Enforceability of Prepetition Waivers of the Automatic Stay

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1. **Introduction:** In workout or forbearance agreements, creditors often include language that purports to prevent the borrower from opposing a motion by the creditor to lift the automatic stay should the borrower subsequently file for bankruptcy. While courts are in agreement that prepetition agreements to forego bankruptcy protection altogether are per se invalid as against public policy, *see, e.g., In re Citadel Properties, Inc.*, 86 B.R. 275, 275 (Bankr. M.D. Fla. 1988), significant confusion surrounds the status of prepetition waivers of the automatic stay. Are they enforceable as a contract? Are they unenforceable as against public policy? What standards should be used to determine whether they are enforceable? Does the context in which the waiver was given matter? Even if the waivers are not self-effectuating, should they be considered as a factor in determining whether "cause" exists under 11 U.S.C. § 362(d)(1) to grant relief from the stay? Courts have produced various and inconsistent answers to these questions.

2. **Per Se Approach**: Initially, many courts viewed prepetition waivers as an all-or-nothing proposition. Either they were enforceable or they were not, often regardless of the specific facts of the bankruptcy case. These courts often focused on the statutory scheme and the public policy reasons for or against enforcement.

    a. Courts Holding Prepetition Waivers Per Se Enforceable

        i. On Public Policy Grounds

            1. *In re Club Tower L.P.*, 138 B.R. 307 (Bankr. N.D. Ga. 1991): The court held that prepetition waivers of the automatic stay are enforceable, because "no provision in the Bankruptcy Code guarantees a debtor that the stay will remain in effect throughout the bankruptcy case," *Id.* at 311, and "enforcing pre-petition settlement agreements furthers the legitimate public policy of encouraging out of court restructurings and settlements." *Id.* at 312. Distinguishing the waiver in the instant case from blanket prohibitions on filing for bankruptcy, the court noted, "enforcing a pre-bankruptcy agreement provision by which a debtor agrees not to oppose the granting to the lender of relief from stay is

[1] The author acknowledges the assistance of Brett Farley, a summer associate at Arnold & Porter LLP, in the preparation of this outline.

significantly different from a provision which prohibits a debtor from filing a bankruptcy petition and thus there is no violation of public policy." *Id.* at 311.

2. *In re Cheeks*, 167 B.R. 817 (Bankr. D.S.C. 1994): The court held that when there are no objections by third-party creditors, a prepetition waiver of the automatic stay in a forbearance agreement will be always be enforced. The public policy in favor of encouraging out of court restructuring and settlement strongly argued in favor of enforcement. However, the court also recognized that the waiver may not be binding on interested third-parties, whose objections to the lifting of the automatic stay may still be heard by the court.

ii. On Freedom of Contract Grounds

1. *In re McBride Estates, Ltd.*, 154 B.R. 339 (Bankr. N.D. Fla. 1993): In upholding a prepetition waiver, the court held that "a stipulation freely entered into by the parties is binding on the parties." *Id.* at 342 (internal citation omitted). However, the court noted that this rule should not be applied inflexibly and that a court, using its equitable powers, may grant relief to the debtor "if there is a radical and new development which drastically changes the economic picture and the value of the collateral." *Id.* (internal citation omitted).

b. Courts Finding Prepetition Waivers Per Se Unenforceable

i. As Against Statutory Scheme

1. *Matter of Pease*, 195 B.R. 431 (Bankr. D. Neb. 1996): Court held that prepetition waivers of the automatic stay are per se unenforceable, "because (1) the waiver is invalid due to debtors' lack of capacity to act on behalf of the debtor in possession; (2) the waiver is unenforceable under specific provisions of the Bankruptcy Code which limit the effectiveness of certain contractual provisions that take effect upon the filing of a bankruptcy case…; and (3) the Bankruptcy Code extinguishes the private right of freedom to contract around its essential provisions." *Id.* at 433.

ii. In a Single Asset Case

1. *In Re Jenkins Court Assoc. Ltd. Partnership*, 181 B.R. 33 (Bankr. E.D. Pa. 1995): The court found that "[i]n single asset cases,

particularly, the Court believes that the public policy behind the automatic stay may frequently outweigh the policy which favors encouragement of out of court restructuring and settlements." *Id.* at 37. This is because, according to the court, in such cases a prepetition waiver and a blanket prohibition on filing for bankruptcy are functionally the same.

iii. In Order to Protect Other Creditors

1. *In re Sky Group Intern., Inc.*, 108 B.R. 86 (Bankr. W.D. Pa. 1989): The court held that prepetition waivers by the debtor are not enforceable or self-executing, because "the automatic stay has a dual purpose of protecting the *debtor and all creditors* alike." *Id.* at 88 (emphasis in original).

