B.R. 888, 893 n.7 (B.A.P. 1st Cir. 2010).

²⁷ See MASS. GEN. LAWS ch. 260, § 33 (2006).

²⁸ *In re 201 Forest St.*, 404 B.R. at 8.

²⁹ *Id.*

³⁰ *Id.* at 8–9.

to foreclose until 30 days after the termination of the automatic stay, regardless of whether the exception may have been permitted LBM to file an extension of the mortgage.³¹

The bankruptcy court in *In re 201 Forest Street* held the mortgage discharged, reasoning that the act of filing an extension of a mortgage under state law was a permitted act pursuant to section 362(b)(3) and therefore not a violation of the automatic stay.³² As a result, the bankruptcy court reasoned, LBM lost its right to foreclose on the mortgage.³³ LBM responded that the automatic tolling provision should toll the state law statute of limitations, however the bankruptcy court reiterated that “while section 108(c) may extend the period of time to bring a foreclosure action, LBM no longer has the right to foreclose because it failed to take action that it was not stayed from taking.”³⁴

The bankruptcy court in *In re Shamus Holdings* was presented with facts similar to those in *In re 201 Forest*.³⁵ In May of 2003, LBM Financial³⁶ was granted a mortgage on a condominium unit in Boston, Massachusetts.³⁷ In 2007, with the mortgage still unsatisfied, the mortgagor, Shamus Holdings, filed a voluntary Chapter 11 petition.³⁸ The filing triggered the automatic stay and LBM was subsequently prevented from instituting a foreclosure proceeding.³⁹ While still under the protection of the automatic stay, Shamus initiated an adversary proceeding

³¹ *Id.* at 9.

³² *Id.* at 15 (“The Court notes that section 362(b)(3) of the Bankruptcy Code expressly excepts acts to ‘perfect, or to maintain or continue the perfection of an interest in property’ from the automatic stay. The extension, acknowledgment, or affidavit required to be recorded by the Obsolete Mortgages Statute unquestionably falls into this category.”).

³³ *Id.* at 14.

³⁴ *Id.* at 14–15.

³⁵ *In re Shamus Holdings, LLC*, 409 B.R. 598 (Bankr. D. Mass. 2009).

³⁶ It should be noted that LBM Financial was the mortgagee in both *In re 201 Forest Street* and *In re Shamus Holdings* however the two cases are unrelated.

³⁷ *See id.* at 600.

³⁸ *Id.*

³⁹ *Id.*

in the bankruptcy court seeking to discharge the mortgage as time-barred.⁴⁰ Shamus pointed to a state law provision that required holders of a mortgage, on pain of forfeiture, to take action against the mortgagor within five years after the end of the mortgage's stated term.⁴¹ This five-year period had passed, Shamus argued, and therefore LBM's mortgage on the property should be discharged. LBM, on the other hand, argued that they had been prevented from instituting a foreclosure proceeding due to the automatic stay and, pursuant to the automatic tolling provision, the state statute of limitations should be extended.⁴² The bankruptcy court held in favor of the mortgagor and ruled the mortgage time-barred.

The bankruptcy court reasoned that the extension available under state law fit the exception found in section 362(b)(3).⁴³ It followed that since the mortgagee was not stayed from recording an extension, the mortgagee could not claim that the statute of limitations was tolled pursuant to the automatic tolling provision. The bankruptcy court rejected the argument that the automatic tolling provision applies even "when state statutes provide avenues for extending enforcement periods that would not violate the automatic stay."⁴⁴ The bankruptcy court distinguished cases that held the automatic stay applicable despite the ability of the creditor to take action while the debtor was under the protection of the automatic stay.⁴⁵ Those cases, the bankruptcy court concluded, required the filing of pleadings and involvement of the court.⁴⁶ The

⁴⁰ See *In re Shamus Holdings, LLC*, No. 08-1030, 2008 WL 3191315 (Bankr. D. Mass. 2008).

⁴¹ See MASS. GEN. LAWS ch. 260, § 33 (2006).

