BRYAN CAVE

I. ENFORCEABILITY OF WAIVER OF AUTOMATIC STAY

A. General Information about an Automatic Stay

The automatic stay is one of most important protections and powerful tools available to a debtor in bankruptcy. It is provided for in section 362 of the Bankruptcy Code. Triggered immediately on filing of the bankruptcy petition, it automatically stops substantially all acts and proceedings against the debtor and its property. It is a nationwide, possibly even worldwide, injunction barring almost all actions against the debtor and its property, including the exercise of remedies concerning collateral, enforcement of prepetition judgments, litigation, collection efforts, and actions to create, perfect, and enforce liens granted before the date the bankruptcy petition is filed.

The automatic stay has a broad scope, applying to all creditors, whether secured or unsecured, and to all of the debtor's property, wherever located. It forbids creditors from pursuing both formal and informal actions and remedies against the debtor and its property. Consensual negotiations with the debtor, however, are permitted.

Despite the power of the automatic stay, it is temporary and may be lifted by the court under certain circumstances as provided by the Bankruptcy Code.

B. Waiving the Automatic Stay

The automatic stay causes delay and inconvenience to lenders who want to exercise remedies to realize the value of their collateral. Lenders are increasingly considering requesting a waiver of the automatic stay before a bankruptcy is filed in forbearance agreements executed during loan workout negotiations and in the resulting restructuring agreements.[1]

While the Bankruptcy Code does not expressly prohibit prepetition waivers of the stay, they are not self-executing in favor of the lenders, nor per se enforceable. Regardless of whether there is language in a waiver providing for the automatic lifting of the stay on the filing or the bankruptcy petition, the lender must file a motion for relief from the stay, with notice to all creditors and other parties in interest.[2]

1. Typical Language Used in Automatic Stay Waiver Clauses

Waiver clauses typically contain similar language, regardless of the agreement's controlling subject matter. Here is an automatic stay waiver template:

> Section 1.01 Waiver. In the event the Borrower is the subject of any voluntary [or involuntary] proceeding under the Bankruptcy

[1] *See* Automatic Stay Waivers: Are They Enforceable?, Practical Law Article 3-525-8880.

[2] *See In re Frye*, 320 B.R. 786 (Bankr. D. Vt. 2005); *In re Bryan Road, LLC*, 382 B.R. 844, 848 (Bankr. S.D. Fla. 2008); *In re Triple A & R Captial Inv., Inc.*, 519 B.R. 581, 586 (Bankr. D. P. R. 2014).

> Code, the Borrower hereby unconditionally and irrevocably agrees that the Lender is immediately entitled, without notice, demand or any other action, to relief from the automatic stay so as to allow the Lender to foreclose on its Collateral and enforce its other rights and remedies under the [Loan Agreement/Security Documents], or at law and in equity under applicable state law. The Borrower hereby consents to the immediate lifting, without notice, demand or any other action, of any such automatic stay and agrees that it shall not, in any manner, contest or otherwise delay any motion filed by the Lender for relief from the automatic stay. The Lender's enforcement of this stay waiver is subject to the approval of the bankruptcy court in which the case is then pending [and is effective only to the extent that it does not result in a breach of any fiduciary duty owed by the Borrower's directors and officers to the Borrower's creditors].[3]

2. Underlying Purpose of Clause

The purpose of an automatic stay waiver clause is to help the lender minimize exposure under the agreement, streamline remedies, and maximize recoveries in connection with their investment – particularly when the borrower has the potential to become financially distressed.[4]

C. Types of Contracts Ordinarily Containing Waiver of Automatic Stay

The majority of contracts containing automatic stay waivers are forbearance agreements, or agreements approved by the court in a previous bankruptcy case (i.e. Chapter 11 reorganization plans). A Chapter 11 reorganization plan may call for merger of the debtor corporation with another corporation. Case law and commentary are silent on the effect of an automatic stay waiver on a merger agreement that results from a Chapter 11 reorganization plan.

Moreover, case law and commentary do not speak about automatic stay waivers in contexts outside of forbearance agreements and Chapter 11 reorganization plans. The one exception is found in *In re Jeff Benfield Nursery, Inc.* where the waiver was contained in a prepetition "grow contract." The waiver was found to be unenforceable.

D. Enforceability of Wavier

When determining the enforceability of automatic stay waivers under § 362 of the Bankruptcy Code, courts usually fall into one of two camps:

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[3] Waiver of Automatic Stay, PRACTICAL LAW STANDARD CLAUSES 3-385-5433 ("This resource is continually monitored and revised for any necessary changes due to legal, market, or practice developments.").

[4] Mark A. Cody and Mark G. Douglas, *A Breif Guide to Automatic Stay Waivers, Bankruptcy Remoteness, and Bad Boy Guarantees*, JONES DAY PUBLICATIONS, http://www.jonesday.com/a-brief-guide-to-automatic-stay-waivers-bankruptcy-remoteness-and-bad-boy-guarantees-08-08-2016/.