2. *Farm Credit of Central Florida, ACA v. Polk*, 160 B.R. 870 (M.D. Fla. 1993): Court upheld the bankruptcy court's holding "that a prepetition agreement that entitled [lender] to an immediate lifting of the automatic stay, in and of itself, is not sufficient to lift the stay unless there is a showing of other criteria, such as bad faith." *Id.* at 872. The automatic stay protects not only the debtor but also other creditors. As a result, the debtor cannot unilaterally waive the automatic stay against the interest of those other creditors. The court also determined (perhaps incorrectly) that the cases holding prepetition waivers enforceable did so only in single asset cases where there was no prospect for reorganization.

3. **Case-by-Case Approach**: The more recent trend has been to forego per se rules and hold that prepetition waivers of the automatic stay are enforceable (although not self-executing) in "appropriate cases." These courts have then determined on a case-by-case basis whether prepetition waivers are enforceable, often considering the waiver as one factor to consider in determining whether relief from the automatic stay should be granted for "cause" under § 362(d)(1).

a. Prepetition Waiver Is Factor in Determining Whether "Cause" Exists to Grant Relief From Automatic Stay

i. *In re Powers*, 170 B.R. 480 (Bankr. D. Mass. 1994): The court held that "the [prepetition] waiver is a primary element to be considered in determining if cause exists for relief from the automatic stay…." *Id.* at 484. Although it declined to decide the matter without an evidentiary hearing, the court indicated it would consider "the benefit which the debtor received from the workout agreement as a whole; the extent to which the creditor waived rights or would be otherwise prejudiced if the waiver is not enforced; the effect of enforcement on other creditors; and,

of course, whether there appears to be a likelihood of a successful reorganization." *Id.*

ii. *In re Darrell Creek Assocs., L.P.*, 187 B.R. 908 (Bankr. D.S.C. 1995): The court found that a workout agreement entered into by debtor with the assistance of sophisticated counsel under which debtor agreed to waive the automatic stay constituted "cause" sufficient to lift the stay. The court analyzed a number of factors, including the public policy in favor of out of court restructuring, the affect on other creditors, and the chances of successful reorganization by the debtor.

b. Harm to Third Parties

i. *In re Atrium High Point Ltd. P'ship*, 189 B.R. 599 (Bankr. M.D.N.C. 1995): In this case, the court declined to enforce language in a prior Chapter 11 plan that waived the automatic stay in subsequent bankruptcies. The court rejected the argument that a prepetition waiver in a single-asset case was, practically, a prohibition on filing for bankruptcy, but, since there was equity in the collateral at issue, the court found that the harm to third-party creditors outweighed the prepetition agreement.

ii. *In Re S. E. Fin. Assocs.*, 212 B.R. 1003 (Bankr. M.D. Fla. 1997): In refusing to enforce a prepetiton waiver resulting from an agreement to delay a foreclosure sale, the court held that, although not invalid per se, such waivers are not self-executing or binding on third parties. The court also held that when a waiver adversely affects other creditors (as it would in this case), it is unlikely that the waiver will be enforced.

c. Multi-Factor Tests

i. *In re Desai*, 282 B.R. 527 (Bankr. M.D. Ga. 2002): Rejecting per se tests, the court held that the following four factors should be considered in determining the enforceability of prepetition waivers: "(1) the sophistication of the party making the waiver; (2) the consideration for the waiver, including the creditor's risk and the length of time the waiver covers; (3) whether other parties are affected including unsecured creditors and junior lienholders, and; (4) the feasibility of the debtor's plan." *Id.* at 532. Because the debtor appeared to have equity in the real property at issue and the lender had not proven that the debtor had filed the second bankruptcy case in bad faith (even though he filed the day before the foreclosure), the court held that a waiver of automatic stay contained in a previous Chapter 11 reorganization plan was unenforceable.

