

The Case for Limited Enforceability of a Pre-Petition Waiver of the Automatic Stay

RAFAEL EFRAT*

In exchange for modifying the terms of a loan agreement, many lenders now require that a debtor prospectively waive the protection of the automatic stay provision of the Bankruptcy Code. Courts that analyze the enforceability of such waivers are forced to address the important question of whether a debtor and its creditors should be allowed to opt out of such a fundamental provision of the Bankruptcy Code. Currently, the bankruptcy courts are split on the issue of whether to enforce pre-petition waivers of the automatic stay. This Article explores the rationale for the conflict among the bankruptcy courts. It then proposes an approach for resolving this conflict consistent with the various important statutory and public policy considerations. It argues that courts should enforce pre-petition waivers of the automatic stay under limited circumstances.

* Mr. Efrat is the legal counsel of Industrial Bank and a former extern to the Honorable Calvin Ashland, United States Bankruptcy Court Judge for the Central District of California. He specializes in creditors' rights litigation. He is an adjunct professor of legal writing at Whittier Law School, and of business law at the University of Phoenix. The author is a graduate of the University of Southern California Law Center. He is also a Certified Public Accountant from the State of Illinois.

I. INTRODUCTION

When filing a petition under the Bankruptcy Code,¹ a debtor gains a major benefit in the protection of the automatic stay² provided in 11 U.S.C. § 362(a).³ However, as part of a workout agreement,⁴ a debtor may agree to prospectively waive this protection in a subsequent bankruptcy petition. Under the former Bankruptcy Act,⁵ the courts clearly enforced such pre-petition agreements.⁶ However, under the current Bankruptcy Code, the courts have split on the issue of whether to enforce the agreements.

1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-1330), *as amended* by Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 344 (codified as amended in various sections of 11 U.S.C. and 28 U.S.C.); Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3114 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.); Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, 102 Stat. 610 (codified as amended in scattered sections of 11 U.S.C.); Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (codified as amended in scattered sections of 11 U.S.C.); Criminal Victims Protection Act of 1990, Pub. L. No. 101-581, 104 Stat. 2865 (codified as amended in scattered sections of 11 U.S.C.); Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.); Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.); Treasury, Postal Service and General Government Appropriations Act of 1990, Pub. L. No. 101-509, 104 Stat. 1389 (codified as amended in scattered sections of 28 U.S.C.); and Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C., 18 U.S.C., and 28 U.S.C.) [hereinafter Bankruptcy Code or Bankruptcy Reform Act of 1978].

2. "The filing of a voluntary, joint, or involuntary petition under any chapter [of the Bankruptcy Code] automatically operates as a stay against lawsuits and lien enforcement [against the debtor]." GEORGE M. TREISTER ET AL., *FUNDAMENTALS OF BANKRUPTCY LAW* 195 (2d ed. Supp. 1991).

3. Bankruptcy Reform Act of 1978, 11 U.S.C. § 362(a) (1994).

4. Workout agreements have been defined as

the treatment of a condition which prevents a company from meeting its contractual obligations in the ordinary course, and which requires a readjustment of expectations on the part of those who look to the company for performance. All parties are faced with the challenge of working out of the difficulty and most nearly achieving their original goals and expectations. This requires review and analysis of goals and expectations in light of then-present circumstances.

Donald L. Rome, *The Business Workout—A Primer for Participating Creditors*, 11 *UCC L.J.* 183, 187 (1979).

5. Act of July 2, 1898, ch. 541, 30 Stat. 544, *as amended* by Act of Mar. 4, 1938, ch. 575, 52 Stat. 84 (repealed 1978).

6. *See, e.g., Association of St. Croix Condominium Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir. 1982); *In re Sky Group Int'l, Inc.*, 108 B.R. 86, 89 (Bankr. W.D. Pa. 1989).

The issue generally arises when the debtor and the lender enter into a workout agreement after the debtor defaults on a loan. Under a typical workout agreement, the lender agrees to forbear from foreclosing on the debtor's encumbered property. In return, the debtor agrees that, under the terms of the workout agreement, a later default, followed by filing for protection under the Bankruptcy Code, will entitle the lender to immediate relief from the automatic stay.⁷

At one end of the spectrum, some bankruptcy courts have taken the position that, absent court approval, debtors cannot waive the automatic stay protection prior to filing bankruptcy petitions.⁸ In rejecting the agreements, these courts relied on a strict interpretation of the Bankruptcy Code's language, its legislative history,⁹ general principles of contract law,¹⁰ and public policy considerations.¹¹

At the other end of the spectrum, other bankruptcy courts have enforced pre-petition waiver agreements, believing that the agreements

7. The following language was used and upheld as a valid pre-petition waiver of the automatic stay in *In re Hudson Manor Partners, Ltd.*, No. 91-81065HR, 1991 WL 472592 (Bankr. N.D. Ga. Dec. 31, 1991):

In the event that Borrower is the subject of any insolvency, bankruptcy, receivership, dissolution, reorganization or similar proceeding, federal or state, voluntary or involuntary, under any present or future law or act, [L]ender is entitled to the automatic and absolute lifting of any automatic stay as to the enforcement of its remedies under the Loan Documents against the Security, including specifically, but not limited to the stay imposed by Section 362 of the United States Federal Bankruptcy Code, as amended; Borrower hereby consents to the immediate lifting of any such automatic stay, and will not contest any motion by Lender to lift such stay; Borrowing Parties expressly acknowledge that (a) there is no equity in the security after consideration of the amounts owed Lender and (b) the Security is not now, and will never be necessary to any plan of reorganization of any type.

Id. at *3-4. Another sample of a pre-petition waiver provision of the automatic stay can be found in John P. McNicholas, Note, *Prepetition Agreements and the Implied Good Faith Requirement*, 1 AM. BANKR. INST. L. REV. 197, 208 (1993).

8. *E.g.*, *Commerzanstalt v. Telewide Sys., Inc.*, 790 F.2d 206 (2d Cir. 1986), *aff'd in part and rev'd in part*, 794 F.2d 763 (2d Cir. 1986); *Association of St. Croix Hotel Corp.*, 682 F.2d 446; *Yorke v. Citibank Nat'l Ass'n (In re BNT Terminals, Inc.)*, 125 B.R. 963 (Bankr. N.D. Ill. 1990); *In re Sky Group Int'l, Inc.*, 108 B.R. 86 (Bankr. W.D. Pa. 1989); *In re Cafe Partners/Wash.* 1983, 81 B.R. 175 (Bankr. D. D.C. 1988); *In re Best Fin. Corp.*, 74 B.R. 243 (Bankr. D.P.R. 1987).

9. *See* cases cited *infra* note 17.

10. *See* cases cited *infra* note 27.

11. *See* sources cited *infra* notes 22-24.

justify granting relief to the creditor.¹² These courts largely relied on the public policy consideration of promoting out-of-court restructurings and settlement agreements,¹³ an alternate reading of the Bankruptcy Code's legislative history,¹⁴ and general principles of contract law.¹⁵

This Article first surveys current case law, analyzing the rationale for the conflict among the bankruptcy courts. It then suggests a possible approach for resolving this conflict consistent with various important statutory and public policy objectives.

II. RATIONALE FOR REFUSING TO ENFORCE A DEBTOR'S PRE-PETITION WAIVER OF THE AUTOMATIC STAY

A. *The Language of the Bankruptcy Code and its Legislative History Mandate that Relief from the Automatic Stay Be Approved by the Bankruptcy Courts*

One fundamental source bankruptcy courts have used to justify their decisions not to enforce a debtor's pre-petition waiver is the language of the Bankruptcy Code itself, which specifically grants exclusive power to the courts to order relief from the automatic stay. These courts contend that, while the former Bankruptcy Act permitted a debtor to waive the stay, section 362(d)¹⁶ of the current Bankruptcy Code vests the bankruptcy courts with the exclusive power to grant relief.¹⁷

12. See, e.g., *Production Credit Ass'n of the Midlands v. Wieseler (In re Wieseler)*, 934 F.2d 965, 967 (8th Cir. 1991); *In re Wheaton Oaks Office Partners, Ltd.*, No. 92-C3955, 1992 WL 381047 (Bankr. N.D. Ill. Nov. 19, 1992), *aff'd*, 27 F.3d 1234 (7th Cir. 1994); *In re Atrium High Point Ltd. Partnership*, 189 B.R. 599 (Bankr. M.D.N.C. 1995); *In re Darrell Creek Assocs., L.P.*, 187 B.R. 908 (Bankr. D.S.C. 1995); *In re Powers*, 170 B.R. 480 (Bankr. D. Mass. 1994); *In re Cheeks*, 167 B.R. 817 (Bankr. D.S.C. 1994); *In re Hudson Manor Partners, Ltd.*, No. 91-81065HR, 1991 WL 472592 (Bankr. N.D. Ga. Dec. 31, 1991); *In re Club Tower L.P.*, 138 B.R. 307, 312 (Bankr. N.D. Ga. 1991); *In re Aurora Invs., Inc.*, 134 B.R. 982, 986 (Bankr. M.D. Fla. 1991); *In re Growers Properties No. 56 Ltd.*, 117 B.R. 1015, 1020 n.2 (Bankr. M.D. Fla. 1990); *In re Citadel Properties, Inc.*, 86 B.R. 275, 276 (Bankr. M.D. Fla. 1988); *In re Orange Park S. Partnership*, 79 B.R. 79, 82 (Bankr. M.D. Fla. 1987); *In re International Supply Corp. of Tampa, Inc.*, 72 B.R. 510, 511 (Bankr. M.D. Fla. 1987); *In re Gulf Beach Dev. Corp.*, 48 B.R. 40 (Bankr. M.D. Fla. 1985) (dictum).

13. See cases cited *infra* notes 34-42.

14. See *infra* note 31 and accompanying text.

15. See cases cited *infra* notes 85-86.

16. Section 362(d) of the Bankruptcy Code provides that "[o]n request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section." 11 U.S.C. § 362(d) (1994) (emphasis added).

