

Waiving the Red Flag: Update on the Enforceability of Certain Waivers in Bankruptcy

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I. INTRODUCTION

Many contracts contain provisions designed either to restrict a party's access to bankruptcy relief, or to limit the scope of the relief available to that party after it becomes a debtor in a case under the Bankruptcy Code (11 U.S.C. §101 *et seq.*).^{1/} The enforceability of these so-called "bankruptcy waivers" frequently is argued when parties negotiate agreements incorporating bankruptcy waivers, and is argued again when enforcement actually is sought in the bankruptcy case anticipated by the waivers.

This article addresses outright waivers of the right to file bankruptcy, as well as agreements that significantly reduce a party's ability to file a voluntary bankruptcy petition. It also discusses waivers of protections that often are viewed as the cornerstones of the federal bankruptcy system; namely, the automatic stay and the discharge of debts. Additionally, it considers the continued viability in a bankruptcy case of arbitration clauses, which effectively constitute a waiver of the debtor's right to have the bankruptcy court determine certain matters, and certain kinds of "springing" or "clawback" provisions, which generally penalize the debtor for filing a bankruptcy case. Where an express or implicit waiver may be enforceable, the article offers drafting suggestions that may enhance the prospects of enforcement.

This article provides a brief overview of this area of the law. Bankruptcy judges frequently express differing views about bankruptcy waivers. Accordingly, parties involved in drafting, enforcing, or challenging direct or indirect waivers of bankruptcy protections should become familiar with the current local laws and practice.

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^{1/} Except as otherwise indicated, all Section references herein are to the Bankruptcy Code.

II. WAIVERS OF BANKRUPTCY RIGHTS

A. Waiver of the Right to Seek Bankruptcy Protection

Every creditor's first instinct is to draft its credit agreements to prohibit the borrower from seeking bankruptcy relief. By now, most business folk and their lawyers know that contract provisions that impose outright prohibitions against any bankruptcy filing generally are void as against public policy.^{2/} However, because the breadth of the public policy constraint is uncertain, parties frequently test the limits by crafting arrangements that substantially impede, but do not actually prohibit, a party's filing bankruptcy. Some arrangements are implemented through the loan documentation, such as an arrangement whereby the borrower delivers a stock pledge agreement that grants the secured creditor the power to vote the stock as long as the debt is outstanding, thereby possibly blocking approval of a bankruptcy filing during the loan term.^{3/} Other arrangements may be required by the loan documentation, but effectuated through the borrower's organizational documents. These arrangements, which run the gamut from limiting the borrower's business purpose and the amount of indebtedness it incurs, to requiring the unanimous vote of all directors to file a bankruptcy petition or take other acts that could result in bankruptcy,^{4/} to requiring that the board of directors include at all times at least one individual who is an "independent director" (who even may be an express fiduciary of creditors whenever the board is considering the possibility of a bankruptcy filing), to even more complex structures which are crafted in connection with securitizations to meet rating agency requirements of "bankruptcy remoteness."^{5/}

^{2/} See In re Los Angeles Lumber Prods. Co., 24 F. Supp. 501, 515 (S.D. Cal.), *aff'd*, 100 F.2d 963 (9th Cir. 1938), *rev'd on other grounds sub nom.*, Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939) (court gave no effect to bond indenture provision that purported to prohibit debtor's bankruptcy filing, ruling that: "any such attempted restriction upon the debtor's rights . . . would . . . be void, as contrary to public policy"); see also In re Tru Block Concrete Prods., Inc., 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983) ("It is a well settled principle that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy."); Fallick v. Kehr, 369 F.2d 899, 904 (2d Cir. 1966) ("an advance agreement to waive the benefits of the Act would be void").

^{3/} E.g., Keenihan v. Heritage Press, Inc., 19 F.3d 1255, 1258-59 (8th Cir. 1994) (stock pledge agreement authorizing creditor to vote stock was enforced, enabling creditor to bar debtor from filing for bankruptcy).

^{4/} In re Minor Emergency Ctr. of Tamarac, Inc., 45 B.R. 310, 311-12 (Bankr. S.D. Fla. 1985) (bankruptcy filing authorized by only one director was invalid where by-laws required both directors to vote on corporate actions).

^{5/} Kristine R. Robertson, Kimberly S. Winick, and Gregg J. Loubier, *Emerging Trends in Real Estate Finance and How To Deal with the Tough Issues: Securitized Mortgage Lending*, 27th Annual Crocker Symposium, Los Angeles County Bar Assn. (April 17, 1998).

These creative arrangements may be incorporated into the parties' initial agreement or included as conditions to any restructuring of the parties' relationship. In either event, there are limits to the effectiveness of the arrangements. For example, if the members of the board of directors, including any independent director, do not perform their statutory duties as fiduciaries of the entity (as well as, in some instances, fiduciaries of the lender and other creditors), principals of the borrower may be able to avoid the intent of the arrangement and precipitate an involuntary bankruptcy case.^{6/}

Of perhaps greater importance, creditors who obtain varying degrees of control over a borrower's governance and business operations, rather than just its assets, may run risks that outweigh any benefits derived from the arrangement. For example, a creditor that obtains the ability to control its borrower may substantially increase the risk that its claims, and even its liens, will be subject to equitable subordination, or avoidance or diminution pursuant to theories of lender liability, or that the creditor will be deemed an "insider" of the debtor and thus subject to the one-year preference period, as well as greater risk that loans or advances may be recharacterized as equity contributions. Additionally, a lender which either directly or indirectly assumes control over a debtor's ability to file for bankruptcy through, for instance, placement of a proxy on its board of directors or the exercise of its rights under a stock pledge agreement, must be cognizant of its responsibilities to other parties even if they are at odds with its own best interests.^{7/} This issue is particularly troubling from and after the time that the borrower's insolvency is reasonably anticipated, as directors and officers of an insolvent company owe a fiduciary duty both to the company's equity holders and, as often is overlooked, to all of the company's creditors.^{8/}

A bankruptcy court is likely to uphold the validity of restraining arrangements that are effectuated through the control of the power to vote the borrower's stock or are integrated into the borrower's corporate documents as long as they are valid under applicable state law, and without regard to when the parties

^{6/} In re Kingston Square Assocs., 214 B.R. 713 (Bankr. S.D.N.Y. 1997) (court declined to dismiss cases on theory of collusion where principal of "bankruptcy remote" debtors whose board of directors had not met as required by by-laws—because insider members believed independent director was a shell of the lender and was charged with blocking bankruptcy filing—solicited creditors and orchestrated filing of involuntary petitions).

