

New Jersey Law Journal

VOL. CLXXV – NO. 11 – INDEX 1076

MARCH 15, 2004

ESTABLISHED 1878

Bankruptcy Law

When a State Law Statute of Limitations Lapses During a Bankruptcy

Plaintiffs can take a number of actions to preserve rights

By Henry M. Karwowski

On occasion, dismissal of bankruptcy cases no doubt results in the concomitant dismissal of adversary proceedings involving state law claims with respect to which the statute of limitations elapsed during the bankruptcy case. The question arises: What can the plaintiff in such proceedings do to safeguard its rights relating to its claims?

No New Jersey court has addressed the question. Still, in order to preserve its rights, such a plaintiff can conceivably take any of a number of actions.

For instance, the plaintiff can request, before dismissal, that the bankruptcy court retain jurisdiction over the proceeding in question. Second, in a subsequent state court action, the plaintiff can invoke an extension provision provided by the Bankruptcy Code. Finally, the plaintiff can, assuming the application of certain facts, argue that the filing of the adversary complaint equitably tolled the applicable statute of

Karwowski is a partner at the law firm of Booker, Rabinowitz, Trenk, Lubetkin, Tully, DiPasquale & Webster, P.C. of West Orange and an adjunct professor at Seton Hall University School of Law.

limitations or, alternatively, that in filing the adversary complaint, the plaintiff substantially complied with the statute of limitations.

A plaintiff in the situation described above can request that the dismissal order in the main bankruptcy case provide for retention of jurisdiction over the adversary proceeding in question. In *Smith v. Commercial Banking Corp.*, 866 F.2d 576 (3d Cir. 1989), the Third U.S. Circuit Court of Appeals recognized that under certain circumstances, a bankruptcy court may retain jurisdiction over related proceedings.

Other courts have found that inability to prosecute a state law cause of action by virtue of a lapsed statute of limitations constitutes adequate cause for retention of jurisdiction. For example, in *Un-Common Carrier Corp. v. Oglesby*, 98 B.R. 751 (S.D. Miss. 1989), the court found that a dismissal of the bankruptcy case required dismissal of a related adversary proceeding, where “[t]here [was] no indication that plaintiff [would] be precluded by reasons of statute of limitations or otherwise from filing this action in another forum.”

The Extension Provision

Assuming that the bankruptcy court

fails to retain jurisdiction, in a subsequent state court proceeding the plaintiff can invoke an extension provision provided by the Bankruptcy Code. Separate extension provisions for debtors and creditors exist. While 11 U.S.C. 108(a) applies to debtors, §108(c) applies to creditors.

Subsection 108(a) provides in relevant part: If applicable non-bankruptcy law ... fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action only before the later of (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) two years after the order for relief.

In other words, a trustee or debtor must commence a state court action relating to a prepetition claim by the later of (i) the expiration of the statute of limitations or (ii) two years after the bankruptcy filing.

Thus, following the dismissal of its bankruptcy case and the resulting dismissal of an adversary proceeding in which it has asserted state law claims, a debtor can conceivably file the same claims in a state court even though the statute of limitations for such claims elapsed during the bankruptcy case.

Subsection 108(a) provides only limited relief, however — the debtor can file such claims only within two years of the date of the bankruptcy filing. Moreover, it is unclear whether under New Jersey law, a debtor can, following dismissal of its bankruptcy case, even avail itself of §108(a). In *Otchy v. City of Elizabeth Bd. of Educ.*, 325 N.J. Super. 98 (App. Div. 1999), the Appellate Division found that former debtors lacked standing to invoke §108(a) in state court because “[they] had been discharged by the bankruptcy court and were no longer even ‘debtors’ at the time they sought to assert the extension provision of §108(a).”

Meanwhile, §108(c) provides in relevant part:

Except as provided in section 524 of this title, if applicable nonbankruptcy law ... fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor, or against [certain co-debtors], 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, including any suspension of such period occurring on or after the commencement of the case; or
- (2) 30 days after notice of the termination or expiration of the [automatic] stay ... with respect to such claim.

In other words, §108(c) provides that a creditor must commence a state court action relating to a pre-petition claim — other than one with respect to which a discharge applies — by the later of (i) the expiration of the statute of limitations or (ii) 30 days after termination or expiration of the automatic stay with respect to such claim.

Thus, on the basis of this subsection, a creditor can, following the dismissal of a bankruptcy case and the resulting dismissal of an adversary proceeding in which it has asserted state law claims, file the same claims in a state court even though the statute of limitations for such claims elapsed dur-

ing the bankruptcy case.

