St. John's Bankruptcy Research Library
A project of St. John's School of Law and the American Bankrupcty Institute Law Review
2012 Volume IV No. 12

Exploring the Enforceability of Pre-Petition Hindrance Mechanisms to Prevent Bankruptcy

Joshua Eisenson, J.D. Candidate 2013

Cite as: *Exploring the Enforceability of Pre-Petition Hindrance Mechanisms to Prevent Bankruptcy*, 4 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 12 (2012)

Introduction

Insolvency and bankruptcy pose great risks to a creditor's investments. Although business entities can never be truly bankruptcy-proof, certain techniques are commonly deployed to make debtors as bankruptcy-remote as possible. Creditors and practitioners have devised and employed a multitude of "hindrance mechanisms"[1] to significantly discourage bankruptcy petitions, while not directly causing debtors to waive their right to voluntarily file for bankruptcy.[2] Creditors will often require debtors to accept these contractual provisions to make it more difficult, or practically impossible, for debtors to declare bankruptcy. However, as a rule of law, courts will render a hindrance mechanism *per se* invalid if the agreement operates as an ipso facto clause,[3] violates state or case law, or otherwise violates the Bankruptcy Code.

This memorandum discusses two commonly used hindrance mechanisms. Each part will explore one of the mechanisms, describe how it is used in practice, review recent relevant case

[1] "A 'hindrance mechanism' is any sort of contractual device between the debtor and creditor that creates a disincentive for the debtor to file voluntarily for bankruptcy." Michael D. Fielding, *Preventing Voluntary and Involuntary Bankruptcy Petitions by Limited Liability Companies*, 18 BANK. DEV. J. 51, 52 (2001).
[2] *See id*. at 51–52.
[3] "An ipso facto clause is a 'contract clause or state law designed to effect a forfeiture or modification of the [d]ebtor's rights when a bankruptcy is filed.'" *Id*. at 53.

law, and consider the advantages and flaws of the mechanism. Part I discusses the "independent" designee mechanism. This mechanism hinders the filing of bankruptcy petitions by allowing the creditor to appoint an "independent" director to the borrower's board of directors and by requiring unanimous board approval to file a petition for bankruptcy. Part II discusses pre-petition waivers, which are contracts "entered into by the debtor and a creditor where the debtor voluntarily waives a right guaranteed in bankruptcy in exchange for consideration by the creditor."[4] This article discusses two types of pre-petition waivers: (1) automatic stay waiver, and (2) bad faith agreement. An automatic stay waiver is a promise by the debtor to waive the automatic stay protections once bankruptcy is filed. A bad faith agreement is a stipulation by the debtor that any bankruptcy petition subsequently filed shall be considered made in "bad faith" and warrant *for cause* dismissal of the case.

I. Appointment of an "Independent" Director

One of the key hindrance mechanisms to improve bankruptcy remoteness is appointment of an "independent" director to the board of directors. The authority to file a voluntary bankruptcy petition on behalf of a corporation or limited liability company ("LLC") is dictated by state law and the entity's governance instrument.[5] Typically, unless the entity's governance instrument provides otherwise, ratification by the board of directors is required to file a voluntary petition on behalf of the corporation.[6]

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[4] FIELDING, *supra* note 1, at 61 n.67.
[5] *See, e.g.*, Price v. Gurney, 324 U.S. 100, 116 (1945); *In re* Gen-Air Plumbing & Remodeling, Inc., 208 B.R. 426, 430 (Bankr. N.D. Ill. 1997).
[6] *See* Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L.J. 663, 702 (2009).

To minimize the risk of bankruptcy, a creditor will require that the corporation amend its by-laws to require a unanimous board vote to authorize a voluntary bankruptcy filing.[7] The creditor will then negotiate the right to place at least one "independent" director on the board of directors.[8] This essentially grants the creditor "veto power over board actions that jeopardize the bankruptcy remoteness" of the corporation.[9] Using this veto power, the "independent" director can act as a check on the debtor's board of directors to ensure that the board acts in the creditor's best interests.

Three potential disadvantages for either the corporation or sponsor-creditor[10] may arise from this "independent" director model. First, "independent" directors may owe conflicting duties to the debtors' shareholders and creditors, and the sponsor-creditor. Corporate directors owe fiduciary duties to the corporation's shareholders.[11] However, when the corporation is likely to become insolvent or is already insolvent, a director's fiduciary duties extend to the

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[7] *See, e.g.*, *In re* Minor Emergency Ctr. Of Tamarac, Inc., 45 B.R. 310, 311 (Bankr. S.D. Fla. 1985). However on rare occasion, a court will permit a corporation to file for voluntary bankruptcy without a unanimous director vote, despite the corporate by-laws requiring otherwise. *See In re* Buckhead America Corp., Nos. 91-978 through 91-986 (Bankr. D. Del. Aug. 13, 1992) (court permitted corporation to file voluntary petition without unanimous director vote enven though corporation's by-laws required such a vote) (unpublished opinion) (discussed in Kenneth N. Klee & Brendt C. Butler, *Asset-Baked Securitization, Special Purpose Vehicles and Other Securitization Issues*, 35 UCC L.J. 23, 34 n.65 (2002)).