^{7/} See generally N. Neville Reid, *Will A Work-Out Work? Issues From The Lender's Perspective*, 25-30, 24th Annual Southeastern Bankruptcy Law Institute Seminar (March 28, 1998).

^{8/} See Harvey R. Miller, *Corporate Governance in Chapter 11: The Fiduciary Relationship Between Directors and Stockholders of Solvent and Insolvent Corporations*, 23 SETON HALL L. REV. 1467, 1479-85 (1993).

entered into the arrangements. Such arrangements are likely to be upheld whether they were created at the outset of a relationship or were incorporated into a restructuring or forbearance agreement.

Many creditors find that waivers relating to governance are not available or are not adequate to meet their needs. These creditors may obtain an indirect bankruptcy waiver in the form of a stipulation that the debtor's filing of a bankruptcy petition would be in "bad faith," and that cause therefore would exist to dismiss the petition.^{2/}

A "bad faith" stipulation is unlikely to be valid if given in connection with the origination of the debt, rather than as partial consideration for a restructuring or forbearance agreement. In any event, such a stipulation generally will not prevent a bankruptcy filing. However, a carefully-drafted "bad faith" stipulation that contains admissions of facts that support a court's finding of bad faith may provide extra impetus for a bankruptcy court to dismiss a case for cause.^{10/}

In particular, courts have been swayed by "bad faith" stipulations containing a debtor's admissions and agreements that, if it sought bankruptcy protection: (i) the lender would be entitled to dismissal of the case on the basis of the debtor's bad faith filing; (ii) the debtor's reorganization efforts would not be consistent with the goals of the Bankruptcy Code; (iii) dismissal would be in the best interest of all parties; and (iv) a bankruptcy filing would be solely for the purpose of delay and would be unfounded.^{11/}

Courts generally have relied on debtors' contractual admissions as constituting some, but not all, of the factors which, in whole, gave rise to a finding of bad faith. Other factors which courts have considered include that the debtor: (i) did not enter into the agreement as a result of duress, fraud, coercion or overreaching; (ii) did not own the property it sought to keep; (iii) had little or no equity in its property; (iv) had no defense to the lender's claim; (v) was a dissolved corporation; (vi) had no

^{2/} See 11 U.S.C. § 1112(b) (permitting a bankruptcy court to dismiss a case for cause).

^{10/} In re Aurora Investments, Inc., 134 B.R. 982, 986 (Bankr. M.D. Fla. 1991); In re Orange Park South Partnership, 79 B.R. 79 (Bankr. M.D. Fla. 1987). But see In re South East Fin. Assocs., Inc., 212 B.R. 1003, 1005 (Bankr. M.D. Fla. 1997) (prepetition agreement which provided that any breach of the agreement would constitute "bad faith" warranting dismissal of chapter 11 case was not enforceable; debtor's scheduled unsecured creditors were not bound by stipulation and would be adversely affected by dismissal).

^{11/} Orange Park, 79 B.R. at 82; Aurora, 134 B.R. at 986; In re University Commons, L.P., 200 B.R. 255, 259 (Bankr. M.D. Fla. 1996).

employees; (vii) lacked the means to pay interest due to the lender; and (viii) lacked the money or borrowing ability necessary to fund a plan of reorganization.^{12/}

Findings of cause to dismiss any bankruptcy case usually are fact specific. However, creditors can increase the likelihood of dismissal by including the following admissions, to the extent they apply, in a “bad faith” stipulation:

1. The creditor has given significant consideration for the stipulation, including granting extensions of payment deadlines, waiving prior defaults, advancing additional sums, restructuring or foregoing portions of the debt, and other concessions which otherwise might have been obtained through the costlier process of a bankruptcy case;^{13/}
2. The restructuring/forbearance/settlement was negotiated at arm’s-length and in good faith, and the debtor participated through (or with the advice of) independent counsel;
3. The debtor has no other creditors (or is current on all trade accounts, or whatever else may be averred to evidence that the arrangement should not be prejudicial to the interests of third parties);
4. The debtor has no operating business, or has no source of necessary operating capital, other than the funds that secure the creditor’s claims;
5. The debt is in default, has a remaining unpaid balance, and is secured by perfected liens;
6. The debtor has no defenses, offsets or counterclaims to the claims of the creditor;
7. The debtor has little or no equity in the encumbered assets and, apart from the negotiated arrangement that contains the “bad faith” admissions, no realistic prospects of reorganization;

^{12/} Id.

^{13/} To the extent an agreement includes forgiveness of debt, it may be advisable to structure it so that the forgiveness is effective only upon the payment of a sum certain and the passage of at least ninety days (or more, depending on the circumstances) after the date the final payment is deposited in the creditor’s account.

8. The agreement effectively serves as a plan of reorganization for the debtor, and no further need for restructuring is contemplated or foreseeable;
9. The debtor acknowledges that it intended for the creditor to change its position in reliance on the agreement and that the creditor did so;
10. Both parties agree that the making of the bad faith admissions was a material condition of the agreement, without which the creditor would not have entered into the agreement; and
11. In the event the debtor directly or indirectly files a petition under the Bankruptcy Code, the debtor admits that such petition was filed to delay and frustrate the creditor's collection actions and was filed in bad faith, the creditor shall have the right to move for a dismissal of the case on short notice on the grounds that the case was filed in bad faith, the debtor waives the right to oppose such a motion to dismiss the case, and dismissal of the case will be in the best interests of the creditor, the debtor, and all other creditors.

Additional admissions may well be appropriate in many circumstances. However, regardless of the content of the admissions, the waiver probably will lose effectiveness with time, as the debtor incurs new obligations and/or arguably experiences changed circumstances.^{14/}

B. Waiver of the Right to Discharge a Particular Debt

A discharge in bankruptcy generally has the effect of discharging a debtor from all debts that arose before the order for relief was entered, or, in a reorganization, the plan was confirmed.^{15/} However, Section 523 lists specific types of debts that are excepted from the bankruptcy discharge.^{16/} The exceptions to discharge are strictly construed to further the policy of providing the debtor a broad discharge and a fresh start, and are not available to protect most creditors' claims. Creditors whose claims are not within the scope of Section 523 often attempt to obtain an analogous contractual protection by requiring an individual debtor to

^{14/} In re Jenkins Court Assocs. Ltd. Partnership, 181 B.R. 33, 36 (Bankr. E.D. Pa. 1995) (court gave little weight to prepetition agreement that bankruptcy filing would be in bad faith where debtor signed agreement two years before filing bankruptcy).

