CONTRIBUTED CONTENT & PRESENTATIONS

Examining the enforceability of prepetition waivers of the automatic stay

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Recently, a bankruptcy court for the district of Puerto Rico held that a debtor's waiver of the automatic stay contained in a pre-petition forbearance agreement was enforceable. In re Triple A & R Capital Inv., Inc., 519 B.R. 581 (Bankr. D.P.R. 2014). Unfortunately, the case adds little to the debate over the enforceability of pre-petition agreements impacting bankruptcy rights for one simple reason — the court's holding was premised on the fact that the pre-petition forbearance agreement waiving the automatic stay was enforceable because the debtor, as part of a post-petition stipulation permitting the use of cash collateral, had ratified and agreed to be bound by the forbearance agreement.

Nonetheless, the court did briefly look at the treatment of pre-petition waivers of the automatic stay lacking post-petition ratification. Its examination provides a good opportunity to review the state of the law on this issue.

Before deciding the issue on its ratification grounds, the court noted that bankruptcy courts that have examined the enforceability of pre-petition waivers of the automatic stay:

[H]ave used different approaches with conflicting results. Three basic approaches have emerged: (1) uphold the stay waiver in broad unqualified terms on the basis of freedom of contract; (2) reject the stay waiver as unenforceable per se as against public policy; and (3) treat the waiver as a factor in deciding whether "cause" exists to lift the stay.

Id. at 584. The court further noted that "[a] review of the cases nationwide that addressed this issue indicate a trend that appears toward the enforcement of stay waivers." *Id.*

Both of these observations oversimplify the issue.

Courts have refused to enforce prepetition stay waivers on a number of grounds, including: (1) a pre-petition debtor's lack of "capacity to waive the rights bestowed by the Bankruptcy Code upon a Chapter 11 debtor in possession," *e.g., In re Pease*, 195 B.R. 431, 433 (Bankr. D. Neb. 1996); (2) as a disguised *ipso facto* clause, *e.g. id.*; (3) as depriving third-party creditors of the protections of the bankruptcy code, *e.g., In re South East Fin. Assocs.*, 212 B.R. 1003, 1005 (Bankr. M.D. Fla. 1997); and (4) as a violation of public policy, which, especially in the case of a single asset case, is said to closely approximate an unenforceable agreement not to file bankruptcy. *In re DB Capital Holdings, LLC*, 454 B.R. 804 (Bankr.D.Colo. 2011); *In re Jenkins Court Assocs. Ltd. Partnership*, 181 B.R. 33, 37 (Bankr. E.D. Pa. 1995).

Nonetheless, for those courts considering the issue, the modern trend appears to be to find "cause" to modify the automatic stay, based at least in part on a debtor's prepetition agreement to waive the benefits of the automatic stay. However, typically a pre-petition stay wavier is not held to be *per se* enforceable. *E.g., In re Frye*, 320 B.R. 786, 787 (Bankr. D. Vt. 2005) Indeed, most courts will consider a stay waiver appearing only in a forbearance agreement or loan modification, and not in the original loan documents. *E.g., Wells Fargo Bank, N.A. v. Kobernick*, 2009 U.S. Dist. LEXIS 126723, 20-22 (S.D. Tex. May 28, 2009). Courts often consider the circumstances in which the stay waiver was agreed upon and changes in circumstances following such agreement, including:

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.

SouthWest Ga. Bank v. Desai (In re Desai), 282 B.R. 527, 532 (Bankr. M.D. Ga. 2002);

1. whether there is evidence that the waiver was obtained by coercion, fraud or mutual mistake of material facts;
2. whether enforcing the agreement will further the legitimate public policy of encouraging out of court restructurings and settlements;
3. whether there appears to be a likelihood of reorganization;
4. the extent to which the creditor would be otherwise prejudiced if the waiver is not enforced;
5. 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
6. whether the debtor has equity in the property and the creditor is otherwise entitled to relief from stay under § 362(d).

In re Frye, 320 B.R. 786, 791 (Bankr. D. Vt. 2005).

Importantly, courts hold that such stay waivers are not self-executing, such that the stay is not automatically lifted and a motion to lift stay is still required. *Id.* at 790. Furthermore, such stay waivers are typically considered alongside other legitimate grounds for stay relief. And, in most cases, a stay waiver will not prevent a court from considering an objection from a third-party creditor. *E.g., In re Atrium High Point Ltd. Partnership*, 189 B.R. 599, 607 (Bankr. M.D.N.C. 1995).

Finally, it should be noted that the modern trend does not include any circuit court opinions, and in fact includes only a handful of cases in total. Furthermore, the modern trend appears inconsistent with the *dicta* of several circuit courts, including the Second Circuit, *Commerzanstalt v. Telewide Sys.*, 790 F.2d 206, 207 (2d Cir. N.Y. 1986) (considering a post-petition waiver and stating, "[s]ince the

purpose of the stay is to protect creditors as well as the debtor, the debtor may not waive the automatic stay."), the Third Circuit, *Constitution Bank v. Tubbs*, 68 F.3d 685, 691 (3d Cir. Pa. 1995) (considering a post-petition wavier and stating, "[t]he automatic stay cannot be waived."); *Maritime Electric Co. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991 (considering a post-petition waiver and stating, "[b]ecause the automatic stay serves the interests of both debtors and creditors, it may not be waived and its scope may not be limited by a debtor."); *Ass'n of St. Croix Condominium Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir. 1982), and the Ninth Circuit, *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.),* 671 F.3d 1011, 1026 (9th Cir. Cal. 2012) (citing *In re Pease* approvingly and invalidating pre-petition waiver of Bankruptcy Code provisions invalidating prepetition anti-assignment clauses.); *Bank of China v. Huang (In re Huang*), 275 F.3d 1173, 1177 (9th Cir. Cal. 2002) (considering pre-petition waiver of dischargability and stating, "[i]t is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code."). *But see, In re Wheaton Oaks Office Partners*, 1992 U.S. Dist. LEXIS 18781 (N.D. Ill. Dec. 9, 1992) (considering and rejecting applicability of *Commerzanstalt* and *Ass'n of St. Croix Condominium Owners* to pre-petition waivers, explaining "[n]either case stands for the proposition that a bankruptcy court can never find such a waiver to constitute cause to grant relief from the automatic stay.").

Given the uncertain state of the law, lenders would be wise to (1) exclude such stay waivers from their original loan documents, (2) consider including stay waivers in their forbearance agreements, and (3) not rely exclusively on such waivers in their motions to lift stay.