⁴² 11. U.S.C. § 108(c) (2006).

⁴³ *In re Shamus Holdings, LLC*, 409 B.R. 598, 609 (Bankr. D. Mass. 2009).

⁴⁴ *Id.* at 605 (internal quotations omitted).

⁴⁵ See *Morton v. Nat'l Bank of N.Y.C. (In re Morton)*, 866 F.2d 561, 566 (2d Cir. 1989); *Spirtos v. Moreno (In re Spirtos)*, 221 F.3d 1079, 1080–81 (9th Cir. 2000).

⁴⁶ See *In re Shamus Holdings*, 409 B.R. at 606.

recording of an extension of a mortgage, the court opined, “is not remotely the equivalent of a suit brought in a court of law.”⁴⁷

Therefore, the bankruptcy court found, since the mortgagee was free to extend the mortgage pursuant to the exception to the automatic stay, the mortgagee was unable to successfully claim that its right to foreclose was tolled under the automatic tolling provision. Reading the pertinent bankruptcy provisions in this manner, the bankruptcy court effectively held that the language of section 362(b)(3) compelled creditor action. In other words, if a creditor is permitted to file an extension of an applicable limitations period due to an exception to the automatic stay, the creditor may not invoke the automatic tolling provision of section 108(c).

III. The First Circuit’s Approach to Section 362(b)(3) in *In re Shamus*

The First Circuit in *In re Shamus* was forced to decide “whether the Bankruptcy Code’s automatic stay provision and its concomitant tolling provision combine[d] to preserve [the mortgagee’s] right to enforce the mortgage notwithstanding [the mortgagee’s] eschewal of a readily available extension” provided by state law.⁴⁸ The First Circuit took an entirely different approach than the bankruptcy court. The bankruptcy court had relied heavily on the fact that LBM was permitted to extend the mortgage, due to the exception to the automatic stay, and its failure to do so removed it from the ambit of the automatic tolling provision. The First Circuit, on the other hand, focused on the rights possessed by the mortgagee at the point the mortgagor filed for bankruptcy.⁴⁹ Immediately before the mortgagor filed for bankruptcy the mortgagee had two general options: it could either enforce the mortgage within the period provided by law,

⁴⁷ *Id.* at 604.

⁴⁸ *See Shamus Holdings, LLC v. LBM Fin., LLC (In re Shamus Holdings, LLC)*, 642 F.3d 263, 265 (1st Cir. 2011).

⁴⁹ *See In re Shamus Holdings*, 642 F.3d at 266.

or file an extension to extend the enforcement period.⁵⁰ However, once the mortgagor filed for bankruptcy, enforcing the mortgage was no longer an option due to the automatic stay. LBM could still take action to extend the enforcement period and therefore, Shamus insisted, LBM could not claim that the limitations period within which it had to enforce its mortgage was tolled.⁵¹ The First Circuit disagreed and held that the automatic tolling provision tolled the limitations period set by state law regardless of whether LBM may have been able to extend the limitations period by recording an extension.⁵²

In reaching its conclusion, the First Circuit emphasized that the decision whether to foreclose or extend the mortgage rested with the mortgagee.⁵³ The mortgagor's bankruptcy petition disrupted this choice. This situation, the First Circuit opined, is exactly what section 108(c) was intended to correct.⁵⁴ LBM's option to commence a judicial foreclosure action is preserved until after the automatic stay is lifted regardless of whether LBM's filing of an extension was excepted from the automatic stay by section 362(b)(3). In support of its determination, the First Circuit stressed "[n]either the case law nor the language of section 362(b)(3) itself suggests that the action it contemplates is mandatory rather than permissive."⁵⁵ The First Circuit, in contrast to the bankruptcy court, treated section 362(b)(3) as permitting action by the mortgagee, but not requiring it. Instead the First Circuit concentrated on ensuring that the mortgagee's options with respect to the mortgage, prior to the mortgagor's bankruptcy petition, were protected throughout the bankruptcy case.