^{15/} 11 U.S.C. §§ 727(b), 1141(d), 1228 and 1328.

^{16/} 11 U.S.C. § 523.

stipulate that his or her obligations to that creditor will not be subject to discharge in the event of the debtor's bankruptcy.^{17/} The enforceability of these waivers largely depends on the time and manner in which they are given, as well as their scope.

Waivers of the right to discharge a particular debt most commonly are found (i) in prepetition contracts, and (ii) in stipulated orders entered (a) in state court proceedings and (b) in bankruptcy proceedings.^{18/} In general, prepetition contract waivers of the right to discharge a debt in bankruptcy are void as against public policy,^{19/} and prepetition waivers incorporated into stipulated state court orders are carefully scrutinized and seldom enforced. In contrast, dischargeability waivers approved by a bankruptcy court usually are enforced in a subsequent bankruptcy case.

A dischargeability waiver granted in connection with a state court proceeding generally will not be enforced in a subsequent bankruptcy proceeding unless the waiver satisfies the conditions to reaffirmation of debt contained in Section 524(c).^{20/} The courts addressing the issue have reasoned that, if Section 524(c) is to have any force in bankruptcy, the protective requirements of Section 524(c) must be fulfilled

^{17/} Discharge waivers customarily are obtained only from individuals. Debtors that are not individuals cannot obtain a discharge in chapter 7 (Section 727(a)(1)) or under a liquidating chapter 11 plan (Section 1141(d)(3)), and creditors have other means of protecting their interests in the context of a legal entity's reorganization. See, e.g., 11 U.S.C. § 1129.

^{18/} See Markizer v. Economopoulos (In re Markizer), 66 B.R. 1014, 1017 (Bankr. S.D. Fla. 1986) (waiver of dischargeability was included in prepetition Property Settlement Agreement); Chilcoat v. Minor (In re Minor), 115 B.R. 690, 691 -92 (D. Colo. 1990) (waiver of dischargeability was a provision in a state court stipulated judgment); Martinelli v. Valley Bank of Nevada (In re Martinelli), 96 B.R. 1011, 1012 (Bankr. 9th Cir. 1988) (debtors stipulated to a judgment in bankruptcy court whereby debt was determined to be nondischargeable).

^{19/} Freeman v. Freeman (In re Freeman), 165 B.R. 307, 312 (Bankr. S.D. Fla. 1994); Markizer, 66 B.R. at 1018.

^{20/} See 11 U.S.C. § 524(c) (section provides that a debtor's agreement to pay a dischargeable debt, "whether or not discharge of such debt is waived," is not enforceable unless the agreement complies with formal requirements of section, which are designed to prevent creditor overreaching and to assure that the debtor fully understands voluntary nature and effects of reaffirming dischargeable debt). See also Minor, 115 B.R. at 694 (declining to uphold dischargeability waiver, contained in state court settlement, which did not satisfy the requirements of § 524(c)); Alsan Corp. v. DiPierro (In re DiPierro), 69 B.R. 279, 282 (Bankr. W.D. Pa. 1987) (court held that debt was nondischargeable on collateral estoppel grounds, but gave no weight to state court consent judgment provision that debt would be nondischargeable; waivers of dischargeability are governed by § 524(c) and the requirements of § 524(c) were not satisfied); Klingman v. Levinson (In re Levinson), 58 B.R. 831, 836-37 (Bankr. N.D. Ill.), aff'd, 66 B.R. 528 (N.D. Ill. 1986), aff'd, 831 F.2d 1292 (7th Cir. 1987) (same).

whenever a debtor purportedly waives its right to discharge its debts.^{21/} Furthermore, the courts generally have concluded that a debtor's prebankruptcy waiver of the right to discharge a particular debt is against public policy.^{22/}

In contrast to their rejection of stipulated state court orders waiving discharge, bankruptcy courts do tend to enforce waivers of the discharge of a particular debt that have been approved by a court in a prior bankruptcy case, both where such waivers are agreed to in a court-approved stipulation, or are imposed by order of the bankruptcy court. In Martinelli v. Valley Bank of Nevada (In re Martinelli),^{23/} the court enforced a consent judgment that was entered in a nondischargeability action in the debtor's previous bankruptcy case and incorporated in the chapter 11 plan confirmed in that case, and that waived the debtor's right to discharge the bank's claim in any subsequent case.^{24/} Contrary to the cases which addressed the waiver issue in the context of state court proceedings, the Martinelli court concluded that it was not necessary for the dischargeability waiver to comply with Section 524(c) because Section 524(c) only applies to debts that are dischargeable, and the stipulated judgment provided that the debt was nondischargeable.^{25/} Although this reasoning seems equally applicable to cases involving waivers approved in state court proceedings, there is an arguably significant difference between the two. The waiver in Martinelli was part of a consent judgment entered in a nondischargeability action in bankruptcy court, where the debtor and its counsel presumably addressed the relevant facts in the context of the applicable sections of the Bankruptcy Code before stipulating to the nondischargeability of the bank's claim. Counsel in state court actions are less likely to analyze this bankruptcy issue before their clients sign dischargeability waivers.

^{21/} Minor, 115 B.R. at 696.

^{22/} In re DiPierro, 69 B.R. at 282; Levinson, 58 B.R. at 836-37. As one would expect, none of the waivers at issue complied with Section 524(c).

^{23/} 96 B.R. 1011, 1014 (Bankr. 9th Cir. 1988).

^{24/} Id. at 1014.

^{25/} Id.

In Saler v. Saler,^{26/} the court recognized the state court / bankruptcy court distinction when it upheld a waiver entered in an earlier bankruptcy proceeding, stating “[t]he enforcement of a nondischargeability settlement reached in bankruptcy dischargeability litigation is quite different from the enforceability of such an agreement entered into by a defendant in a nonbankruptcy forum prior to the filing of any bankruptcy case.”^{27/} The Saler court noted that the central issue in bankruptcy discharge litigation is the dischargeability of a debt, while in state court prebankruptcy litigation, the question of dischargeability is not an issue.^{28/} The Saler court further supported its decision to enforce the waiver by finding: (i) the other creditors were not adversely affected because they had the opportunity to learn of the litigation by checking the case docket entries; (ii) the bankruptcy trustee protected the creditors’ interests; (iii) the debtor had the benefit of bankruptcy counsel; and (iv) the settlement occurred in the bankruptcy forum.^{29/}

Parties should expect that a prepetition contract waiver of the dischargeability of a debt contained in a prepetition out-of-court agreement will not be enforced. They also should expect that a dischargeability waiver approved by a bankruptcy court is likely to be enforced in a subsequent bankruptcy case regardless of whether the debt was properly reaffirmed. Finally, parties should expect that a waiver entered into during a state court proceeding is likely to be enforced only if the waiver is found to comply with Section 524(c)’s requirement regarding debt reaffirmation.