1. Reject the stay waiver as unenforceable *per se* against public policy.
2. Treat the stay waiver as a factor in deciding whether "cause" exists to lift the stay.[5]

1. Reject the stay waiver as unenforceable per se against public policy.

A majority of courts in earlier cases held that stay waivers were *per se* unenforceable. Although a majority of courts in recent cases are shifting away from this view, there are a minority of courts that hold onto this theory. These courts favor the public policy of protecting the debtor and the creditor group as a whole. They believe that parties should not be able to circumvent this protection by contract.

Matter of Pease[6]

Debtors were farmers who had entered into a prepetition "debt resolution agreement" with their primary secured creditor. The Agreement included an automatic stay waiver. The court held that the prepetition stay waiver was *per se* invalid.

The court provided the following reasons:

- The prepetition debtor does not have authority to bind the post-petition debtor in possession.
- The Bankruptcy Code specifically prohibits certain contractual provisions that take effect upon filing in §§ 363, 365, and 541.
- The Bankruptcy Code extinguishes the private right to contract around its essential provisions.
- The automatic stay was part of the collective process mandated by the Bankruptcy Code to protect debtors and creditors.

In re DB Capital Holdings, LLC[7]

This case involved three single asset real estate debtors (Debtors) and their lender. Debtors defaulted on the payment of their loans, resulting in the parties amending the loan documents to include a stay waiver. Debtors ultimately filed Chapter 11 bankruptcy petitions, and the lender sought to enforce the stay waiver. The court held that prepetition stay waivers are *per se* unenforceable.

In making its ruling, the court elaborated on the *Pease* court's reasoning:

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[5] Many commentators and courts have identified a third trend: uphold the stay waiver in broad unqualified terms on the basis of freedom of contract. This trend no longer independently exists, but rather, it is now a part of the "treat the stay waiver as a factor in deciding whether "cause" exists to lift the stay" trend. The last court to follow this trend was the *In re Club Tower L.P.* court in 1991. (see *In re Club Tower L.P.*, 138 B.R. 307, 309 (Bankr. N.D. Ga. 1991). No court since *In re Club Tower L.P.* has followed this trend. Courts now use the policy of freedom of contract to substantiate why using the factor test is better than the unenforceable *per se* theory.

[6] *See Matter of Pease*, 195 B.R. 431, 433 (Bankr. D. Neb. 1996).

[7] *See In re DB Capital Holdings, LLC*, 454 B.R. 804 (Bankr. D. Colo. 2011).

- Before bankruptcy, the debtor does not have the capacity or authority to waive fundamental rights conferred by the Bankruptcy Code, including the protection of the automatic stay. This is because the prepetition debtor and the postpetition debtor are "separate and distinct" entities, with different rights and duties. Before bankruptcy, the debtor only has the capacity to enter into agreements which bind it under applicable non-bankruptcy law. It may not waive the automatic stay until after it is in bankruptcy, and even then, this would require court approval after notice and an opportunity to object is provided to all parties in interest.
- The Bankruptcy Code explicitly invalidates provisions of private agreements which deprive the debtor of the use and benefit of property after the filing of a bankruptcy case (§§ 541(c), 363(l) and 365(e), Bankruptcy Code). Therefore, stay waivers are not enforceable because they deprive the debtor of the ability to use, sell or lease a lender's collateral.
- The Bankruptcy Code abolishes the private right of freedom to contract around its essential provisions. This is implied by the comprehensive nature of the Bankruptcy Code and its purpose, which is to provide a uniform collective remedy for debtors and creditors. Enforcing the stay waiver would allow a single creditor to opt out of this process to the potential detriment of the debtor and other creditors.

In re Jeff Benfield Nursery, Inc.[8]

This case involved a landscape supply company that delivered trees to Chapter 11 debtor prepetition to grow on company's behalf. The supply company asserted that stay relief was warranted because the debtor waived the protections of the automatic stay in the language of the prepetition grow contracts. The court denied the supply company's argument on the grounds that prepetition stay waivers were *per se* unenforceable.

The court's reasoning was based on:

- Stay waiver provisions effectively render the automatic stay meaningless.
- Upholding prepetition stay waivers deprives debtors of the "breathing spell" contemplated by the Bankruptcy Code, and waivers thwart the congressional intent underlying the automatic stay.
- NOTE: Although the court held that such waivers are *per se* unenforceable, the court also buttressed its conclusion by analyzing "factors" used by other courts. For example, the court determined that the waiver:
    - was a single term in a much broader agreement dealing with an entirely different subject matter;
    - did not appear that there was any bargained-for exchange with respect to the waiver language;
    - would have negatively impacted other creditors; and
    - there was substantial equity in the estate.