17. E.g., *Maritime Elec. Co., Inc. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1992) ("Only the bankruptcy court with jurisdiction over a debtor's case has the

Courts have also relied upon the legislative history of Bankruptcy Code section 362(d). For example, the Sixth Circuit, after reviewing and analyzing the legislative history, found that it “unambiguously identifies the bankruptcy court as the exclusive authority to grant relief from stay.”¹⁸ In making its findings, the court emphasized statements made by members of the Judiciary Committee.¹⁹ The Sixth Circuit concluded that, by granting bankruptcy court judges exclusive power to grant relief, Congress implicitly refused to grant the same power to the debtor through the mechanism of waiving the protection of the automatic stay.²⁰

Other circumstantial evidence of congressional intent not to allow a pre-petition waiver includes the absence of express language in the Bankruptcy Code authorizing it. Bankruptcy Code section 362(d) provides that relief from the automatic stay may be granted for only two alternative reasons: for cause, or where the debtor lacks equity in the subject property and the property is not necessary for an effective reorganization.²¹ It does not provide for relief from the automatic stay where the debtor waives this protection, pre-petition. Thus, the

authority to grant relief from the stay of judicial proceedings against the debtor.”); *Cathey v. Johns-Manville Sales Corp.*, 711 F.2d 60, 62 (6th Cir. 1983), *cert. denied*, 478 U.S. 1021 (1986) (“The legislative history of § 362(d) unambiguously identifies the bankruptcy court as the exclusive authority to grant relief from the stay”); *Association of St. Croix Condominium Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir. 1982) (“Under the old Bankruptcy Act, a debtor apparently could waive a stay. Under the new Code, relief from a stay must be authorized by the Bankruptcy Court”); *Holtkamp v. Littlefield (In re Holtkamp)*, 669 F.2d 505, 507 (7th Cir. 1982) (Section 362(d) “commits the decision of whether to lift the stay to the discretion of the bankruptcy judge.”); *Farm Credit of Cent. Fla., ACA v. Polk*, 160 B.R. 870, 873 (Bankr. M.D. Fla. 1993) (“Relief from the automatic stay must be authorized by the Bankruptcy Court.”); *In re Sky Group Int’l, Inc.*, 108 B.R. 86, 89 (Bankr. W.D. Pa. 1989) (“Although waiver of a stay by the debtor apparently was possible under the old Bankruptcy Act, such a waiver is not self-executing under the Bankruptcy Code. Relief from stay must be authorized by the Bankruptcy Court.”); *In re Clark*, 69 B.R. 885, 889 (Bankr. E.D. Pa. 1987), *modified*, 71 B.R. 747 (Bankr. E.D. Pa. 1987) (“[T]he stay not only may but must be invoked by the court to protect the debtor”); *In re Related Asbestos Cases*, 23 B.R. 523, 526 (Bankr. N.D. Cal. 1982) (“[T]he original bankruptcy courts alone should have exclusive power to lift an actual stay under section 362.”).

18. *Cathey*, 711 F.2d at 62.

19. *Id.* at 62-63 (citing H.R. REP. NO. 595, 95th Cong., 2d Sess. 5 (1978), reprinted in 1978 U.S.C.A.N. 5963, 5973).

20. *Id.* at 63; see also *Association of St. Croix Condominium Owners*, 682 F.2d at 448; *Sky Group*, 108 B.R. at 89; *Clark*, 69 B.R. at 889.

21. Bankruptcy Reform Act of 1978, 11 U.S.C. § 362(d) (1994).

argument concludes, since the drafters of the Bankruptcy Code did not include the debtor's waiver of the automatic stay as a basis for granting relief, such waivers cannot be grounds for the courts to grant such relief.²²

B. A Debtor May Not Waive Pre-Petition the Protection of the Automatic Stay Because the Stay is Necessary to Prevent Depletion and Dismemberment of the Debtor's Estate and Because the Stay is Necessary to Promote Fair Distribution of the Estate's Assets to the Unsecured Creditors

Bankruptcy courts have used two additional reasons to hold that a debtor may not waive the automatic stay: avoiding an inefficient depletion of the estate's assets, and preventing an inequitable distribution of the estate's assets. To support their reasoning, the courts again looked to the legislative history of the Bankruptcy Code, focusing particularly on the *House Report*:

The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.²³

Since the automatic stay provision is designed to protect and treat all creditors equally, and promote orderly liquidation or reorganization procedures, with the ultimate goal of maximizing the estate's value, these courts argue that they should not lift it simply because the debtor elected to waive the protection it afforded him.²⁴

22. Some courts use a similar rationale in refusing to enforce a debtor's waiver of other bankruptcy protections. In *In re Levinson*, the bankruptcy court explained that "[t]he general rule is that all debts are dischargeable in bankruptcy unless specifically excepted by the Bankruptcy Code provisions." *Klingman v. Levinson (In re Levinson)*, 58 B.R. 831, 837 (Bankr. N.D. Ill. 1986), *aff'd*, 66 B.R. 831 (Bankr. N.D. Ill. 1986), *aff'd*, 831 F.2d 1292 (7th Cir. 1987). The court then noted that the statutory exceptions to a discharge do not include contractual waivers of a discharge. *Id.* Therefore, the judge concluded that a debtor may not waive the right to a bankruptcy discharge. *Id.* On the other hand, one may argue that since Congress enacted special provisions under § 524 of the Bankruptcy Code to protect a debtor from waiving the discharge of a debt and since Congress did not enact similar safeguard provisions for a debtor's waiver of the automatic stay rights, Congress has demonstrated an intent to allow and tolerate a debtor's pre-petition waiver of the automatic stay protection.

23. H.R. REP. NO. 595, 95th Cong., 2d Sess. 5 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6297.

24. See *Maritime Elec. Co., Inc. v. United Jersey Bank*, 959 F.2d 1194 (3d Cir. 1992), where the court stated:

[T]he stay protects creditors by preventing particular creditors from acting unilaterally in self-interest to obtain payment from a debtor to the detriment of other creditors

. . . Because 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. *Id.* at 1204. Similarly, in *Association of St. Croix Condominium Owners*, the court held: Under the new [Bankruptcy] Code, relief from a stay must be authorized by the Bankruptcy Court to prevent certain creditors from gaining a preference for their claims against the debtor; to forestall the depletion of the debtor's assets due to legal costs in defending proceedings against it; and, in general, to avoid interference with the orderly liquidation or rehabilitation of the debtor. Because it is the bankruptcy judge who is the most knowledgeable about the debtor's affairs, and about the effect that any judicial proceeding would have on the debtor's reorganization, it is essential that he make the determination as to whether an action against the debtor may proceed or whether the stay against such actions should remain in effect.

Association of St. Croix Condominium Owners, 682 F.2d at 448. In *Yorke v. Citibank Nat'l Ass'n*, the court stated:

It is well accepted that the automatic stay not only protects the debtor's attempt to repay his debts or reorganize . . . but it also protects creditors by preventing dismemberment of the estate. Purposely, the automatic stay maintains the status quo, to ensure orderly distribution of estate assets, and, more importantly, facilitate the administration of the estate by allowing the court to resolve claims and distribute assets in accord with priorities recognized in the Code.

Yorke v. Citibank Nat'l Ass'n (In re BNT Terminals, Inc.), 125 B.R. 963, 971 (Bankr. N.D. Ill. 1990). In *In re Clark*, the court noted:

[The automatic stay] is necessary not only to protect the debtor, but also to protect the equal treatment and distribution of the debtor's assets, where appropriate, among all creditors Hence, the stay not only may but must be invoked by the court to protect the debtor—and the principle of equal treatment of all creditors

Clark, 69 B.R. at 889. In *In re Sky Group Int'l, Inc.*, the court held that

[t]o grant a creditor relief from stay simply because the *debtor* elected to waive the protection afforded the debtor by the automatic stay ignores the fact that it also is designed to protect *all creditors* and to treat them *equally*. The orderly liquidation procedure contemplated by the Code would be placed in jeopardy

. . . [S]uch a waiver is not self-executing under the Bankruptcy Code. *Sky Group*, 108 B.R. at 89. See also *S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc. (In re S.I. Acquisition, Inc.)*, 817 F.2d 1142, 1146 (5th Cir. 1987) ("In a chapter 11 reorganization proceeding, the stay prevents the dissipation or diminution of the bankrupt's assets while rehabilitative efforts are undertaken"); *Tringali v. Hathaway Mach. Co., Inc.*, 796 F.2d 553, 562 (1st Cir. 1986) ("The purpose of this section [362] . . . is . . . to preclude one creditor from pursuing a remedy to the disadvantage of other creditors") (quoting *A.H. Robbins Co., Inc. v. Piccinin (In re A.H. Robbins Co., Inc.)*, 788 F.2d 994, 998 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986)); *Commerzanstalt v. Telewide Sys., Inc.*, 790 F.2d 206, 207 (2d Cir.), *aff'd in part and rev'd in part*, 794 F.2d 763 (2d Cir. 1986) ("Since the purpose of the stay is to protect creditors, as well as the debtor, the debtor may not waive the automatic

Since those creditors who are not privy to the pre-petition waiver agreement may benefit from the application of the automatic stay, judicial enforcement of the waiver may harm them. For example, a junior under-secured creditor in a real estate transaction may find that postponing foreclosure of the subject real property will enhance the chances of obtaining a full or, at the very least, a greater repayment of debt. It may be too risky or simply not cost-effective to protect only a limited equity in the property at the foreclosure sale. Therefore, the under-secured creditor may conclude that the best chance to maximize the recovery on the unsecured portion of the debt and to increase the value of the equity in the property would lie in letting the debtor continue operating the property under bankruptcy protection for some period of time. The creditor would hope that, under bankruptcy protection, the debtor would be able to effectively reorganize, improve the property's cash flow (thereby potentially increasing its value), and repay some, if not all, of the unsecured portion of the debt. In such a situation, judicially enforcing the pre-petition agreement between the debtor and the senior over-secured creditor may substantially harm the junior creditor's interests. In the absence of the protection of the automatic stay, the senior over-secured creditor could foreclose on its

stay."); *Farm Credit of Cent. Fla., ACA v. Polk*, 160 B.R. 870, 873 (Bankr. M.D. Fla. 1993) ("Since the purpose of the stay is to protect the creditors, as well as [the debtor, the debtor] could not have unilaterally waived the automatic stay against the interest of his creditors."); *In re Cafe Partners/Wash.* 1983, 81 B.R. 175, 181 (Bankr. D.D.C. 1988); *In re Best Fin. Corp.*, 74 B.R. 243, 245 (Bankr. D.P.R. 1987) ("A debtor cannot waive the automatic stay, since the purpose of its enactment by Congress was not only to protect debtors and creditors, but also to provide an 'orderly and efficient administration of a bankruptcy estate.'") (quoting *Olsen v. Deutscher (In re Nashville White Trucks, Inc.)*, 22 B.R. 578 (Bankr. M.D. Tenn. 1982)); *Bankers Life Ins. Co. v. Alyucan Interstate Corp. (In re Alyucan Interstate Corp.)*, 12 B.R. 803, 806 (Bankr. D. Utah 1981) ("[The stay] shields creditors from one another by replacing 'race' and other preferential systems of debt collection with a more equitable and orderly distribution of assets."). See generally Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 99 (1995). Rasmussen and Skeel write:

Although the waiver may make sense as between the parties who agreed to it, other creditors may not have any idea that the debtor has relinquished its right to the automatic stay. For these creditors, the waiver imposes significant costs. Most important, the debtor's promise to give up its principal creditor's collateral may sacrifice the benefits of any collective proceeding If other creditors knew that the debtor had agreed to a stay waiver, they could adjust their relationship with the debtor accordingly (perhaps, by monitoring more closely or insisting on more restrictive credit terms). What makes waivers in existing agreements particularly problematic is the element of secrecy and the costs they impose on other creditors.

Id.

lien, wipe out the junior under-secured creditor's limited equity in the subject real property, and end any prospect of dividends arising out of the debtor's potentially successful reorganization.

This exercise of a single creditor's remedies creates an inefficient result detrimental to the collective group of creditors. To prevent this, some courts refuse to enforce the debtor's pre-petition waiver and opt to impose the collective and compulsory proceedings to make the diverse individuals act as one. This collective proceeding results in a net gain for all the creditors by ensuring that, individually, they cannot pick apart the estate's assets through piecemeal liquidation. It also helps guarantee fair and equal treatment for all creditors, not just those who are party to a pre-petition waiver agreement.

C. A Debtor May Not Waive Pre-Petition the Protection of the Automatic Stay Because Such a Waiver Is Against Public Policy

Courts have also been reluctant to enforce pre-petition waivers because they do not want to deprive a debtor of the opportunity to attempt a reorganization. They point out that, in addition to protecting the relative position of creditors, the drafters of the Code designed the automatic stay to provide the debtor with enough time to attempt to reorganize without the creditors' pressure and interference.²⁵ The drafters characterized this protection as:

one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to

25. *Maritime Elec. Co., Inc.*, 959 F.2d at 1204; see also *Stringer v. Huet (In re Stringer)*, 847 F.2d 549, 551 (9th Cir. 1988) ("In addition to protecting the relative position of creditors, [the automatic stay] was designed to shield the debtor from financial pressure during the pendency of the bankruptcy proceeding."); *Tringali*, 796 F.2d at 562. One court opined:

[T]he Bankruptcy Court's holding that prepetition agreements providing for the lifting of the stay are "not per se binding on the debtor, as a public policy position," is consistent with the purposes of the automatic stay to protect the debtor's assets, provide temporary relief from creditors and promote equality of distribution among the creditors by forestalling a race to the court house.

Farm Credit of Cent. Fla., 160 B.R. at 873. See also *Air Line Pilots Ass'n, Int'l v. Eastern Air Lines, Inc. (In re Ionosphere Clubs, Inc.)*, 105 B.R. 765, 771 (Bankr. S.D.N.Y. 1989); *Yorke*, 125 B.R. at 971; *Sky Group*, 108 B.R. at 88; *Cafe Partners*, 81 B.R. at 181.

attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.²⁶

Based on this legislative history, courts held that allowing a creditor to proceed against a debtor pursuant to a pre-petition waiver of the automatic stay effectively takes away the fundamental protection of the mandated breathing spell.²⁷

Courts have also suggested that depriving the debtor of the Bankruptcy Code's most fundamental protection amounts to a waiver of the right to file bankruptcy altogether. Since a waiver of that sort violates the Bankruptcy Code's public policy underpinnings, courts analogously refused to enforce a pre-petition waiver of the automatic stay.²⁸

D. A Pre-Petition Waiver of the Automatic Stay Entered Between the Debtor and One Creditor Is Not Enforceable Because It Fails to Include All the Necessary Parties

Very often, only one of the creditors is party to a pre-petition waiver agreement. In the absence of pre-petition waivers by all creditors of the estate, courts have held such agreements unenforceable because they are

26. H.R. REP. NO. 595, 95th Cong., 1st Sess. (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97; *see also* S. REP. NO. 989, 95th Cong., 2d Sess. 5787 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97.

27. *See Yorke*, 125 B.R. at 971:

[T]he automatic stay . . . protects the debtor's attempt to repay his debts or reorganize his financial affairs by giving the debtor a respite from creditor demands The court will not tolerate unauthorized acts by debtors . . . [by] facilitating the exercise of control over, or permitting the dismemberment of property of the estate outside the provisions of the Code. To do so would make a nullity of § 362 and what it attempts to accomplish as well as invite horrendous fraud upon the court.

Id. *See also Maritime Elec. Co., Inc.*, 959 F.2d at 1204 ("The automatic stay . . . gives a bankrupt a breathing spell from creditors by stopping all collection efforts, all harassment, and all foreclosure actions Because the automatic stay serves the interests of both debtors and creditors, it may not be waived"); *Farm Credit of Cent. Fla.*, 160 B.R. at 873 ("It is the opinion of this Court that the Bankruptcy Court's holding that prepetition agreements providing for the lifting of the stay are 'not per se binding on the debtor, as a public policy position,' is consistent with the purposes of the automatic stay to protect the debtor's assets"); *Cafe Partners*, 81 B.R. at 181-82 (The automatic stay "gives the debtor a breathing spell from his creditors [S]ince the purpose of the stay is to protect creditors as well as the debtor, the debtor may not waive the automatic stay.").

28. *See, e.g., Clark*, 69 B.R. at 889 ("[T]he automatic stay is one of the most fundamental debtor protections provided by the bankruptcy laws"); *In re Jenkins Court Assocs. Ltd. Partnership*, 181 B.R. 33, 36-37 (Bankr. E.D. Pa. 1995); *see also* Peter S. Partee, *The Enforceability of Pre-Petition Waivers of a Debtor's Rights Under The Automatic Stay*, 1992 NORTON BANKR. L. ADVISER 5, 8.

not binding on the other non-party creditors who are intended beneficiaries of the automatic stay.²⁹

This holding is based on the rationale that creditors are also congressionally designated beneficiaries of the automatic stay, allowing them to invoke its protection despite the debtor's waiver.³⁰ The legislative history specifically states that the automatic stay provision of the Bankruptcy Code provides protection to *both* the debtor and to the estate's creditors.³¹ As such, a waiver of the automatic stay by the debtor cannot be enforced unless the other creditors, also intended beneficiaries of the stay's protection, waive the protection as well. A waiver would be ineffective unless *all* of the debtor's creditors consent.³² Thus, a pre-petition waiver of the automatic stay entered between the debtor and one creditor may be objected to by any other creditor because, as beneficiaries of the automatic stay provision, they have the standing to object.³³

29. See, e.g., *Farm Credit of Cent. Fla.*, 160 B.R. at 873-74:

The automatic stay provision is intended to preclude the opportunity of one bankruptcy creditor to pursue a remedy against the debtor to the disadvantage of the other bankruptcy creditors No other creditors were involved in the prepetition agreement, nor did the Bankruptcy court approve this agreement. . . . The Bankruptcy Court correctly determined that the agreement to waive the automatic stay was not self-executing.

Id. See also *Sky Group*, 108 B.R. at 89 ("To grant a creditor relief from stay simply because the debtor elected to waive the protection afforded the debtor by the automatic stay ignores the fact that it also is designed to protect *all creditors* and to treat them *equally*."); *Commerzanstalt v. Telewide Sys., Inc.*, 790 F.2d 206, 207 (2d Cir.), *aff'd in part and rev'd in part*, 794 F.2d 763 (2d Cir. 1986) ("Since the purpose of the stay is to protect creditors as well as the debtor, the debtor may not waive the automatic stay.").

30. See *In re Clark*, 69 B.R. 885 (Bankr. E.D. Pa. 1987).

31. H.R. REP. NO. 595, 95th Cong., 1st Sess. (1977), *reprinted in* 1978 U.S.C.A.N. 5963, 6297 ("The automatic stay also provides creditor protection."); see also *S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc. (In re S.I. Acquisition, Inc.)*, 817 F.2d 1142, 1146 (5th Cir. 1987).

32. See *Partee*, *supra* note 28, at 8.

33. Some courts have also indicated that, when needed, they have the duty to invoke the automatic stay provision *sua sponte* even when neither the debtor nor any other creditor has raised the issue. See, e.g., *Clark*, 69 B.R. at 889 ("[T]he stay not only may but must be invoked by the court to protect the debtor—and the principle of equal treatment of all creditors").

III. THE RATIONALE FOR ENFORCING A DEBTOR'S PRE-PETITION WAIVER OF THE AUTOMATIC STAY

A. *A Debtor's Pre-Petition Waiver of the Automatic Stay Is Binding Upon All Creditors of the Estate Because Only the Debtor Has Standing to Invoke the Protection of the Automatic Stay*

Other courts have upheld pre-petition waivers of the automatic stay based on agreements between the debtor and only one creditor. They have taken the position that, since only the debtor may invoke the protection of the automatic stay, the debtor's pre-petition waiver of the protection must also bind all other creditors. Consequently, creditors have no standing to object to the enforcement of the pre-petition waiver.³⁴

These courts reason that, though creditors may be incidental beneficiaries of the automatic stay, they "are afforded no *substantive or procedural* rights under [section 362] of the Bankruptcy Code"³⁵ and thus may not invoke the automatic stay to protect their interests. As a result, creditors cannot effectively oppose the enforcement of the debtor's pre-petition waiver of the automatic stay protection.