To increase the likelihood that a waiver incorporated into a state court order will be enforced in a subsequent bankruptcy case, the debtor should acknowledge and agree that the requirements of Section 524(c) have been met, as follows:

1. The waiver was given before any discharge was granted by a bankruptcy court.

^{26/} 205 B.R. 737 (Bankr. E.D. Pa. 1997), aff’d, 217 B.R. 166 (E.D. Pa. 1998). See also Laing v. Johnson (In re Laing), 1993 WL 732230, *4 (N.D. Okla. October 25, 1993), aff’d, 31 F.3d 1050 (10th Cir. 1994) (“public policy denying preclusive effect to state court consent determinations of nondischargeability should not apply in a bankruptcy context, where a bankruptcy court has approved nondischargeability by agreement in approving a chapter 11 Plan.”).

^{27/} 205 B.R. at 744.

^{28/} Id. at 745-46.

^{29/} Id. at 746.

2. The debtor may revoke the waiver within 60 days of its filing with the court or at any time prior to discharge, whichever occurs later.
3. The waiver is not required under either bankruptcy or nonbankruptcy law.
4. The debtor has been represented by independent legal counsel in negotiating the agreement that includes the waiver of discharge.
5. The debtor has been fully informed about the meaning and availability of the bankruptcy discharge and the legal effect and consequences of its waiver, and nonetheless voluntarily has elected to waive the right to discharge its debt to the creditor.
6. The debtor understands the financial effect of the waiver and believes in good faith that the waiver does not impose an undue hardship on the debtor or any of its dependents.^{30/}

Promptly after the anticipated bankruptcy case is filed, the creditor should file the state court order with the bankruptcy court.

A state court dischargeability waiver is most likely to be enforced if the debtor is represented by its own attorney in the negotiations and the attorney signs the agreement. If possible, the creditor should obtain from that attorney a separate affidavit affirming that the debtor was fully informed about the legal and financial effects of the waiver, and that it does not impose an undue hardship on the debtor or the debtor's dependents. If the debtor is not represented by counsel, a creditor may increase the likelihood that the waiver will be enforced by requesting that the state court, before approving the waiver, hold a hearing to determine whether the agreement imposes an undue hardship on the debtor or the debtor's dependents and is in the debtor's best interests. These measures enhance the prospects, but certainly do not ensure, that a bankruptcy court will enforce the dischargeability waiver.

C. Waiver of the Protection of the Automatic Stay

From a creditor's perspective, one of the most vexing aspects of bankruptcy is the delay imposed by Section 362(a), which, upon the filing of a bankruptcy case, automatically stays, *inter alia*, all collection and civil enforcement actions against the

^{30/} To support this, creditors may wish to obtain a financial statement and budget reflecting the debtor's ability to satisfy the nondischargeable debt.

debtor or its assets.^{31/} The automatic stay halts all collection efforts relating to debts that arose before the filing of the bankruptcy case insofar as those efforts relate to the debtor or property of the debtor's bankruptcy estate,^{32/} and a creditor who violates the automatic stay may be liable to the debtor for actual and punitive damages.^{33/} Therefore, creditors often seek to reduce the obstacles of the automatic stay by entering into agreements in which the debtor waives the protections of the automatic stay if a bankruptcy case is commenced by or against it.

Waivers of the automatic stay most commonly are obtained: (i) in connection with a loan origination; (ii) as an element of a work-out or forbearance agreement; or (iii) as an element of a bankruptcy court-approved stipulation or plan of reorganization that is designed to protect the creditor in the event of the debtor's subsequent bankruptcy case.^{34/}

Waivers given as part of a loan origination are not likely to be enforced. However, waivers negotiated as elements of work-out agreements in an effort to avoid a bankruptcy, in anticipation of a bankruptcy, or during a bankruptcy case may be enforced by some bankruptcy courts under certain circumstances.

The bankruptcy courts have not reached a consensus on the enforceability of waivers of the automatic stay. Their conflicting opinions reflect the tension between the public policy favoring workouts and settlements on the one hand, and the Bankruptcy Code's goal of protecting the collective interests of the debtor's creditors, on the other hand. In general, provided that the waiver is properly documented, is supported by consideration, and arose in the context of a workout or settlement (as opposed to an initial loan transaction), the court's decision to enforce the waiver is likely to turn on two principal considerations: (i) whether

^{31/} See 11 U.S.C. § 362.

^{32/} 11 U.S.C. § 362(a) defines the scope of the automatic stay. 11 U.S.C. § 541(a) defines property of the estate. Cf. Chugach Timber Corp. v. Northern Stevedoring & Handling Corp. (In re Chugach Forest Prods., Inc.), 23 F.3d 241, 246 (9th Cir. 1994) (automatic stay does not halt collection efforts against sureties or joint debtors) (citations omitted). However, the filing of a chapter 12 or 13 petition stays actions against a co-debtor on certain obligations. See 11 U.S.C. §§1201, 1301.

^{33/} See 11 U.S.C. § 362(h).

^{34/} In re Sky Group Int'l, Inc., 108 B.R. 86, 88 (Bankr. W.D. Pa. 1989) (waiver of automatic stay was a provision in assumption agreement used in connection with purchase of a hotel); In re Darrell Creek Assocs., L.P., 187 B.R. 908, 910 (Bankr. D. S.C. 1995) (waiver of the automatic stay was an element of a workout agreement); Abdul-Hasan v. Fireman's Fund Mortgage, Inc. (In re Abdul-Hasan), 104 B.R. 263, 264 (Bankr. C.D. Cal. 1989) (bankruptcy court order provided for waiver of the automatic stay).

other creditors will be harmed, since the automatic stay is not just for the debtor's benefit, but also protects the competing interests of creditors of the estate; and (ii) whether there is evidence that the debtor has strong prospects of a successful reorganization.^{35/}