ii. *In re Frye*, 320 B.R. 786 (Bankr. D. Vt. 2005), subsequent determination, 323 B.R. 396 (Bankr. D. Vt. 2005): The court held that although prepetition waivers are not per se enforceable, they will be analyzed case-

by-case using the following ten factors: "(1) the sophistication of the party making the waiver; (2) the consideration for the waiver, including the creditor's risk and the length of time the waiver covers; (3) whether other parties are affected including unsecured creditors and junior lienholders[;] (4) the feasibility of the debtor's plan[;] (5) whether there is evidence that the waiver was obtained by coercion, fraud or mutual mistake of material facts; (6) whether enforcing the agreement will further the legitimate public policy of encouraging out of court restructurings and settlements; (7) whether there appears to be a likelihood of reorganization; (8) the extent to which the creditor would be otherwise prejudiced if the waiver is not enforced; (9) the proximity in time between the date of the waiver and the date of the bankruptcy filing and whether there was a compelling change in circumstances during that time; and (10) whether the debtor has equity in the property and the creditor is otherwise entitled to relief from stay under 362(d)." *Id.* at 790-91. The court also noted that the burden is on the party opposing enforcement of the waiver to show why it should not be enforced. The court found that the creditor was entitled to enforce a waiver of the automatic stay contained in a forbearance agreement because nine of the ten factors (all but whether the debtor had equity in the property) supported the result.

iii. *In re Bryan Road, LLC*, 382 B.R. 844 (Bankr. S.D. Fla. 2008): A creditor that held a mortgage against debtor's boat storage facility moved for relief from the automatic stay pursuant to a prepetition mortgage forbearance agreement. Applying the *Desai* factors, the court held that the provision in the forbearance agreement waiving the automatic stay was enforceable. First, "the sophistication of the party making the waiver" weighed in favor of enforcement because the debtor's counsel was "a very experienced bankruptcy lawyer fully capable of understanding the implications of the Forbearance Agreement." *Id*. at 849. Second, a detailed analysis of the debtor's bankruptcy plan indicated that the plan was not feasible. Because the agreement was enforceable, the court determined that stay relief was warranted under the bankruptcy statute.

d. Pubic Policy in Favor of Enforcement

i. *In Re Shady Grove Tech Center Associates Ltd. Partnership*, 227 B.R. 422 (Bankr. D. Md. 1998): The court held that a prepetition waiver stemming from a loan restructuring agreement was enforceable. The waiver was negotiated by sophisticated counsel, substantial consideration was given for the waiver, and there were no third-party interests that would be affected. Thus, although "[w]aivers of [bankruptcy] rights are inherently suspect," under the specific facts of this case, "the public policy of encouraging workout and restructuring agreements out of bankruptcy between sophisticated parties…overcomes the policy of affording Debtor a respite…under the automatic stay…." *Id.* at 426.

ii. *In Re Excelsior Henderson Motorcycle Mfg. Co.*, 273 B.R. 920 (Bankr. S.D. Fla. 2002): The court held that a prepetition waiver resulting from a prior Chapter 11 case was specifically enforceable, because the debtor received valuable consideration in return for the waiver and "the enforcement of such agreements furthers the public policy in favor of encouraging out of court restructuring and settlements." *Id.* at 924. It appears there were no third-party creditors objecting to relief from the stay in this case.

e. Distinguishing Between Waiver Agreements Made in Court Proceedings and Outside Agreements

i. *In re Deb-Lyn, Inc.*, No. 03-00655, 2004 WL 452560 (N.D. Fla. 2004): Taking a fact specific approach, the court held that a prepetition waiver was unenforceable because the debtor was not a single asset holder and had a realistic possibility of reorganization. Moreover, "the pre-petition waiver was not part of a plan of reorganization or one that was approved by a prior adjudication," but instead part of an independent forbearance agreement. *Id.* at *4.

f. Unsophisticated Debtor

i. *In re Riley*, 188 B.R. 191 (Bankr. D.S.C. 1995): The lender sought to enforce a waiver of automatic stay provision in a prepetition forbearance agreement *after* the debtor cured the default that was the subject of the forbearance agreement. The court found that, although forbearance agreements to waive automatic stay are generally enforceable, they "must be strictly construed in light of the contractual language and the associated circumstances." *Id.* at 192. Because the debtor was unsophisticated and the agreement lacked specific contractual provisions showing they intended for it to continue after cure of the default, the court declined to enforce the waiver.

g. Debtor's Ability to Reorganize

i. *In re Lopez-Granadino*, No. 08-30707-H3-13, 2008 WL 694698 (Bankr. S.D. Tex. 2008): The court did not reach the issue of the enforceability of a waiver of the automatic stay resulting from a prior bankruptcy case, because the debtor failed to rebut the presumption that the new bankruptcy case was not filed in good faith. The court did, however, note that "the single most important factor in the enforcement of the waiver is the prospect of the reorganization of the debtor." *Id*. at *2.