B. *A Debtor's Pre-Petition Waiver of the Automatic Stay Should Be Enforced Because It Does Not Violate Public Policy As It Does Not Amount to a Waiver of the Debtor's Right to File for Bankruptcy Protection*

Some bankruptcy courts enforce pre-petition waiver agreements of the automatic stay by reasoning that such an agreement does not violate public policy because it does not prohibit the debtor from actually filing

34. *Washington Mut. Sav. Bank v. James (In re Brooks)*, 79 B.R. 479, 481 (Bankr. 9th Cir. 1987), *aff'd*, 871 F.2d 89 (9th Cir. 1989); *see also Magnoni v. Globe Inv. & Loan Co., Inc. (In re Globe Inv. & Loan Co., Inc.)*, 867 F.2d 556, 559 (9th Cir. 1989) ("The appellees argued, and the district court concluded, that section 362 is intended solely for the benefit of the debtor[']s] estate. The appellees' position is supported by the majority of the courts which have considered standing under section 362."); *Bryce v. Stivers (In re Stivers)*, 31 B.R. 735, 735 (Bankr. N.D. Ca. 1983) ("I conclude that the automatic stay operates in favor of debtors and estates (represented by trustees and debtors-in-possession) only and that it gives junior lienholders and other parties interested in the property affected by the automatic stay no substantive or procedural rights."); *Hodsell v. Estate of Fuel Oil Supply and Terminaling, Inc. (In re Fuel Oil Supply and Terminaling, Inc.)*, 30 B.R. 360, 362 (Bankr. N.D. Tex. 1983) ("The automatic stay is for the benefit of the debtor and if it chooses to ignore stay violations other parties cannot use such violations to their advantage.").

35. *Brooks*, 79 B.R. at 481. *See also* cases cited *supra* note 34.

a bankruptcy petition. The case of *In re Club Tower L.P.*³⁶ addresses the question of whether a pre-petition waiver of the automatic stay amounts to a waiver of the right to file a bankruptcy petition. The court held that while a pre-petition waiver of the right to file bankruptcy was unenforceable because it was against public policy, a pre-petition waiver of the automatic stay is not against public policy and is therefore enforceable.³⁷ The court reasoned that a pre-petition waiver of the automatic stay is significantly different than an agreement prohibiting the debtor from filing a bankruptcy petition altogether.³⁸

The court first pointed out the obvious: agreeing not to contest a motion for relief from the automatic stay does not stop the debtor from filing for bankruptcy relief.³⁹ Moreover, by agreeing not to contest relief from the automatic stay, the debtor waives only a single benefit of the Bankruptcy Code and does not waive the remaining protection conferred on the debtor by the Bankruptcy Code.⁴⁰ Unlike when a borrower waives the right to file a bankruptcy petition altogether, a pre-petition waiver of the automatic stay still leaves the debtor with the

benefits . . . as to other creditors, as well as all the other benefits and protections provided by the Bankruptcy Code including but not limited to the right to conduct an orderly liquidation, discharge debt or pay it back on different terms, assume or reject executory contracts, sell property free and clear of liens, and pursue preferences and fraudulent conveyance claims. Debtor still retains the core rights under the Bankruptcy Code and has the ability to make a "fresh start."⁴¹

Thus, the court concluded that pre-petition waiver agreements are enforceable because they do not raise the same public policy concerns as does a pre-petition waiver of the right to file for bankruptcy protection.⁴²

36. 138 B.R. 307 (Bankr. N.D. Ga. 1991).

37. *Id.* at 312.

38. *Id.* at 311-12.

39. *Id.* at 311.

40. *Id.* at 311-12.

41. *Id.*

42. *Id.* at 312. See *In re Hudson Manor Partners, Ltd.*, No. 91-81065HR, 1991 WL 472592 (Bankr. N.D. Ga. Dec. 31, 1991):

To permit [the secured creditor] to enforce its [pre-petition waiver provision of the automatic stay entered with the debtor] does not violate public policy. Debtor at all times was free to file in the bankruptcy court. The agreement in question only impacts debtor and one of its creditors Debtor has all the protection of the Bankruptcy Code with respect to all its other creditors. In other words, 11 U.S.C. § 362 is still in effect as to them. Also, debtor may

C. *Enforcing a Debtor's Pre-Petition Waiver of the Automatic Stay, As Part of a Workout Agreement, Furthers the Legitimate Public Policy of Encouraging Out-Of-Court Restructurings and Settlements*

The most powerful rationale put forth by courts in enforcing pre-petition waivers is that they advance the important public policy of promoting out-of-court workouts and settlement agreements.⁴³ Some courts have viewed the policy of encouraging out-of-court workouts as an overriding objective of the Bankruptcy Code. In analyzing relevant legislative history, one court concluded that "Congress designed the [Bankruptcy] Code, in large measure, to encourage workouts in the first instance, with refuge in bankruptcy as a last resort."⁴⁴ The *In re Colonial Ford* court attached importance to the legislative history of the Bankruptcy Code that stated: "Most business arrangements, that is, extensions or compositions (reduction) of debts, occur out-of-court. The out-of-court procedure, sometimes known as a common law composition, is quick and inexpensive When an out-of-court arrangement is inadequate to rehabilitate a business, the bankruptcy laws provide an alternative."⁴⁵

Congress had at least three strong reasons for promoting pre-petition workouts. First, a workout is expeditious. Debtors and creditors

file a plan of liquidation or reorganization in this pending Chapter 11, or convert and discharge all its debts in a Chapter 7 proceeding, assume or reject its executory contracts in Chapter 11, sell property free and clear of liens, and prosecute preference actions and fraudulent conveyance claims. In other words, notwithstanding enforcement of the [pre-petition waiver of the automatic stay], debtor has all the rights afforded by the bankruptcy code as to any other creditor. Thus, there is no violation of public policy by enforcing the [pre-petition waiver] agreement.

Id. at *5-6. See also *In re Darrell Creek Assocs., L.P.*, 187 B.R. 908, 913 (Bankr. D.S.C. 1995) ("[A] waiver of stay is different from, and not equivalent to, a waiver of the right to file bankruptcy."); *In re Cheeks*, 167 B.R. 817, 818-19 (Bankr. D.S.C. 1994) (pre-petition agreements to waive the automatic stay "are distinguishable from an agreement which precluded the debtor from filing a bankruptcy petition in that the debtor has elected to forego only a single benefit of the Bankruptcy Code in exchange for the creditor's forbearance.").

43. *Hudson Manor Partners, Ltd.* at *2 ("[T]his court agrees with movant's argument that to enforce the [pre-petition waiver of the stay] agreement would further the legitimate public policy of encouraging out of court restructurings and settlements."); see also *Cheeks*, 167 B.R. at 819 ("Perhaps the most compelling reason for enforcement of the forbearance agreement is to further the public policy in favor of encouraging out of court restructuring and settlements."); *In re Club Tower L.P.*, 138 B.R. 307, 312 (Bankr. N.D. Ca. 1991) ("[E]nforcing pre-petition settlement agreements furthers the legitimate public policy of encouraging out of court restructurings and settlements.").

44. *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1015 (Bankr. D. Utah 1982).

45. *Id.* (quoting H.R. REP. NO. 595, 95th Cong., 1st Sess. (1977), reprinted in 1978 U.S.C.A.N. 5963, 6179-80).

enjoy a substantially greater flexibility in a workout arrangement than in a bankruptcy context. The flexibility in a workout setting results in quicker dispute resolution and in fewer delays. On the other hand, the bankruptcy mechanism can be “‘a very time-consuming and hydraheaded kind of delaying structure’ which ‘frequently works to the detriment of creditors.’”⁴⁶ It is the most expensive element in any bankruptcy proceeding, and can best be avoided by a pre-petition workout agreement.⁴⁷

Second, workouts are cost-effective. They avoid the costs of delays generally associated with a bankruptcy proceeding.⁴⁸ They also avoid the inevitable superstructure of reorganization and its related costs, including those of trustees, creditors’ committees, and their professional representatives. These direct costs of reorganization are estimated to range from three to twenty-five percent of a debtor’s value.⁴⁹

In addition to direct costs of reorganization under the Bankruptcy Code, a debtor may incur indirect opportunity and uncertainty costs. Opportunity costs result from management’s down-time. As management of the debtor-in-possession concentrates its efforts in reorganizing, it “‘may have few resources [and little time] to expend on the debtor’s business operations. The uncertainty costs emerge from the doubts reorganization raises about the firm’s ultimate survival. Reorganization

46. *Id.* at 1016 (quoting *Bankruptcy Reform Act of 1978: Hearings on S. 2266 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 599 (1977) [hereinafter *Senate Hearings*]).

47. *Id.*

48. Marcia B. Pine & Paul L. Alpern, *Pre-Bankruptcy Automatic Stay Agreements*, L.A. LAW., Sept. 1993, at 28 (“Single-asset bankruptcies are expensive [I]t is not uncommon for a debtor with a troubled, depreciating asset to remain in bankruptcy for a year or more.”).