One of the first cases to enforce a prepetition waiver of the automatic stay, In re Citadel Properties, Inc.,^{36/} did so with very little analysis.^{37/} Since Citadel, the courts upholding prepetition waivers of the automatic stay have done so for a number of reasons, including, most predominantly, that: (i) public policy favors encouraging out-of-court workouts;^{38/} (ii) the waivers more efficiently facilitate the restructuring of the relationship between the debtor and its creditor than would a bankruptcy filing;^{39/} and (iii) a prepetition waiver of the automatic stay is significantly different than a waiver of the right to file a bankruptcy petition because the debtor still retains all of its rights and benefits under the Bankruptcy Code.^{40/}

A second line of cases treats prepetition stay waivers as violating public policy, and refuses to enforce such waivers.^{41/} The primary rationale of these courts include their determinations that: (i) the automatic stay is designed to protect not just the debtor, but all of the debtor's creditors, and that the debtor cannot waive the rights of third parties; and (ii) a prepetition stay waiver threatens the debtor's ability to conduct an orderly liquidation or effective reorganization under the

^{35/} See Michael St. Patrick Baxter, *Prepetition Waivers of the Automatic Stay: A Secured Lender's Guide*, 52 BUS. LAW. 577, 590-97 (1997).

^{36/} 86 B.R. 275, 276 (Bankr. M.D. Fla. 1988).

^{37/} Id. at 276 (stating in broad terms that "the terms of the prepetition stipulation [to waive the automatic stay] are binding upon the parties.").

^{38/} In re Darrell Creek Assocs., L.P., 187 B.R. 908, 913 (Bankr. D. S.C. 1995); In re Cheeks, 167 B.R. 817, 818-19 (Bankr. D. S.C. 1994); In re Club Tower L.P., 138 B.R. 307, 312 (Bankr. N.D. Ga. 1991).

^{39/} Club Tower, 138 B.R. at 312.

^{40/} Darrell Creek, 187 B.R. at 913; Cheeks, 167 B.R. at 819; Club Tower, 138 B.R. at 312 (Bankr. N.D. Ga. 1991); In re Hudson Manor Partners, Ltd., 28 Collier Bankr. Cas.2d 221 (Bankr. N.D. Ga. 1991). But see In re Jenkins Court Assocs. Lmt. Partnership, 181 B.R. 33, 36-37 (Bankr. E.D. Pa. 1995) (court refused to enforce the single asset debtor's prepetition waiver of the automatic stay on grounds that ceding lender right immediately to foreclose on debtor's sole asset was tantamount to a waiver of the right to file a bankruptcy petition, and therefore clearly against public policy).

^{41/} In re Jenkins Court Assocs. Lmt. Partnership, 181 B.R. 33, 36-37 (Bankr. E.D. Pa. 1995); Farm Credit of Central Florida, ACA v. Polk, 160 B.R. 870, 872-74 (Bankr. M.D. Fla. 1993); In re Sky Group Int'l, Inc., 108 B.R. 86, 89 (Bankr. W.D. Pa. 1989).

Bankruptcy Code.^{42/} A Nebraska bankruptcy court has gone so far as to hold that a prebankruptcy waiver of the automatic stay is unenforceable per se because: (i) a prepetition debtor does not have the power to waive rights that vest in a legally distinct postpetition entity; (ii) the waiver is unenforceable under the provisions of the Bankruptcy Code that limit the enforceability of contractual agreements that are affected by a bankruptcy filing;^{43/} and (iii) the Bankruptcy Code does not allow a party to contract around its essential provisions, including Section 362.^{44/}

A third line of cases has adopted a moderate, case-by-case approach that weighs the existence and content of a prepetition automatic stay waiver as a factor in deciding whether cause^{45/} exists to grant relief from the automatic stay.^{46/} Furthermore, in the special case of serial bankruptcy filings, courts have upheld prospective waivers of the automatic stay where, during a previous bankruptcy proceeding, the parties stipulated to a prospective waiver of the automatic stay or a court order provided for prospective relief from the stay.^{47/}

^{42/} Farm Credit, 160 B.R. at 873-84; Sky Group, 108 B.R. at 88-89.

^{43/} See 11 U.S.C. §§ 363, 365 and 541, and text accompanying notes 60-75 infra.

^{44/} In re Pease, 195 B.R. 431, 433-35 (Bankr. D. Neb. 1996).

^{45/} See 11 U.S.C. § 362(d)(1).

^{46/} See, e.g., Darrell Creek, 187 B.R. at 912 (“A prepetition agreement involving a waiver is a primary element in determining if cause exists for relief from the stay.”); In re Powers, 170 B.R. 480, 483 (Bankr. D. Mass. 1994) (same); In re Shady Grove Tech Ctr. Assocs. Ltd. Partnership, 216 B.R. 386, 390 (Bankr. D. Md. 1998) (“self-executing clauses in prepetition agreements purporting to provide that no automatic stay arises in a bankruptcy case are contrary to law and hence unenforceable, and that self-executing clauses in prepetition agreements that purport to vacate the automatic stay are likewise unenforceable. However, a pre-petition agreement that consents to relief from stay, or provides that the debtor will not contest a motion for a relief from stay, may be considered as a circumstance in determining whether cause exists for relief from stay.”).

^{47/} See, e.g., Beneficial Trust Deeds v. Franklin (In re Franklin), 802 F.2d 324 (9th Cir. 1986) (bankruptcy court’s decision, which was affirmed by the district court and Ninth Circuit, held that a foreclosure sale that took place three days after the third bankruptcy case was filed did not violate the automatic stay because the debtors and creditors entered into a stipulation during the second bankruptcy case which provided for prospective relief from the stay); Abdul-Hasan v. Fireman’s Fund Mortgage, Inc. (In re Abdul-Hasan), 104 B.R. 263, 266 (Bankr. C.D. Cal. 1989) (prospective relief set forth in order for relief from stay granted in prior chapter 13 case relieved creditor of any responsibility to seek relief from the automatic stay prior to holding of foreclosure sale when subsequent bankruptcy case was filed by debtor). Cf. Great Western Bank v. Snow (In re Snow), 201 B.R. 968 (Bankr. C.D. Cal. 1996) (bankruptcy court entered an order, which operated as an equitable servitude on property for a period of 180 days, to prevent chapter 7 debtor and its successors from using automatic stay to thwart foreclosure).

Bankruptcy courts in the Ninth Circuit are not likely to uphold a self-effecting stay waiver, except one contained in an order recently entered in a previous bankruptcy case. The courts are likely, however, to consider all relevant facts, including the existence and content of any waiver of the automatic stay contained in a prebankruptcy work-out or forbearance agreement, or in an order entered in a prior bankruptcy case, in deciding whether to grant relief from the automatic stay pursuant to a motion filed in the pending case.