Like §108(a), however, §108(c) provides only limited relief; the creditor can file such claims only within 30 days of termination or expiration of the automatic stay.

In *Nativo v. Grand Union Co.*, 315 N.J. Super. 185 (App. Div. 1998), the court recognized that §108(c) technically does not toll a statute of limitations for the period of time in which an automatic stay applies. Rather, the court confirmed, the statute merely extends, if necessary, the deadline for a period of 30 days after termination of the stay.

And in *Berke v. Buckley*

Before dismissal, a plaintiff can request that the bank- ruptcy court retain juris- diction over the proceeding in question.

Broadcasting Corp., 359 N.J. Super. 587 (App. Div.), the court noted that “[T]he evident purpose of [28 U.S.C. 1367(d)] is only to preserve a plaintiff’s right of access to the state court for a minimum 30-day period in order for it to assert those state causes over which the federal court has declined to exercise jurisdiction and as to which the statute of limitations has run before that declination.”

Equitable Tolling

Assuming it cannot avail itself of §108, the plaintiff can invoke, if certain operative facts apply, either the “substantial compliance” doctrine or the “equitable tolling” doctrine.

In *Staub v. Eastman Kodak Co.*, 320 N.J. Super. 34 (App. Div. 1999), the court said: “A long line of New Jersey cases have held that the filing of an

action in one forum will toll the statute of limitations during the pendency of that proceeding so that, if the action is dismissed without an adjudication on the merits, the plaintiff can, subject to equitable considerations, pursue substantially the same claim in another forum, even if the action is instituted in the second forum after the expiration of the period of limitations.”

In *Galligan v. Westfield Centre Serv., Inc.*, 82 N.J. 188 (1980), the Supreme Court of New Jersey addressed the issue of whether the timely filing of a federal court action — subsequently dismissed on the basis of lack of diversity of citizenship jurisdiction — had equitably tolled the statute of limitations relating to the claims asserted. While the action had been pending in federal court, 22 days after the lapse of the applicable statute of limitations the plaintiff filed a substantively identical complaint in state court.

The trial court granted a motion to dismiss, and the plaintiff appealed. In addressing the appeal, the Court noted:

[u]nswerving, ‘mechanistic’ application of statutes of limitations would at times inflict obvious and unnecessary harm upon individual plaintiffs without advancing ... legislative purposes. ... Whenever dismissal would not further the Legislature’s objectives in prescribing the limitation, the plaintiff should be given an opportunity to assert his claim.

The Court also recognized that “a mistake in the selection of a court having questionable or defective jurisdiction should not defeat tolling of the statute when all other purposes of the statute of limitations have been satisfied.”

The court found:

examining the circumstances of this case, we find that giving effect to the filing of the complaint in federal court within the limitations period does no violence to the purposes underlying [the statute of limitations]. The federal complaint stated claims identical to those now before us. ... Since the passage of an additional 22 days has impaired neither the

defendants' ability to litigate nor the court's capacity to adjudicate, plaintiff's cause of action has not become 'stale.' ... Defendants' repose in reliance upon the passage of time would not be justified in this case. ... Prohibiting this plaintiff from vindicating his claims in a State forum would not advance the Legislature's desire for security and stability in human affairs.

"Finally," the Court observed, "the filing of a lawsuit itself shows the proper diligence on the part of the plaintiff which statutes of limitations were intended to insure. ... Since the plaintiff exhibited this very diligence before the expiration of two years from the date of the accident, he cannot be said to have 'slept on his rights.'"

Accordingly, the Court held that the filing of the federal complaint had suspended the running of the statutory period of limitations and that the plaintiff had timely commenced the suit.

In the wake of *Galligan*, New Jersey courts have continued to apply the doctrine. For example, in *Zacharias v. Whatman PLC*, 345 N.J. Super. 218, 225-26 (App. Div. 2001), the court that "no doubt that plaintiff's joinder and attempted joinder of all defendants in the federal action suspended the running of the statute [of limitations] as to them during the pendency of the first federal action."

And in *Medical Diagnostics Assocs. v. Hawryluk*, 317 N.J. Super. 338 (App. Div. 1998), the court noted that "[I]n future cases in which [a] medical provider proceeds directly in the Division [of Workers' Compensation for unpaid services] the statute of limitations will be tolled during the period that the matter is pending in the Division."

The doctrine is not unlimited, however.