49. See, e.g., DAVID T. STANLEY & MARJORIE GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 176 (1971) (estimate costs at about 25%); Jerold B. Warner, *Bankruptcy, Absolute Priority, and the Pricing of Risky Debt Claims*, 4 J. FIN. ECON. 239, 271 (1977) (legal costs of railroad bankruptcies are about five percent of the market value of the firm at the time of bankruptcy); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 286 (1990) (costs estimated at about three percent under the Bankruptcy Reform Act of 1978). While the first two studies *supra* examine and analyze the costs of bankruptcies prior to the Bankruptcy Reform Act of 1978, the process of court-supervised negotiations among claimants was fundamentally the same then as it is now. See DOUGLAS G. BAIRD & THOMAS H. JACKSON, *CASES, PROBLEMS & MATERIALS ON BANKRUPTCY* 36 (2d ed. 1990) (“A new Bankruptcy Code was passed by Congress in 1978 . . . [codifying] . . . many of the judicial developments in bankruptcy law.”).

often creates uncertainty about whether or to what extent the debtor will continue as a going concern.”⁵⁰ This uncertainty may result in a loss of key employees and may contribute to wasteful or excessive precautionary behavior.⁵¹

Additionally, reorganization under bankruptcy protection is costly because creditors do not have perfect information at their disposal, which gives them an incentive to engage in strategic behavior. Bankruptcy proceedings would be much more efficient and inexpensive if each interested party had all the relevant information relating to the debtor’s estate, including the real value of the debtor’s assets, the real amount of its own claim, and the priority of its own claim. However, in reality, claimants and equity holders often heavily litigate over these factors and have incentives to engage in strategic behavior even if they understand their legal rights.⁵² “These reorganization battles and bargains impose both direct and indirect costs on a debtor. And while not all these costs are properly attributable to bankruptcy reallocation, most probably are.”⁵³

Moreover, reorganization under the Bankruptcy Code may destroy the debtor’s essential business relationships, which the debtor often desperately needs to keep the business afloat. For example, once a debtor-manufacturer commences a bankruptcy petition, customers may become reluctant to do business with her because she may not survive to honor product warranties.⁵⁴ Another type of debtor in a similar position is the lessor who cannot guarantee the habitability of its premises.⁵⁵

In general, sales will slow and the debtor may be forced to cut prices.⁵⁶ The debtor may have difficulty finding supplies. If he does, his credit costs may substantially increase.⁵⁷ Likewise, upon commencing a bankruptcy petition, “the debtor’s own debtors often decline to pay as they would have in the ordinary course, suddenly reporting that the dresses were the wrong size, were the wrong color, or were not

50. Barry E. Adler, *Bankruptcy And Risk Allocation*, 77 CORNELL L. REV. 439, 465 (1992). For further discussion of how uncertainty in the outcome of bankruptcy proceedings affects costs, see David C. Webb, *The Importance Of Information Explaining The Existence Of Costly Bankruptcy*, 54 ECONOMICA 279 (1987).

51. Thomas H. Jackson & Robert E. Scott, *On The Nature Of Bankruptcy: An Essay On Bankruptcy Sharing And the Creditors’ Bargain*, 75 VA. L. REV. 155, 199 (1989).

52. Adler, *supra* note 50, at 464-65.

53. *Id.*

54. *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1016 (Bankr. D. Utah 1982).

55. *Id.*

56. *Id.*

57. *Id.*

ordered.”⁵⁸ Similarly, “accounts receivable can deteriorate to an unbelievable extent as soon as word gets around that the debtor is headed for the cemetery.”⁵⁹ Such direct and indirect costs can significantly impede the debtor’s prospects for an effective bankruptcy reorganization. However, if the debtor and her creditors can reach an out-of-court workout, and the debtor thus never files a bankruptcy petition, she can largely minimize these impediments and costs.

That reorganization through a consensual workout agreement simply makes more business sense than reorganization through a bankruptcy proceeding presents the third primary reason to promote out-of-court workouts. Out-of-court restructurings require cooperation and good faith from all the involved parties. “The alternative is litigation [in the bankruptcy courts] and its bedfellows—bluff, petti-foggery, and strife. Moreover, the parties who are ‘on site,’ and prepared by education or experience, are more able than a judge, ill-equipped in resources and training, to rescue a beleaguered corporation.”⁶⁰ Furthermore, “[t]he courtroom is not a boardroom. The judge is not a business consultant.”⁶¹ The problems of insolvency, for the most part, are matters for extra-judicial resolution, calling for “*business not legal judgment*.”⁶²

Recognizing the benefits of pre-petition workout agreements, the Bankruptcy Code’s authors promoted the policy of pre-petition workout agreements in at least two ways. First, they structured the Code to provide incentives to both debtors and creditors to enter into workout agreements and not to resort to bankruptcy. By themselves, the Code provisions may force the creditor and the debtor to enter into negotiations for mutual accommodations which would result in a consensual workout agreement, and the need to file a bankruptcy petition would be eliminated.⁶³ For example, a creditor should consider the possibility that recovering on a judgment will be meaningless if a bankruptcy

58. *Id.* (quoting Peter F. Coogan et al., *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 BUS. LAW. 1149, 1155 (1975)).

59. *Bankruptcy Reform Act of 1978: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Committee on the Judiciary*, 94th Cong., 1st Sess. 483 (1975) (testimony by Peter F. Coogan) [hereinafter *House Hearings*].

60. *Colonial Ford, Inc.*, 24 B.R. at 1016.

61. *In re Curlew Valley Assocs.*, 14 B.R. 506, 511 (Bankr. D. Utah 1981).

62. *Id.*

63. *House Hearings*, *supra* note 59, at 396.

petition ensues. Preference law will void the recovery.⁶⁴ Similarly, a debtor “may not break faith with creditors by preferring some over others, or by secreting assets, lest they file an involuntary petition.”⁶⁵

Second, the Bankruptcy Code’s drafters promoted out-of-court consensual workout agreements by providing, under certain conditions, a binding effect to a pre-petition workout agreement in a subsequently filed bankruptcy case. Under certain conditions, Bankruptcy Code section 1102(b)(1) allows a pre-petition creditors’ committee to function as the official committee⁶⁶ in the bankruptcy case.⁶⁷ Likewise, section 1126(b) endorses pre-petition acceptance of pre-packaged plans⁶⁸ in some circumstances.⁶⁹ Congress specified that acceptance of a plan of reorganization “obtained before the commencement of the filing may be counted in the voting if there was adequate prepetition disclosure and, if necessary, ‘compliance with any applicable non-bankruptcy law governing the adequacy of disclosure.’”⁷⁰ Indeed, incentives to use “prepackaged plans” are “written all through the new [Bankruptcy Code].”⁷¹

64. *Colonial Ford, Inc.*, 24 B.R. at 1017 (relying on *House Hearings, supra* note 59, at 394-97, 490-91).

65. *Id.*

66. The Bankruptcy Code requires the U.S. Trustee to appoint a committee consisting of creditors holding unsecured claims as soon as practicable after the filing of the Chapter 11 petition. DAVID G. EPSTEIN ET AL., *BANKRUPTCY* 750-51 (1993). A committee ordinarily consists of those persons holding the seven largest claims or amounts of equity securities against the estate. *Id.*

67. Bankruptcy Reform Act of 1978, 11 U.S.C. § 1102(b)(1) (1994) (“A committee of creditors shall . . . ordinarily consist of the persons, willing to serve, that hold the seven largest claims . . . or of the members of a committee organized by creditors before the commencement . . . if such committee was fairly chosen, and is representative”); see also *Colonial Ford, Inc.* 24 B.R. at 1017.

68. A prepackaged Chapter 11 plan of reorganization is a plan proposed and accepted out of court by all classes of impaired creditors and shareholders prior to the commencement of the bankruptcy case. As long as the solicitation of votes is conducted in accordance with applicable non-bankruptcy law, the acceptances obtained prior to the filing may be used after the commencement of the bankruptcy case to consummate a plan of reorganization under the authority of the bankruptcy court. See LAWRENCE P. KING, *COLLIER ON BANKRUPTCY* ¶ 1126.02 (15th ed. 1995).

69. See Bankruptcy Reform Act of 1978, 11 U.S.C. § 1126(b) (1994); see also *Colonial Ford, Inc.*, 24 B.R. at 1017.

70. *Colonial Ford, Inc.*, 24 B.R. at 1017 (quoting J. Ronald Trost, *Business Reorganization Under Chapter 11 of the New Bankruptcy Code*, 34 *BUS. LAW.* 1309, 1325 (1979)).

71. *Id.* (quoting Richard I. Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-for-Lawyers Bill*, 1982 *Utah L. Rev.* 1, 38). As the congressional sponsors of the Bankruptcy Code stated:

One cannot overemphasize the advantages of speed and simplicity to both creditors and debtors. Chapter XI allows a debtor to negotiate a plan outside of court and, having reached a settlement with a majority in number and amount of each class of creditors, permits the debtor to bind all unsecured

By providing binding effect to certain pre-petition consensual workouts, the Bankruptcy Code's sponsors clearly demonstrated favoritism toward pre-petition workout agreements as an alternative to bankruptcy proceedings.⁷² Those courts enforcing pre-petition waivers have taken this implicit legislative intent to heart, while also recognizing the significant benefits of out-of-court pre-petition workout agreements.

In *In re Club Tower L.P.*,⁷³ the debtor defaulted on a loan secured by real property. As a result of this default, the lender and the debtor entered into a workout agreement under which the debtor's debt was restructured. In addition to restructuring the payment schedule, the lender agreed not to pursue foreclosure proceedings against the debtor as long as payments called for under the workout agreement were kept current. In return, the debtor promised to waive the protection of the automatic stay. The debtor later defaulted under the workout agreement, commenced bankruptcy proceedings, and invoked the protection of the automatic stay. The lender then moved for relief from the automatic stay under section 362(d)(1) of the Bankruptcy Code on the basis of the debtor's pre-petition waiver of the automatic stay.⁷⁴

Siding with the lender, the court enforced the pre-petition waiver because enforcement "furthers the legitimate public policy of encouraging out of court restructurings and settlements."⁷⁵ The court found that the Bankruptcy Code "recognizes that the filing of a bankruptcy petition might not always be the most efficient means of restructuring the relations of a debtor and its creditors."⁷⁶ The court concluded that pre-petition workouts among debtors and creditors should be promoted.⁷⁷ "In order to facilitate this goal, the pre-petition agreements should be

creditors to the terms of the arrangement. From the perspective of creditors, early confirmation of a plan of arrangement: first, generally reduces administrative expenses which have priority over the claims of unsecured creditors; second, permits creditors to receive prompt distribution on their claims with respect to which interest does not accrue after the filing date; and third, increases the ultimate recovery on creditor claims by minimizing the adverse effect on the business which often accompanies efforts to operate an enterprise under the protection of the Bankruptcy Act.

124 CONG. REC. H32405 (daily ed. Sept. 28, 1978).

72. See 124 CONG. REC. H32405 (daily ed. Sept. 28, 1978).

73. 138 B.R. 307 (Bankr. N.D. Ga. 1991).

74. *Id.* at 308-09.