To enhance the potential enforceability of a stay waiver, the waiver should be supported by as much evidence of “cause” as possible. Thus, a work-out or forbearance agreement should contain as many admitted facts in support of the stay waiver as is feasible (and accurate) to obtain, and should be signed by both the waiving party and its counsel. An order imposing a prospective waiver in a yet-unfiled case should be supported by detailed findings of fact that set out the evidentiary basis for finding cause for the prospective relief. Many of the elements that support dismissal of a bankruptcy case also may support a finding of cause to grant a creditor’s motion for relief from the stay, and the admissions set forth at pages 5-6 above should be included, as applicable, in any waiver of the automatic stay. The following admissions also may be included:

1. The creditor is entitled to immediate relief from the stay and the debtor waives its right to oppose a lift-stay motion;
2. The creditor is permitted to have its motion for relief from the automatic stay heard on short (i.e., 3 days) notice;
3. The debtor has adequate cash flow to pay ordinary operating expenses as they come due;
4. The debtor has few or no employees;
5. The debtor generally is paying and is able to pay all of its debts, other than its debt to the creditor who is a party to the agreement, as they mature;
6. The debtor acknowledges that no disputes exist with any of its creditors other than the creditor who is a party to the agreement; and
7. The debtor acknowledges that any future bankruptcy filing would be for the sole purpose of delaying and hindering any foreclosure, seizure, or execution by the creditor.

Finally, a creditor may find it prudent to obtain a formal declaration, signed by the debtor, admitting as many of the facts supporting stay relief as possible.^{48/}

III. THE EFFECT OF A BANKRUPTCY FILING ON NON-BANKRUPTCY STIPULATIONS AND AGREEMENTS

A. Arbitration Clauses

Some agreements which have the apparent effect of waiving bankruptcy protections are not necessarily drafted for that purpose, and the parties may dispute the enforceability of the “boilerplate” in bankruptcy. For example, many contracts contain forum selection clauses providing for arbitration of contract disputes. When one of the contracting parties finds itself in bankruptcy, an issue arises as to whether this forum selection clause will be enforced by the bankruptcy court. The Federal Arbitration Act (the “Arbitration Act”)^{49/} requires federal courts to enforce arbitration agreements.^{50/} However, one purpose of bankruptcy is to centralize all disputes concerning the debtor’s property so that a case may be handled fairly and quickly.^{51/} The question of whether to enforce an arbitration clause commonly arises when a debtor files an adversary proceeding against a creditor in the bankruptcy case, and the creditor responds by filing a motion to stay the adversary proceeding in favor of arbitration.^{52/}

One of the first cases to address the question, Zimmerman v. Continental Airlines,^{53/} held that the decision to enforce a valid arbitration agreement was within the sound discretion of a bankruptcy judge. However, the current trend in the case

^{48/} See generally Scotta E. McFarland, *Waivers of Bankruptcy Rights in Workout Agreements*, 8 PROB. & PROP. 15, 16-17 (1994).

^{49/} Federal Arbitration Act of 1947, Pub. L. No. 80-282, 61 Stat. 669 (codified as 9 U.S.C.A. §§ 1-307).

^{50/} Bender Shipbuilding and Repair Co., Inc. v. Morgan (In re Morgan), 28 B.R. 3, 5 (Bankr. 9th Cir. 1983) (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967)).

^{51/} Morgan, 28 B.R. at 5 (BAP 9th Cir. 1983) (citing Johnson v. England, 356 F.2d 44 (9th Cir. 1966)).

^{52/} Insurance Co. of North America v. NGC Settlement Trust & Asbestos Claims Management Corp. (In re National Gypsum Co.), 118 F.3d 1056, 1058 (5th Cir. 1997); MCI Telecommunications Corp. v. Gurga (In re Gurga), 176 B.R. 196, 198 (Bankr. 9th Cir. 1994).

^{53/} 712 F.2d 55, 59-60 (3rd Cir. 1983), cert. den., 464 U.S. 1038 (1984).

law favors the reference of noncore matters to arbitration,^{54/} but defers to the bankruptcy court's discretion when the arbitration clause concerns a core proceeding.

Ninth Circuit case law appears to mandate enforcement of arbitration clauses in noncore matters.^{55/} The courts reason that they should enforce arbitration clauses because the text and legislative history of the Bankruptcy Code do not indicate a congressional intent to make an exception to the Arbitration Act for claims involving a debtor in bankruptcy and no inherent conflict exists between the policies of the Bankruptcy Code and the Arbitration Act.^{56/}

No reported Ninth Circuit opinion addresses the enforceability of arbitration clauses where the disputed matter constitutes a "core" proceeding.^{57/} However, there is no indication that the Ninth Circuit would not concur with the several courts that have found that the enforceability of an arbitration clause, where the reference to arbitration would result in the arbitrator's consideration of all or part of a "core" proceeding, is within the discretion of the bankruptcy court. For example, the court in Insurance Co. of North America v. NGC Settlement Trust & Asbestos Claims Management Corp. (In re National Gypsum Co.), 118 F.3d 1056, 1067 (5th Cir. 1997), held that the bankruptcy court properly exercised its discretion in deciding not to order arbitration of a core bankruptcy issue pursuant to an arbitration

^{54/} See, e.g., Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1156-57 (3rd Cir. 1989) (reversing the district court's denial of a motion to compel arbitration, finding no congressional intent to exclude arbitration in noncore adversary proceedings to enforce a claim of the estate). The core/noncore distinction was discussed at length in Hays. See 28 U.S.C. § 157 (if a proceeding arises under or arises in a case under title 11, it is a core proceeding. A noncore proceeding is one that is related to a case under title 11). The Hays court reasoned from the principle that district courts have original but not exclusive jurisdiction over noncore matters (see 28 U.S.C. § 1334(b)), "that . . . Congress did not envision all bankruptcy related matters being adjudicated in a single bankruptcy court." Id., 885 F.2d at 1157.

^{55/} Gurga, 176 B.R. at 199-200 (BAP 9th Cir. 1994) (bankruptcy court had no discretion to refuse to enforce arbitration clause in prepetition agreement, and should have granted creditor relief from stay to allow arbitration of noncore claims); Bender Shipbuilding and Repair Co., Inc. v. Morgan (In re Morgan), 28 B.R. 3, 5 (BAP 9th Cir. 1983) (chapter 11 debtor which filed a contract claim against a nondebtor was bound by contract's mandatory arbitration clause); Kipperman v. Kidder Peabody & Co. (In re Tre Scalini, Inc.), 178 B.R. 237, 239 (Bankr. C.D. Cal. 1995) (trend in Ninth Circuit has been to enforce arbitration clauses in bankruptcy cases).