⁵⁰ *Id.*

⁵¹ *Id.* at 267.

⁵² *Id.* at 267–68.

⁵³ *Id.* at 267 (“The choice of which route to take to protect its rights was . . . up to the mortgagee.”).

⁵⁴ *Id.* at 266 (“The bottom line is that this case falls squarely within the maw of 11 U.S.C. § 108(c).”).

⁵⁵ *Id.* at 267.

IV. Implications for Creditor's Rights after *Shamus*

The First Circuit's decision in *Shamus* reinforced the bankruptcy policy of preserving the status quo upon the filing of a bankruptcy petition, an aim that recognizes the inherent compromise between debtors and creditors.⁵⁶ Debtors are afforded protection by the automatic stay while in bankruptcy, and creditors' pre-petition rights are preserved by operation of the automatic tolling provision. Interpreting section 362(b)(3) as permissive rather than mandatory is consistent with freezing the rights of creditors upon filing of the petition. Such an interpretation is compatible with the determination by other courts that focus should be on the inability of the creditor to enforce its rights.⁵⁷ Rights temporarily restricted by the automatic stay will be tolled regardless of whether there is action the creditor could take due to an exception to the automatic stay.

A debtor, in light of the inherent compromise with creditors, may argue that a creditor fails to hold up its end of the bargain by neglecting to take action it was excepted from taking. For example, if a mortgage is deemed time-barred because the mortgagor failed to record an extension it was permitted to record, the mortgagee (or trustee in bankruptcy) could divert funds it would have had to pay the mortgagor in order to satisfy other obligations the mortgagee owed. If the exception to the automatic stay is considered permissive, the debtor cannot be certain whether the creditor will exercise its right to record an extension of the mortgage until after the automatic stay is lifted, despite the deadline to take action on the mortgage having passed. This concern is outweighed, however, by the intrinsic certainty created by the automatic tolling provision. Both the debtor and creditor can be assured that a perfected interest valid at the time

⁵⁶ See *Morton v. Nat'l Bank of N.Y.C. (In re Morton)*, 866 F.2d 561, 564 (2d Cir. 1989).

⁵⁷ See *Spirtos v. Moreno (In re Spirtos)*, 221 F.3d 1079, 1081 (9th Cir. 2000).

of the bankruptcy filing will not lapse during the pendency of the bankruptcy proceeding despite a creditor's failure to extend.⁵⁸

In light of the decision in *Shamus*, creditor's can make the argument that the limitations period provided under state law should be tolled even if the creditor had means of otherwise extending the limitations period. This removes the burden a creditor would otherwise bear; to perform a ministerial act not necessarily barred by the automatic stay. Instead, a creditor can simply fall back on the rights it possessed pre-petition, before the bankruptcy filing curtailed its options. A prudent creditor, nevertheless, may be better served taking action as simple as recording an extension in order to avoid the sort of protracted litigation seen in *Shamus*. However failure to do so, at least in the First Circuit, will likely not result in the creditor losing its pre-petition rights.

Conclusion

Section 108(c) of the Bankruptcy Code tolls an applicable statute of limitations period associated with underlying state law. This tolling provision is meant to protect the rights of creditor's curtailed by the debtor's bankruptcy petition. The automatic stay provision and the automatic tolling provision act in concert to maintain the compromise between debtor and creditor at the heart of the Bankruptcy Code. This compromise was placed in jeopardy by decisions in the bankruptcy courts that required the creditor to take action it was not barred from taking due to the exception to the stay found in section 362(b)(3). However, the language of section 362(b)(3) does not contemplate that action need be taken by a creditor simply because the creditor is excepted from the stay. The First Circuit's decision makes clear that the creditor has the power to choose the means by which it enforces its rights. The creditor need not fear

⁵⁸ See *Toranto v. Dzikowski*, 380 B.R. 96, 101 (S.D. Fla. 2007) (stating automatic tolling provision excuses creditors from requirement to renew lien post-petition under state law).

sacrificing one or more of its rights due to the debtor falling under the protection of the automatic stay.