75. *Id.* at 312.

76. *Id.*

77. *Id.*

enforced against a borrower who later files for bankruptcy. To hold otherwise would make lenders more reticent in attempting workouts with borrowers outside of bankruptcy.”⁷⁸

Courts have also enforced pre-petition waivers of the automatic stay to encourage lenders to enter into pre-petition workout agreements.⁷⁹ In doing so, the courts attempted to minimize the lender’s risks stemming from pre-petition workout agreements and thereby encourage other lenders to enter into such agreements in the future.⁸⁰ Otherwise, lenders could make concessions, sincerely bargained for, as part of a workout agreement. Courts could then alter those concessions in the debtor’s subsequent Chapter 11 petition. Such a scenario would make the debtor’s promise in the pre-bankruptcy workout phase—to avoid filing a bankruptcy petition in return for bargained changes to the loan agreement—imaginary at best.⁸¹ The lender’s purpose of avoiding the debtor’s bankruptcy by consenting to liberalize the terms of the underlying loan would be meaningless if, after entering into a formal restructuring agreement, the debtor “could file a bankruptcy petition and obtain a stay of the lender’s bargained-for right to foreclosure and extort even more concessions to which the lender would not have agreed outside of bankruptcy.”⁸²

“These severe uncertainties and risks cause many lenders to reject workout attempts and seek foreclosure, knowing that if bankruptcy is

78. *Id.* See *Crown Life Ins. Co. v. Springpark Assocs. (In re Springpark Assocs.)*, 623 F.2d 1377 (9th Cir.), *cert. denied*, 449 U.S. 956 (1980):

“The authority of a trial court to enter a judgment enforcing a settlement agreement has as its foundation the policy favoring the amicable adjustment of disputes and the concomitant avoidance of costly and time consuming litigation.” . . . [A] contrary result would tend to encourage delays similar to this one in future bankruptcy proceedings and discourage the use of settlements.

Id. at 1380 (quoting *Dacanay v. Mendoza*, 573 F.2d 1075, 1078 (9th Cir. 1978)). See also *In re Hudson Manor Partners, Ltd.*, No. 91-81065HR, 1991 WL 472592 (N.D. Ga. Dec. 31, 1991):

[T]his court agrees with movant’s argument that to enforce the agreement would further the legitimate public policy of encouraging out of court restructurings and settlements. In situations such as this, i.e., a dispute between essentially two parties over a single real estate asset, workouts and restructurings should be encouraged between market-wise, equally knowledgeable commercial entities. If the court were not to enforce this agreement it would send the wrong signal to the market place.

Id. at *2.

79. *Pine & Alpern*, *supra* note 48, at 31 (citing *In re Club Tower L.P.*, 138 B.R. 307 (Bankr. N.D. Ga. 1991); *In re Aurora Invs., Inc.*, 144 B.R. 899 (Bankr. M.D. Fla. 1992)).

80. *Pine & Alpern*, *supra* note 48, at 31, 60.

81. *Id.* at 31.

82. *Id.* at 30-31.

filed, at least the lender has not bid against itself by entering into prepetition settlement or workout agreements.”⁸³ Thus,

[u]nless the borrower enters into an enforceable stipulation that the lender will have relief from the automatic stay should the borrower later file for bankruptcy—a prepetition automatic stay relief provision—the borrower will not have truly shared the risks and concessions that the borrower is asking the lender to make in a workout agreement.⁸⁴

In other words, pre-petition waivers of the automatic stay as part of a comprehensive pre-petition workout agreement helps assure a secured creditor that the debtor is acting in good faith. By enforcing the pre-petition waiver of the automatic stay, courts can help minimize the secured creditor’s risks and reduce the possibility of the debtor’s abuse of a pre-petition workout agreement. In doing so, the courts make it more likely that lenders will feel confident when entering into the much-valued workout agreements.

D. Enforcing a Debtor’s Pre-Petition Waiver of the Automatic Stay As Part of a Workout Agreement Furthers the Legitimate Public Policy of Enforcing Otherwise Valid Contracts

Judicial enforcement of pre-petition waivers of the automatic stay also promotes the vital public policy interest of recognizing otherwise valid contracts. The legal system has always recognized the enormous socio-economic contributions of valid contracts by consistently enforcing them.⁸⁵

Following this rationale, a number of bankruptcy courts have approved private agreements, entered into prior to the debtor filing a bankruptcy petition, that call for the waiver of the automatic stay as part of a workout agreement. In one such case, *In re Orange Park South Partnership*,⁸⁶ the lender filed a judicial foreclosure action against the debtor’s real property after the debtor defaulted on two secured notes of

83. *Id.* at 31.

84. *Id.* at 30.

85. JOHN D. CALAMARI & JOSEPH M. PERILLO, *CONTRACTS* 9 (1977); *see also In re Silverman*, 13 B.R. 72, 75 (Bankr. D. Mass. 1981) (“If a party to a stipulation can unilaterally waive its terms whenever the circumstances change in that party’s favor, the beneficial activity of negotiation and settlement will cease.”).

86. 79 B.R. 79 (Bankr. M.D. Fla. 1987).

the lender.⁸⁷ Subsequently, in an attempt to work out the debtor's financial obligations to the lender, the two parties entered into a stipulated judgment in which the lender agreed to postpone the maturity date of the two notes. In exchange, the debtor agreed to stipulate, among other things, that he would admit the filing as being totally unfounded, a mere delaying tactic, if he subsequently filed for bankruptcy. As part of the stipulation, the debtor also conceded that he had no equity in the subject property.⁸⁸ The debtor later failed to pay off the obligations on the newly agreed-upon maturity date.⁸⁹ Four days prior to the scheduled foreclosure sale, the debtor filed a bankruptcy petition.⁹⁰

In dismissing the case, the court rejected the debtor's contention that the pre-petition stipulation should not be enforced. The court found that "there is absolutely nothing in this record which would warrant the conclusion that the stipulation was obtained either by coercion, fraud or by mutual mistake of material facts which have been traditionally recognized as the only valid bases to rescind an agreement."⁹¹

In upholding pre-petition waivers of the stay in the context of a workout agreement where the pre-petition workout agreement is an otherwise valid and enforceable contract, these courts view the waivers no differently than other valid private contractual agreements that have been traditionally enforced and recognized under the legal system.

87. *Id.* at 80.

88. *Id.*

89. *Id.* at 81.

90. *Id.*

91. *Id.* at 82. *See also In re Aurora Invs., Inc.*, 134 B.R. 982 (Bankr. M.D. Fla. 1991):

There is absolutely nothing in this record to warrant the conclusion that the Stipulation was obtained either by coercion, fraud or by mutual mistake of material facts which have been traditionally recognized as the only valid bases to rescind an agreement, therefore the Debtor cannot escape the legal consequences of the stipulation.

Id. at 986. *See also In re Silverman*, 13 B.R. 72 (Bankr. D. Mass. 1981):

The parties who negotiate . . . stipulations must be aware that they have altered their relationships, and will be bound by the terms of the new agreement. Furthermore, the court is aware of the importance that stipulations and negotiated settlements play in the management of a reorganization case . . . Much of the nature of reorganization is to negotiate mutually advantageous arrangements between the debtor and his creditors. If a party to a stipulation can unilaterally waive its terms whenever the circumstances change . . . the beneficial activity of negotiation and settlement will cease.

Id. at 75.

IV. PROPOSED MODEL FOR LIMITED ENFORCEABILITY OF PRE-PETITION WAIVERS OF THE AUTOMATIC STAY

A. Introduction

Pre-petition waivers of the automatic stay in an out-of-court workout agreement, while not self-executing, should be given limited enforceability in reorganization cases under certain circumstances. This proposed model for limited enforceability of pre-petition waivers of the automatic stay attempts to strike a balance between the important competing public policy interests of the opponents and proponents of such pre-petition waivers.

Courts should enforce pre-petition waivers of the automatic stay on a limited basis⁹² only after determining their validity. Prior to enforcement, courts should find that the waivers are fair, freely entered into, and supported by consideration. The burden of proof would then shift to the secured creditor to establish a prima facie case that the estate lacks equity in the subject property. To safeguard her rights, any interested party, except for the debtor or the debtor-in-possession, would have standing to challenge the secured creditor's prima facie case. After finding that the debtor lacked equity in the subject property, the court would hold as a matter of law that, pursuant to the pre-petition waiver of the automatic stay, the subject property is unnecessary for an effective reorganization. The court would then grant the secured creditor's motion for relief from the automatic stay.

However, a valid pre-petition waiver of the automatic stay would not bind an appointed trustee in either a liquidation or a reorganization case under the Bankruptcy Code.⁹³ Furthermore, a valid pre-petition waiver of the automatic stay would have a conclusive presumptive effect only with respect to the second prong of the relief-from-stay standard of section 362(d)(2).⁹⁴

B. The Model

92. The proposed model is limited to the context where the creditor, who is seeking relief from stay, is a secured creditor who wishes to foreclose on its collateral.

93. See *infra* text accompanying notes 107-09.

94. Bankruptcy Reform Act of 1978, 11 U.S.C. § 362(d)(2) (1994).

1. *The Secured Party's Burden of Proof Under the Proposed Model*

In the proposed model, pre-petition waivers would not be self-executing.⁹⁵ Rather, they would require court scrutiny and approval, which would begin by requiring the secured creditor, a party to the pre-petition waiver agreement, to file a motion for relief from the automatic stay in order to foreclose on its collateral. The secured creditor would base the motion for relief on section 362(d)(2)(A) and (B).⁹⁶

To satisfy the requirements of section 362(d)(2)(A), a secured creditor would have to allege that the estate and the debtor have no equity in the subject property. The secured creditor would have to support this allegation by providing the court with admissible evidence. Thus, the secured creditor would still have to establish a prima facie case of lack of equity as it is otherwise obligated to do pursuant to section 362(g)(1) of the Bankruptcy Code.⁹⁷

Next, in petitions for reorganizations, the secured creditor would have to allege, with respect to section 362(d)(2)(B), that the subject property is not necessary for an effective reorganization.⁹⁸ To that end, the secured creditor would have to show that the parties stipulated as part of a pre-petition agreement that the property is not necessary for an effective reorganization. The secured creditor would also have to allege facts and provide support sufficient to establish the validity of the pre-petition waiver agreement, which must meet judicial scrutiny.