^{56/} Gurga, 176 B.R. at 199-200; Hays, 885 F.2d 1149 at 1156.

^{57/} 28 U.S.C. § 157(b)(2) contains an exemplary list of proceedings that are "core."

clause.^{58/} The court opined that a decision to order arbitration should not be governed solely by the core/noncore distinction, but also should be made with reference to the underlying nature of the proceeding, including whether the proceeding derives exclusively from the Bankruptcy Code and if so, whether an arbitration proceeding would conflict with the purposes of the Bankruptcy Code.^{59/}

In negotiating and drafting contracts, and in litigating contract issues in the context of bankruptcy, parties generally should expect that noncore issues arising in or relating to a bankruptcy case with respect to a contract containing a valid arbitration agreement are likely to be referred to arbitration. They also should recognize that core matters are much less likely to be referred to arbitration, regardless of the presence of a valid arbitration agreement and that the decision resides within the sound discretion of a bankruptcy judge (and therefore, effectively is unlikely to be reversed on appeal).

B. Contract Provisions

“Springback” provisions, “claw back” provisions and “snap-back” provisions (collectively referred to as “springback provisions”) are provisions found in documents that deprive a debtor of certain benefits upon the happening of a particular event. Springback provisions vary greatly in type and their enforceability generally is determined on a case-by-case basis.

Three Bankruptcy Code provisions appear to govern the enforceability of springback provisions. Section 541(c)(1)(B) provides that an interest of the debtor in property becomes property of the estate despite any restriction in an agreement that is conditioned on or triggered by: (i) the commencement of a bankruptcy case; (ii)

^{58/} “[A]t least where the cause of action at issue is not derivative of the prepetition legal or equitable rights possessed by a debtor but rather is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion to assess whether arbitration would be consistent with the purpose of the Code, including the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.” National Gypsum Co., 118 F.3d at 1069. See also BNY Licensing Corp. v. Isetan of America, Inc. (In re Barney’s, Inc.), 206 B.R. 336 (Bankr. S.D.N.Y. 1997) (finding chapter 11 debtor’s Section 544(a) avoidance action, Section 549 avoidance action, and Section 542 turnover action were, in the court’s discretion, not subject to arbitration); In re Spectrum Info. Technologies, Inc., 183 B.R. 360, 363-64 (Bankr. E.D.N.Y. 1995) (enforcement of an arbitration agreement is in the bankruptcy court’s discretion; “especially with respect to core proceedings, . . . arbitration should not triumph over the specific jurisdiction bestowed upon bankruptcy courts under the Bankruptcy Code.”).

^{59/} See also In re James P. Barkman, Inc., 170 B.R. 321, 323 n.1 (Bankr. E.D. Mich. 1994) (“For purposes of determining whether Congress intended to carve out an exception to Section 3 of the Arbitration Act, the core/non-core distinction would seem to be of only indirect significance.”).

the insolvency or financial condition of the debtor; (iii) the appointment of, or taking of possession by, a trustee in a bankruptcy case; or (iv) the appointment of, or taking of possession by, a custodian before the commencement of a bankruptcy case.^{60/} Section 365(e) expressly invalidates ipso facto and other clauses in an executory contract or unexpired lease that allow an entity to terminate or modify the agreement in the event of the debtor's bankruptcy filing or as a result of the debtor's financial condition.^{61/} Finally, Section 363(l), subject to Section 365, generally voids provisions that restrict the debtor's ability to use, sell, or lease property of the estate.^{62/}

The issue of the enforceability of springback provisions frequently arises in lease documents. Examples of provisions rendered unenforceable by the nullification of ipso facto or bankruptcy termination clauses have included: (i) a lease provision that prohibited a chapter 11 debtor from liquidating its inventory at its retail store locations^{63/} and (ii) where the only basis for default was the bankruptcy filing, a clause that provided if the lessee was in default, the lessee was required to pay, among other things, the lessor's attorneys fees in connection with such default.^{64/} However, in In re David Orgell, Inc.,^{65/} although the court refused to enforce a lease provision that provided for an increase to the current market rate upon the debtor's assignment of the lease, the court ruled that the assignee would take the lease subject to the escalation clause, and that escalation would take effect upon the assignee's subsequent assignment of the lease.^{66/} Thus, parties should be aware that contract provisions that are not enforceable against a debtor effectively may "spring back" to life after assumption and assignment of the agreement under Section 365, and become enforceable against the debtor's successor-in-interest.

^{60/} See 11 U.S.C. § 541(c)(1)(B).

^{61/} See 11 U.S.C. § 365(e)(1). Note that Sections 365(e)(2)(A) and (B) provide exceptions to the operation of Section 365(e)(1) with respect to: (i) contracts as to which applicable nonbankruptcy law excuses a nondebtor party from accepting performance from or rendering performance to the trustee or assignee and the nondebtor party does not consent to the assumption or assignment; and (ii) contracts that concern the provision of financial accommodations to or for the benefit of the debtor.

^{62/} See 11 U.S.C. § 363(l).

^{63/} In re Tobago Bay Trading Co., 112 B.R. 463, 467 (Bankr. N.D. Ga. 1990).

^{64/} Reloeb Co. v. LTV Corp. (In re Chateaugay Corp.), 1993 WL 159969, *5 (S.D.N.Y. May 10, 1993).

^{65/} 117 B.R. 574 (Bankr. C.D. Cal. 1990).

^{66/} Id. at 576-77.

Another area in which the issue of enforceability of springback provisions frequently arises, although there are few reported decisions in the Ninth Circuit, is when the general partner of a partnership becomes a debtor in a bankruptcy case and the nondebtor partners attempt to terminate the debtor's management interest in the partnership. The primary issue a court must address in this situation is whether the provisions of state law and the parties' partnership agreement, which deprive a general partner of its management rights upon the filing of a bankruptcy,^{67/} survive the Bankruptcy Code's prohibition of *ipso facto* provisions in executory contracts. Since a majority of courts have concluded that partnership agreements are executory contracts,^{68/} the key issue becomes the interpretation of Section 365(e)(2)(A). To support its position, the general partner generally alleges that the state law provisions and partnership agreement are invalid *ipso facto* provisions under Section 365(e)(1).^{69/} The nondebtor partners argue that the state law provisions and partnership agreements are effective pursuant to Section 365(e)(2)(A).^{70/}

In In re Cardinal Indus., Inc.,^{71/} limited partners in three partnerships moved to terminate the debtor's management interest in the partnership pursuant to Sections 365(c)(1) and 365(e)(2)(A). They also sought to lift the automatic stay, to permit them to elect a new general partner. In denying the movants' motion and

^{67/} See California Corporations Code § 15642.