In *Troum v. Newark Beth Israel Medical Ctr.*, 338 N.J. Super. 1 (App. Div. 2001), the court declined to apply the equitable tolling doctrine on the grounds that "the [earlier] complaint [had been] voluntarily dismissed at plaintiff's behest, before discovery proceedings were completed" and "[t]he

[new] claim [had been] renewed only after the lapse of a substantial period of time."

Hence, the court found, "[the] earlier lawsuit alerted [the defendant] of her claims only in the most ephemeral sense."

Likewise, in *Mitzner v. West Ridgelawn Cemetery, Inc.*, 311 N.J. Super. 233 (App. Div. 1998), the appellate division addressed the issue of whether application of *Galligan* is restricted to "an action filed in this state while the first action is pending." Although it asserted that "only a narrow reading of *Galligan*" would permit such a restriction, the court determined that, because the action before the court had been filed prior to the deadline for filing an appeal in a previously-filed action, "[it need] go no further than to hold that tolling does not end before the time to appeal [on the first action] has expired."

These cases suggest that a plaintiff should undertake efforts to further alert the defendant of the claims asserted, e.g., commence discovery, and should file the subsequent action *immediately* after dismissal, or if possible, even during the pendency of the initial action.

Substantial Compliance

Alternatively, assuming the application of certain facts, the plaintiff can invoke, the "substantial compliance" doctrine.

As laid out in *Negron v. Llarena, M.D.*, 156 N.J. 296 (1998), in order to establish substantial compliance, the defaulting party must establish: (1) the lack of prejudice to the defending party; (2) a series of steps taken to comply with the statute involved; (3) a general compliance with the purpose of the statute; (4) a reasonable notice of petitioner's claim; and (5) a reasonable explanation why there was not a strict compliance with the statute.

In *Negron*, the Supreme Court addressed the issue of whether an accident victim's widow, by timely filing a wrongful death complaint in federal court, had substantially complied with the Wrongful Death Act's statute of limitations. The federal complaint had previously been dismissed on the basis of lack of diversity jurisdiction. The

widow subsequently filed an identical complaint in state court, but not until after the applicable statute of limitations had lapsed.

After noting that "there is nothing reflective in the objectives of [the Wrongful Death Act] or its history that suggests the Legislature intended to foreclose the familiar doctrine of substantial compliance in the [statute of limitations] context," the Court held that the widow had substantially complied with the applicable statute of limitations.

First, the Court found that "[the widow's] failure to file her wrongful death complaint in New Jersey court within the statute of limitations did not prejudice defendant because the filing came immediately following dismissal in federal court. ... Defendant could not have been prejudiced because he was already prepared for the lawsuit."

Second, the Court found that "[the widow] clearly [had taken] 'a series of steps' to comply with the statute of limitations in that she filed her federal complaint within the appropriate time frame and then filed her state complaint immediately after her federal complaint was dismissed."

Third, the Court found that "in filing both of her complaints diligently, [the widow had] generally complied with the purpose of the statute of limitations."

Fourth, the Court found that "the federal complaint with the ensuing discovery process adequately notified defendant of [the widow's] claim."

Finally, the Court found that "[the widow] had a colorable claim in believing that complete diversity did exist at the time of filing her complaint in federal court," and hence, that "[the widow's] failure to comply strictly with the wrongful death statute of limitations in her state suit [had] a reasonable explanation."

As a result, the Court reversed a judgment in favor of the defendant.

More recently, the *Berke* court employed the substantial compliance doctrine in a case in which plaintiffs had filed state law claims, with respect to which the statute of limitations had already elapsed, subsequent to the dismissal of a similar, timely-filed action

in federal court, and beyond the 30-day extension provided under 28 U.S.C. 1367(d) for the commencement of a state action with respect to which the statute of limitations has run during a federal action.

The court allowed the late filing of the action on the following grounds: (i) the plaintiffs had diligently pursued the federal action; (ii) the relief would

cause no prejudice to the defendant; and (iii) a legitimate federal question conferred jurisdiction on the federal court.

Accordingly, assuming that — (i) nothing in the applicable statute of limitations forbids use of the doctrine; (ii) it had a basis for believing that the bankruptcy court possessed jurisdiction over its claim; (iii) it acted diligently in

prosecuting its claim; and (iv) its actions do not cause prejudice to the defending party — a plaintiff may rely on the substantial compliance doctrine as a means of raising in-state court claims previously asserted in an adversary proceeding dismissed on jurisdictional grounds and with respect to which the statute of limitations has passed. ■