2. *Judicial Scrutiny Under the Proposed Model*

(a) *Whether the Pre-Petition Waiver is Valid*

In deciding the merits of a motion for relief from the automatic stay based upon a pre-petition waiver, the bankruptcy judge must first

95. See *In re Powers*, 170 B.R. 480, 483 (Bankr. D. Mass. 1994) (“[T]he contention that this ‘waiver’ is enforceable and self-executing is without merit.”).

96. Bankruptcy Reform Act of 1978, 11 U.S.C. 362(d)(2) (1994). The section states: “[T]he court shall grant relief from the stay . . . with respect to a stay of an act against property under subsection (a) of this section, if (A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.” *Id.*

97. See Bankruptcy Reform Act of 1978, 11 U.S.C. § 362(g)(2) (1994). The section states: “In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—(1) the party requesting such relief has the burden of proof on the issue of the debtors equity in property”

98. See 11 U.S.C. § 362(d)(2)(B) (1994).

determine whether all the conditions precedent have been satisfied: the parties freely and fairly entered into the pre-petition waiver agreement, the pre-petition waiver agreement is supported by consideration, and the pre-petition waiver agreement was entered into in close temporal proximity to the bankruptcy petition. When inquiring into whether the pre-petition waiver was entered into freely and whether its terms are fair, the court should examine several factors, such as whether the debtor understood or should have understood the terms of the waiver, and whether the waiver was a boilerplate provision in a loan agreement or specifically negotiated as part of a workout agreement. The court would also question whether the debtor consulted with, or at least had the opportunity to consult with, an attorney prior to entering into the pre-petition waiver agreement.⁹⁹

99. See *In re Darrell Creek Assocs., L.P.*, 187 B.R. 908 (Bankr. D.S.C. 1995), where the court stated:

Here, it is clear to this Court that the Debtor understood or should have understood the [pre-petition] waiver [of the automatic] stay. The principal of the Debtor testified that this Agreement was negotiated over a very long period of time and that it was an active negotiation. Further, [the Debtor] testified that he made comments on certain provisions through the course of this negotiation. Clearly, the evidence is undisputed that during at least a portion of these negotiations, the Debtor was represented by counsel. The Debtor's principal was by his own testimony a sophisticated real estate developer who had great experience in this area. The language of the waiver of stay is clear, and is clearly and conspicuously disclosed in the Workout Agreement. Debtor . . . acknowledged in the Workout Agreement that they [sic] had read and understood its terms.

Id. at 913. See also *In re Riley*, 188 B.R. 191, 192 (Bankr. D.S.C. 1995) (“[T]he first determination is whether the affected party understood the terms and consequences of the waiver of stay.”); *In re McBride Estates, Ltd.*, 154 B.R. 339, 342 (Bankr. N.D. Fla. 1993) (“This court is in agreement with the principal that a stipulation freely entered into by the parties is binding on the parties.”); *In re Hudson Manor Partners, Ltd.*, No. 91-81065HR, 1992 WL 472592, at *2 (N.D. Ga. Dec. 31, 1991) (in rationalizing its decision to enforce a pre-petition waiver provision of the automatic stay, the court mentioned that the debtor, having the advice of counsel, agreed to the waiver: “This is what debtor specifically agreed to with advice of counsel and offered to [the secured creditor] as consideration for its agreement to stop foreclosure proceedings”); Jeffrey W. Warren & Wendy V.E. England, *Pre-Petition Waiver of The Automatic Stay Is Not Per Se Enforceable*, 13 AM. BANKR. INST. J. 22, 22 (1994) (“[C]ourts typically enforce waiver provisions that are conspicuous, negotiated by parties who are experienced, professional and sophisticated in business dealings; negotiated where there is no great degree of disparity in bargaining power between the parties; and negotiated where the opposing party has an ability to negotiate the contract terms.”).

The judge must also make a finding as to whether consideration supports the pre-petition waiver agreement.¹⁰⁰ The judge must examine whether the debtor received value in exchange for the pre-petition waiver of the automatic stay. Determination of value in such cases will generally be based on an inquiry as to whether the debtor received, under the pre-petition workout agreement, reasonable accommodations to restructure the underlying troubled debt. Such accommodation could include meaningful forbearance, interest rate adjustment, or maturity date extension.¹⁰¹

(b) *Whether the Estate Has Equity in the Property*

After determining the validity of the pre-petition waiver of the automatic stay, the bankruptcy judge would examine whether the movant has met the burden of proof in establishing lack of equity.¹⁰² The judge should not accept contradictory evidence from the debtor or the

100. See *In re Atrium High Point Ltd. Partnership*, 189 B.R. 599 (Bankr. M.D.N.C. 1995), where the court held:

There was no prepetition waiver in the original loan agreement or under the First or Second Modification. The agreement not to object to the motion to lift stay was bargained for under the Third Modification The Debtor received a lower interest rate and a five-year extension of the loan Enforcing the Debtor's agreement under these conditions does not violate public policy concerns. This is not a situation where a prohibition to opposing a motion [for] relief from stay was inserted in the original loan documents. The Debtor received significant benefits under the Third Modification and the confirmed plan treatment of [the lender]. In exchange for these benefits, the Debtor bargained away its right to oppose a motion to lift stay in a subsequent bankruptcy proceeding. Accordingly, the court will not consider the objection to relief from stay filed by the Debtor.

Id. at 607. See also *Riley*, 188 B.R. at 192 ("Generally, forbearance agreements are enforceable when the parties have used the contract to afford a mortgagor the opportunity to avoid foreclosure [E]ach party concedes certain rights in the context of such agreements and thereby furthers the public policy in favor of encouraging out of court settlements."); *Darrell Creek Assocs., L.P.*, 187 B.R. at 913 ("A further factor considered . . . is whether there was some surrender of rights by the lender in regards to the giving and receiving of the waiver of stay."); *Powers*, 170 B.R. at 484 ("[T]he Court will consider other factors, such as the benefit which the debtor received from the workout agreement as a whole"); *In re Cheeks*, 167 B.R. 817, 819 (Bankr. D.S.C. 1994) ("In the instant case the Debtor received relief under the forbearance agreement approximating that which would have been available in a bankruptcy proceeding."); Craig H. Averch, *Bankruptcy Issues: Emphasizing Drafting Considerations In Protecting Against Insolvency (Including Selected Issues in Single Asset Real Estate Bankruptcies)*, C950 A.L.I.-A.B.A. COURSE OF STUDY: REAL ESTATE DEFAULTS, WORKOUTS, AND REORGANIZATIONS 303, 316 (1994) ("The best case for [prepetition waiver] enforcement is the workout situation where consideration (in the form of forbearance, loan concessions, or modifications by the lender) is clearly established").

101. Averch, *supra* note 100, at 316.

102. See *supra* notes 95-98 and accompanying text.

debtor-in-possession on the issue of equity. Because the debtor effectively waived protection of the automatic stay before making a petition, the court should not permit him to oppose the creditor's motion.¹⁰³ However, the judge should allow other creditors to file motions opposing the secured creditor's motion for relief from the stay.¹⁰⁴ These parties could base their opposition on the presence of debtor's equity in the subject property, which can be used to make distribution to unsecured creditors of the debtor's estate.¹⁰⁵

103. By precluding the debtor and debtor-in-possession from opposing the creditor's motion for relief from stay, the model attempts to minimize the biggest risk facing the lender when entering pre-petition workout agreements: that the debtor could take advantage of the benefits of the workout agreement and then file a bankruptcy petition just prior to the date the agreement requires that he perform. Prohibiting opposition to the creditor's motion forces the debtor to share the risks and concessions that he is asking the lender to make in a workout agreement. *See supra* text accompanying notes 82-84.

104. This provision attempts to satisfy the concerns of several courts that assert that pre-petition waivers inefficiently deplete the estate's assets to the detriment of the unsecured creditors. *See supra* Part II.B. The proposed provision ensures that the estate's unsecured creditors have the opportunity to oppose enforcement of the waiver if there is equity to distribute.

Recently, a number of bankruptcy courts have adopted this position. *See, e.g., Powers*, 170 B.R. at 483; *Atrium High Point Ltd. Partnership*, 189 B.R. at 607. In *In re Atrium*, the court held:

Enforcement of a forbearance agreement does not in itself mean that in all bankruptcy cases where one exists, the automatic stay will be lifted. These agreements do not oust this Court's Jurisdiction to hear objections to stay relief filed by other parties in interest. It simply means that this court will give no weight to a Debtor's objection as this conflicts with and is in derogation of the previous agreement [W]hen creditors and parties in interest entitled to notice on a motion to lift the stay do not object, the stay becomes lifted as though the motion is in default, as the 'objection' of the debtor is meaningless and of no effect because of the forbearance agreement. In short, if the automatic stay remains it is not because of the debtor.

Atrium High Point Ltd. Partnership, 189 B.R. at 607 (quoting *In re Cheeks*, 167 B.R. at 817, 819-20 (Bankr. D.S.C. 1994)). In *Cheeks*, the court held that the pre-petition waiver of stay eliminated the debtor's standing to object to a request for relief from stay in that case. However, the court's ruling recognized that the waiver may not be binding on third parties, and therefore such parties may have standing to object to relief from stay. *Cheeks*, 167 B.R. at 819-20.

105. When bringing a motion to enforce the pre-petition waiver, the secured creditor would have the burden of establishing that the debtor has no equity in the subject property. However, unsecured creditors could file opposing motions. To prevail, they would have to present contradictory evidence that showed that the debtor does have equity in the subject property.

(c) *Whether the Property is Necessary for an Effective Reorganization*

Having determined that the pre-petition waiver of the automatic stay is valid and that the estate has no equity in the subject property, the judge would then conclusively presume that the subject property is not necessary for an effective reorganization.¹⁰⁶ After finding that both prongs of section 362(d)(2) have been met, the judge could then grant an order for relief from the automatic stay.