^{68/} In re Catron, 158 B.R. 629, 634 (E.D. Va. 1993), *aff'd*, 25 F.3d 1038 (4th Cir. 1994); In re Cardinal Indus., Inc., 116 B.R. 964, 972-73 (Bankr. S.D. Ohio 1990); In re Corky Foods Corp., 85 B.R. 903, 904 (Bankr. S.D. Fla. 1988).

^{69/} See *supra* note 62.

^{70/} Section 365(e)(2)(A) provides in relevant part:

(2) Paragraph (1) of this subsection [which invalidates *ipso facto* clauses] does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if –

(A)

(i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment

11 U.S.C. § 365(e)(2)(A).

^{71/} 116 B.R. 964 (Bankr. S.D. Ohio 1990).

declining to enforce the partnership termination provisions and the termination provisions of the applicable R.U.L.P.A.,^{72/} the Cardinal court also determined that: (i) the partnerships had not been dissolved by the filing of the debtor's bankruptcy petition;^{73/} and (ii) the partnership agreements were executory contracts.^{74/} The court reasoned, after its lengthy analysis of Section 365, that Section 365(e)(2) is:

meant to reflect the same philosophy [of § 365(c)]. If the contract is neither assumable nor assignable under § 365(c), invalidating the ipso facto clause serves no purpose. Where the contract may be assumed, because assumption by a trustee on behalf of the estate results in the debtor's performance of the contract in a chapter 11 case, invalidation of ipso facto clauses should be the rule, however, either under 11 U.S.C. § 365(e)(1) or by application of the Supremacy Clause generally. A general partner which is eligible for chapter 11 relief and its operating trustee should not have the means for reorganization taken away because of ipso facto bankruptcy termination provisions either in executory contracts or in nonbankruptcy law. That result would harm the estate where assumption would benefit creditors without harm to the other party to the contract.

Cardinal, 116 B.R. at 982.

^{72/} Id. at 982. See also Summit Inv. and Dev. Corp. v. Leroux, 69 F.3d 608, 612-14 (1st Cir. 1995) (Code section 365(e) preempted enforcement of termination provision in partnership agreement and Massachusetts limited partnership statute that divested bankruptcy partner of right to participate in management of partnership, and the partnership agreement did not come within the § 365(e)(2) ipso facto exception); Calvin v. Siegal (In re Siegal), 190 B.R. 639 (Bankr. D. Az. 1996) (Code section 365(e) preempts the Arizona Uniform Partnership Act that provides that dissolution is caused by the bankruptcy of any partner or partnership, and partnership agreement did not fall within § 365(e)(2) ipso facto exception); In re Rittenhouse Carpet, Inc., 56 B.R. 131, 133 (Bankr. E.D. Pa. 1985) (removal of debtor-partner from partnership could not be predicated solely on the filing of the bankruptcy petition, notwithstanding state law to the contrary).

^{73/} Id. at 972. See also In re Safren, 65 B.R. 566, 569-70 (Bankr. C.D. Cal. 1986) (filing of a chapter 11 case by or against a general partnership or general partner does not dissolve the partnership under state law). Cf. Siegal, 190 B.R. at 643 (Arizona Uniform Partnership Act provides that a partnership is dissolved upon the filing of a bankruptcy petition by any partner or partnership under any bankruptcy chapter); In re Doddy, 164 B.R. 276, 279 (Bankr. S.D. Ohio 1994) (without much analysis, the court concluded the partnership was dissolved under Ohio law upon the filing of a partner's chapter 13 bankruptcy petition); Walters v. Sawyer (In re Sawyer), 130 B.R. 384, 397 (Bankr. E.D.N.Y. 1991) (the court summarily stated that under New York law, when the debtor filed under chapter 7, the debtor automatically dissolved the partnership).

^{74/} Id. at 973.

Furthermore, the court denied the movants' motion to lift the automatic stay because the movants' alleged harms, including their inability to proceed with contractual and state law remedies and the apparent conflicts of interest between the debtor's role as general partner and its fiduciary duties to its creditors as a debtor-in-possession, did not constitute "cause" under section 362(d)(1).^{25/}

IV. CONCLUSION

It is clear from an overview of case law that the enforceability of waivers in bankruptcy is determined on a case-by-case basis, with a demonstrated tendency of courts to protect debtors by denying enforcement. The inconsistencies found in court decisions and the uncertainty that practitioners face in litigation concerning the enforceability of waivers has compelled the National Bankruptcy Review Commission (the "Commission") to include in its October 20, 1997, final report a suggestion to amend the Bankruptcy Code to address prebankruptcy waivers of Bankruptcy Code provisions. The Commission's suggestion is as follows:

Section 558 of the Bankruptcy Code should provide that except as otherwise provided in title 11, a clause in a contract or lease or a provision in a court order or plan of reorganization executed or issued prior to the commencement of a bankruptcy case does not waive, terminate, restrict, condition, or otherwise modify any rights or defenses provided by title 11. Any issue actually litigated or any issue resolved by consensual agreement between the debtor and a governmental unit in its police or regulatory capacity, whether embodied in a judgment, administrative order or settlement agreement, would be given preclusive effect.

National Bankruptcy Review Commission Final Report, § 2.4.5 (October 20, 1997).

According to the Commission's comment accompanying the report, the Commission's proposed amendment is intended to clarify that waivers, in any form, are not effective to limit or alter provisions of Title 11. However, the amendment is not intended to alter the preclusive effect of judgments. Thus, this provision would not require duplicate litigation on substantive matters when that issue had already been determined in a nonbankruptcy forum and the final order would be given preclusive effect. Furthermore, settlements with the government in its police or regulatory capacity are excepted on the assumption that these types of settlements would not involve the waiver of bankruptcy rights.

^{25/} Id. at 983-85.

If implemented, the amendment to Section 558 will negate many of the concerns and issues addressed in this paper. In the meanwhile, parties involved in drafting and/or challenging waivers of bankruptcy rights should acquaint themselves with the issues that are involved in order to increase the likelihood of achieving their desired results.

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