2. Treat the stay waiver as a factor in deciding whether "cause" exists to lift the stay.

[8] *See In re Jeff Benfield Nursery, Inc.*, 565 B.R. 603, 63 (Bankr. W.D. N.C. 2017)

A majority of courts are now treating the stay waiver as a factor in deciding whether "cause" exists to lift the stay. Under this theory, courts balance several factors in determining the enforceability of stay waivers. These factors look not only to the waiver itself, but also to the context in which the waiver was obtained.

Generally, courts find that:

- An automatic stay waiver, even if enforceable, does not enable a lender to enforce a lien without first obtaining stay relief from the bankruptcy.[9]
- The burden is on the party opposing enforcement of the waiver (debtor) to demonstrate that the court should not enforce it.[10]
- Stay waivers contained in a confirmed plan of reorganization should be respected (as they are negotiated and approved after notice to all interested parties) and those granted in forbearance agreements, workouts, and other agreements should be considered on a case-by-case basis.[11]

Courts are not uniform, however, in providing a clear set of factors. In recent cases, courts have used a combination of these factors:

- The sophistication of the party making the waiver and if both parties were represented by experienced counsel.
- The consideration given for the waiver, including the length of the waiver period, and the risks assumed and concessions granted by the lender.
- The effect on other parties, such as unsecured creditors and junior lienholders.
- The feasibility of the debtor's plan.
- The presence of any evidence that the waiver was obtained by coercion, fraud, or mutual mistake of material facts.
- Whether enforcing the waiver will promote the public policy of encouraging out-of-court restructurings and settlements.
- Whether there appears to be a likelihood of reorganization.
- The extent to which the lender would be otherwise prejudiced if the waiver is not enforced.
- The time gap and changes in circumstances between the date of the waiver and the date of the bankruptcy filing.
- Whether the debtor has equity in the property and if the lender is otherwise entitled to relief from the stay under section 362(d) of the Bankruptcy Code.

The weight given to each factor is determined on a case-by-case basis in the court's discretion, based on the facts and circumstances surrounding the granting of the waiver.

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[9] *See In re Triple A & R Captial Inv., Inc.*, 519 B.R. 581, 586 (Bankr. D. P. R. 2014).

[10] *See In re Frye*, 320 B.R. 786, 791 (Bankr. D. Vt. 2005).

[11] *See In re Bryan Road, LLC*, 382 B.R. 844, 848 (Bankr. S.D. Fla. 2008).

In re 4848, LLC[12]

This case involved a single asset real estate debtor (Debtor) and its lender. After defaulting on two promissory notes secured by perfected mortgages on the Debtor's real property, the parties entered into a forbearance agreement which extended the maturity of the notes from December 10, 2008 to December 30, 2010. The forbearance agreement included a stay waiver, which stipulated that the waiver was a material inducement for the lender's forbearance. The court followed the current trend and upheld the stay waiver, after considering it as a factor in its stay relief analysis.

In making its ruling, the court determined that the public policies of freedom of contract and the goal of encouraging out-of-court restructuring and settlements outweigh the public policy behind the automatic stay. The court highlighted many of the factors stated in the list provided above, but the court only took issue with one: the extent to which the creditor would be prejudiced if the waiver was not enforced. Noting that almost four years passed from the time the notes matured on December 10, 2008 to the time the lender filed the foreclosure on October 12, 2012, the court held that it was not fair to delay the lender's enforcement of its rights any longer. The court also noted that the stay waiver facilitated the out-of-court workout because the lender would not have entered into a forbearance agreement without it.

Despite the fact that the court upheld the stay waiver, it stated that it would be "dismayed if such clauses were used routinely." It emphasized that it did not take automatic stay waivers lightly, particularly in single asset real estate cases where the entire case may depend on the protection of the stay to prevent an early loss of the only property in the estate. In addition, the court stated that "a facially confirmable and feasible plan might have tipped the scales in the debtor's favor" against enforcement of the waiver.

In re Triple A & R Capital Inv., Inc.[13]

This is a single asset real estate case, where Debtor entered into a Forbearance Agreement with its one secured creditor. The Agreement contained an automatic stay waiver. Debtor also entered into a stipulation stating that Debtor's obligation under the loan documents – which included the automatic stay waiver – were ratified by Debtor, remained in full force and effect, and would not be subject to further challenge. The stipulation was duly filed and noticed, no objections were filed, and the court entered an order approving it. Because of this stipulation the court held that its "conclusion is inescapable," the waiver was enforceable and the Creditors motion to lift the automatic stay was granted.

In re Bryan Road[14]

Debtor and Lender entered into a Forbearance Agreement that was approved by the court in Debtor's prior foreclosure case. The Agreement contained an automatic stay waiver clause. The court held that the waiver was enforceable and "cause" exists to lift the automatic stay.