C. *Limitations of the Proposed Model*

1. *No Binding Effect on Trustee*

Only the secured creditor and the debtor are parties to an agreement for pre-petition waiver of the automatic stay. A subsequent, court-appointed trustee in a debtor's bankruptcy petition is not a party.¹⁰⁷ Therefore, the terms of the pre-petition waiver should not bind the trustee.¹⁰⁸ Thus, in either a Chapter 7 or a Chapter 11 petition, a court-appointed trustee may oppose the secured creditor's motion for relief from a stay notwithstanding the pre-petition waiver agreement entered between the debtor and the secured creditor. The trustee may center opposition on allegations that the estate has equity in the subject property, or that the subject property is necessary for an effective reorganization, or both. Where the trustee opposes the secured creditor's motion for relief on the basis that the property is necessary for an effective reorganization, the court shall not conclusively presume that the property is unnecessary. Instead, the trustee would have to meet the burden of proof in establishing that the property is necessary for an effective reorganization.¹⁰⁹

106. The conclusive presumption lightens the secured creditor's burden in obtaining relief. The model provides secured creditors with an important incentive to enter out-of-court workout agreements. See *infra* text accompanying notes 114-15. The model also ensures that the debtor receives a comparable breathing spell prior to filing for bankruptcy. See *infra* text accompanying notes 117-18. However, the model allows for certain circumstances when the court should not make the conclusive presumption. See *infra* text accompanying notes 107-09.

107. See Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 701(a), 1104(a) (1994).

108. LAURENCE P. SIMPSON, HANDBOOK OF THE LAW OF CONTRACTS 242 (1965) (“[L]iability may not be imposed by contract upon a stranger to it . . .”).

109. See Bankruptcy Reform Act of 1978, 11 U.S.C. § 362(g)(2) (1994).

2. *Conclusive Presumption Only In Regard to the Second Prong of the Standard for Granting Relief From Stay*

Under the proposed model, a valid pre-petition waiver of the automatic stay precludes the debtor from opposing a motion for relief from the automatic stay on the basis that the estate has equity in the subject property. To prevail in such a motion, the movant must still produce evidence sufficient to establish a prima facie case that the estate has no equity.

However, under the proposed model, the second prong of the standard for granting relief from stay under section 362(d)(2) will be conclusively presumed in favor of the creditor, as long as the pre-petition waiver was deemed valid. Thus, upon finding the pre-petition waiver a valid agreement as defined in this model, the bankruptcy court would not allow the debtor to rebut the presumption that the subject property is not necessary for an effective reorganization.¹¹⁰

D. *Justification for the Proposed Model of Limited Enforceability of Pre-Petition Waivers of the Automatic Stay*

1. *Continued Court Monitoring of the Debtor's Reorganization or Liquidation Process*

This proposed model strikes a balance between the important interests of both opponents and proponents of pre-petition waivers of the automatic stay. It provides continued court intervention and involvement in granting relief from the automatic stay. By not regarding pre-petition waivers of the automatic stay as self-executing, the model preserves the bankruptcy judge's important role in monitoring and overseeing the debtor's reorganization or liquidation process. Preservation of the bankruptcy judge's judicial role in connection with the automatic stay provision permits the model to remain consistent with the Bankruptcy Code mandate that a bankruptcy judge has the power to grant relief from the automatic stay. Under the proposed model, the bankruptcy judge still has to make a ruling as to whether the estate has equity in the

110. As stated earlier, this conclusive presumption is not binding on a trustee.

subject property. Moreover, the bankruptcy judge still has the ultimate power to order relief from the automatic stay.

Furthermore, the modified judicial role adopted by the proposed model of scrutinizing pre-petition waiver agreements prevents secured creditors from potentially abusing them. Because the model requires close examination of whether the pre-petition waiver is fair, entered into freely, and supported by consideration, the court will be in a position to prevent the enforcement of one-sided and unconscionable pre-petition waivers. The court's oversight will function as a control mechanism to ensure orderly distribution of the estate, preventing unnecessary depletion and inefficient dismemberment.

2. *Safeguards of the Debtor's Reorganization Attempts*

The proposed model also provides the debtor with adequate safeguards in its reorganization attempts. Bankruptcy Code section 105 vests the bankruptcy judge with discretionary equitable powers that may be exercised to safeguard the debtor's reorganization attempts, enforceability of the pre-petition waiver notwithstanding.¹¹¹ If the debtor experiences a genuine change in circumstances when filing the bankruptcy petition, necessitating the protection of a stay of liquidation of the estate, he may seek a temporary restraining order followed by an injunction pursuant to section 105 of the Bankruptcy Code. The courts have interpreted section 105 to mean that if "there is a radical and new development which drastically changes the economic picture and the value of the collateral, . . . it is clear that . . . [the bankruptcy] . . . Court may grant additional relief to the debtor by way of injunctive relief."¹¹²

Judicial discretion in determining the validity of the pre-petition waiver provides yet another highly effective safeguard of the debtor's reorganization efforts. If the judge believes that the debtor was not

111. See Bankruptcy Reform Act of 1978, 11 U.S.C. § 105 (1994) (A bankruptcy court may "issue any order . . . necessary or appropriate to carry out the provisions of this title.").

112. B.O.S.S. Partners I v. Tucker (*In re* B.O.S.S. Partners I), 37 B.R. 348, 351 (Bankr. M.D. Fla. 1984). See also *In re* Jenkins Court Assocs. Ltd. Partnership, 181 B.R. 33, 36 (E.D. Pa. 1995), where the court held:

[I]t is not unreasonable to wonder whether the Debtor's circumstances or market conditions might not have changed during the lengthy period between the Debtor's execution of the pre-petition settlement agreement and the filing of the bankruptcy petition, thereby undercutting the thrust of the earlier representations It is again not unreasonable to posit that if the Debtor's circumstances have changed, or market conditions have improved, the Debtor's acknowledgments to the contrary in a pre-petition settlement agreement two years earlier may no longer be valid.

Id.

given an adequate and meaningful chance to reorganize under the pre-petition workout agreement, then she may find that the debtor did not receive value or real benefit in exchange for the pre-petition waiver. In that scenario, the judge would hold that the pre-petition waiver of the automatic stay is invalid and unenforceable for a lack of consideration.¹¹³ As discussed in the preceding sections, these safeguards provide the necessary protection for the debtor's reorganization attempts and prevent inefficient depletion of the estate.

3. *Promote Out-Of-Court Settlements*

This proposed model provides secured creditors with strong incentives to enter into out-of-court workout agreements through selective enforcement of pre-petition waivers of the automatic stay. A secured creditor entering into a pre-petition workout agreement with a valid waiver provision of the automatic stay significantly enhances his chances of quickly prevailing in any subsequent motion for relief from the automatic stay. A validly held pre-petition waiver of the automatic stay precludes the debtor from producing evidence that the debtor has equity in the subject property.¹¹⁴ Furthermore, the secured creditor is entitled to have the second prong of the relief-from-stay standard conclusively presumed to be in its favor.¹¹⁵

Although the pre-petition waiver of the automatic stay does not provide a secured creditor with self-executing relief from the stay, the proposed model lightens the burden of obtaining such relief. The model improves the probability that a secured creditor will enter into an out-of-court restructuring with the debtor by dramatically reducing the risks associated with a pre-petition workout agreement.¹¹⁶

4. *Protection of the Interests of Other Creditors*

The proposed model also protects and preserves the rights of other creditors to a fair distribution of the estate's equity by fostering a principle of fair distribution. The model requires the court to scrutinize whether the estate has equity in the subject property which can be

113. See *supra* notes 99-101 and accompanying text.

114. See *supra* text accompanying notes 107-09.

115. See *supra* text accompanying note 110.

116. See *supra* text accompanying notes 79-84.

distributed among the unsecured creditors of the estate. This requirement ensures that, to the extent that there is equity to distribute among unsecured creditors of the estate, the court possesses adequate safeguards and control mechanisms to prevent uncontrolled depletion and dismemberment of the estate, as well as to provide a fair and equitable distribution of such equity.

5. *The Proposed Model Ensures That the Debtor Will Receive a Breathing Spell to Reorganize*

The provisions and mechanisms of the proposed model ensure that the debtor will receive an adequate breathing spell to reorganize.¹¹⁷ The proposed model requires the bankruptcy judge to conduct an inquiry as to whether the pre-petition waiver of the automatic stay was indeed a genuine waiver of the stay protection. A pre-petition waiver of the stay will be deemed genuine only when, among other things, the waiver is supported by appropriate consideration.

In determining whether the waiver provision is supported by appropriate consideration, the court will examine whether the debtor enjoyed a breathing spell under the terms of the pre-petition workout agreement.¹¹⁸ By limiting enforcement of pre-petition waivers of the automatic stay to circumstances where a genuine out-of-court workout agreement was reached, the proposed model attempts to ensure that such pre-petition waivers are enforced only in cases where the debtor has already received a comparable breathing spell out of court prior to filing for bankruptcy.

By ensuring that a debtor is given at least one genuine breathing spell, the proposed model consistently follows the broad policy goals of the Bankruptcy Code which provide the debtor with a breathing spell to reorganize.

V. CONCLUSION

As the split of authority continues among the federal courts on the issue of the enforceability of pre-petition waivers of the automatic stay, lenders remain uncertain and hesitant about entering into a workout agreement with a delinquent debtor. While some courts acknowledge the valid concerns and important interests of lenders in promoting

117. Pine points out the importance of the breathing spell to the beleaguered debtor. See Pine & Alpern, *supra* note 48, at 31.

118. See *supra* text accompanying notes 25-28.

certainty in the marketplace, many courts are reluctant to enforce such waivers because they fear such waivers impair the debtor's fundamental rights under the Bankruptcy Code.

The proposed model strikes a delicate balance between the important interests of the opponents and proponents of enforcing pre-petition waivers of the automatic stay. By providing limited enforceability to pre-petition waivers of the automatic stay, the courts can promote the important policy interests of encouraging consensual out-of-court agreements; maintaining judicial scrutiny of relief-from-stay motions; providing adequate safeguards for the debtor's reorganization efforts; protecting the interests of other creditors; and ensuring that the debtor receives an adequate breathing spell to reorganize.