In making its decision the court used a combination of factors from the list above. The court also noted that, "the existence of a prior confirmed reorganization plan is not a condition precedent to

[12] *See In re 4848, LLC*, No. 12-36114, 2013 WL 1402052 (Bankr. E.D. Wis. Apr. 8, 2013)
[13] *See In re Triple A & R Captial Inv., Inc.*, 519 B.R. 581 (Bankr. D. P. R. 2014).
[14] *See In re Bryan Road, LLC*, 382 B.R. 844 (Bankr. S.D. Fla. 2008).

the enforceability of a stay relief agreement." In other words, the court leaves open the possibility of finding a waiver contained in a non-court approved reorganization plan as enforceable.

In re Frye[15]

Debtor and Lender entered into a Forbearance Agreement, which contained a clause waiving the automatic stay should Debtor file bankruptcy. The court reviewed case law on the enforceability of stay waiver clauses and determined that "prepetition agreements waving the protection afforded by the automatic stay are enforceable" but "in deciding whether relief from stay should be granted based on such waivers, the factors identified by the *Atrium* court must be considered." The court held that the waiver was enforceable and "cause" existed to lift the stay.

While explaining its decision for choosing the factor test, the court made the following points:

- The court discounted the notion that prepetition waivers in single asset cases are effectively a prohibition to filing bankruptcy. Up until relief is granted to the creditor who is a party to the prepetition agreement, the debtor has received the protection of the stay vis a vis other creditors and retains all the rights provided to a debtor in bankruptcy.
- The court addressed the bargained-for-exchange principle by noting that in forbearance agreements, debtors received value (e.g. low interest rates) in exchange for the stay waiver.

In re Desai[16]

In a previous Chapter 11 case, Debtor and its primary secured creditor agreed to a Restructured Debt Agreement, which was later confirmed by the court. The Agreement contained an automatic stay waiver. The court chose to use the waiver as a factor in determining whether "cause" existed to lift the automatic stay. The court held that cause did not exist, because there was significant equity in Debtor's asset ($1.2 million).

In re BGM Pasadena[17]

The court enforced a stay waiver contained in a court-approved settlement agreement in the debtor's prior Chapter 11 case. This case stands alone within the Ninth Circuit as having dealt with prepetition automatic stay waivers. Its analysis is convoluted, and it is a non-citable opinion.

The court initially cites to *Pease* for the proposition that, "any attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable. The Bankruptcy Code preempts the private right to contract around its essential provisions." By doing this the court seems to be leaning toward the first camp: reject the waiver as per se unenforceable against public policy.

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[15] *See In re Frye*, 320 B.R. 786 (Bankr. D. Vt. 2005).
[16] *See In re Desai*, 282 B.R. 527 (Bankr. M.D. Ga. 2002).
[17] *See In re BGM Pasadena, LLC*, No. 2:15-BK-27833-BB, 2016 WL 1738109, at *2-3 (Bankr. C.D. Cal. Apr. 27, 2016).

Because the waiver was contained in a court approved settlement agreement, however, the court dismissed *Pease* and began analyzing the waiver and other factors for "cause" to lift the stay.

E. Prevailing Trends Regarding Waivers

There is little information from which to determine how widespread or frequent parties use automatic stay waivers. Case law and commentary provide insight to forbearance agreements and Chapter 11 restructuring plans, but not much else. One cause for this narrow coverage may be that automatic stay waivers are not being used outside of these two areas. If automatic stay waivers were, then there would likely be case law on the subject. Also, the court in *In re 4848* adds to the evidence that automatic stay waivers are not widely used outside of forbearance agreements and Chapter 11 restructuring plans. The court states that it would be "dismayed if such clauses were used routinely."[18]

F. Tips for Lenders Considering Using an Automatic Stay Waiver

Lenders, who are considering inserting an automatic stay waiver clause into an agreement, should be advised to[19]:

- Clearly establish that consideration for the stay waiver was given. This consideration may take the form of forbearance to exercise remedies, loan concessions, or amendments to the credit agreement. However, lenders should not bargain too much away in exchange for the waiver, as the existence of the waiver is only one factor that courts consider in their lift-stay analysis, and it is likely lenders will still need to demonstrate some ground for relief from the stay.
- If there are other creditors with significant claims against the borrower, have these creditors specifically consent in writing to the stay waiver, or become party to the actual stay waiver document.
- Make sure that the borrower is represented and advised by experienced counsel.
- Be able to definitively show that the debtor has no equity in the property (the outstanding loan balance exceeds the value of the collateral securing the loan).

[18] *See In re 4848, LLC*, No. 12-36114, 2013 WL 1402052 (Bankr. E.D. Wis. Apr. 8, 2013).
[19] *See* Automatic Stay: Lender's Perspective, PRACTICAL LAW PRACTICE Note 9-380-7953 (2017).