[8] *See* FIELDING, *supra* note 1, at 66 n.91 (discussing importance of carefully crafted agreements between sponsoring-creditor and debtor-corporation to dissuade and prevent debtor-corporation from removing "independent" director or amending concerned provisions in by-laws).

[9] Kenneth N. Klee & Brendt C. Butler, *Asset-Baked Securitization, Special Purpose Vehicles and Other Securitization Issues*, 35 UCC L.J. 23, 34–35 (2002).

[10] For purposes of this paper, "sponsor-creditor" refers to the creditor that appoints the "independent" director to the debtor's board.

[11] *See* Revlon, Inc. v. Macandrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The "independent" director's allegiance to the creditor does not automatically disqualify him from serving as a director. In the wake of the recent economic recession however, an increasing number of shareholder proposals have recommended corporations to amend by-laws to require a minimum percentage of directors be disinterested.

corporation's creditors as well.[12] This duality gives rise to inherent conflicts of interest for the "independent" director, who statutorily owes fiduciary duties to shareholders and all creditors, but contractually has an obligation to act in the sponsor-creditor's best interest. The result can be catastrophic. Shareholders, creditors, or the sponsor-creditor may file a derivative or direct lawsuit depending on the "independent" director's actions, potentially resulting in liability for any of the parties involved.[13] Also, bankruptcy courts have historically refused to honor these unanimous voting provisions where a single dissenting director has breached fiduciary duties by voting against a resolution to file for bankruptcy.[14]

Second, the sponsor-creditor may be considered an insider for property avoidance purposes. If the corporation defaults on the loan and the sponsor-creditor subsequently repossesses the securitized asset, the board of directors will vacate the "independent" designee's position as a director. This in turn allows the board to unanimously vote in favor of a voluntary bankruptcy petition, thereby permitting the trustee to avoid the repossession,[15] since the sponsor-creditor will likely be considered an insider under the Bankruptcy Code.[16] Under section 547(b)(4)(A), "the trustee may avoid any transfer of an interest of the debtor in property made on or within 90 days before the date of the filing of the petition."[17] This preferential-grace period is

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[12] *See, e.g.*, RSL Commc'ns PLC v. Bildirici, 649 F. Supp. 2d 184, 201–202 (S.D.N.Y. 2009).
[13] *See* FIELDING, *supra* note 1, at 68 n.94 and accompanying text. There are "several reasons why creditors and 'independent' voters may want to seriously consider the implications of their actions. First, both the creditor and 'independent' designee are subject to substantial liability and/or punitive damages. Second, attorneys should be particularly wary of playing the role of the independent designee because of the serious ethical dilemmas created by the conflicting fiduciary duties."
[14] *See* BUSSEL, *supra* note 6, at 702–703.
[15] It is worth noting that even if a one-year provision is included, other creditors may still file an involuntary petition for bankruptcy before the twelve-month preferential-grace period expires. *See* 11 U.S.C. §302.
[16] *See* 11 U.S.C. §547(b) (2006). *See also* BUSSEL, *supra* note 6, at 68–69.
[17] 11 U.S.C. § 547(b)(4)(A).

extended to one year for insiders.[18] In the context of a corporation-debtor, the Bankruptcy Code defines an "insider" to include a "director of the debtor" or "person in control of the debtor."[19] The sponsor-creditor may avoid the insider designation, however, by including a provision that requires the "independent" director to remain on the board for at least one-year following repossession. Although this would further the sponsor-creditor goal of bankruptcy-proofing its collateral interest, the debtor's other creditors may still defeat the sponsor-creditor's scheme by filing an involuntary bankruptcy petition.

The problems inherent in the creditor-appointed "independent" director model were discussed at length in *Anstine v. Carl Zeiss Meditec AG (In re U.S. Medical, Inc.)*.[20] In *U.S. Medical*, the debtor entered into a "strategic alliance" with the creditor, whereby creditor agreed to serve as debtor's sole manufacturer of lasers, creditor had the right to appoint a member of debtor's board of directors, and creditor acquired a 10.6% equity interest in the debtor for $2 million in cash and $2 million in inventory-purchase credit. Creditor's CEO was ultimately appointed to debtor's board. Following financial difficulties, debtor voluntarily filed for Chapter 7 bankruptcy. During proceedings, the trustee sought to avoid several transfers made to the creditor prior to the one-year preferential-grace period by proving that the creditor was an "insider." Although the Tenth Circuit held that the creditor was not an insider,[21] the court thoroughly analyzed when a creditor should be classified as an insider. According to the court,

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[18] 11 U.S.C. § 547(b)(4)(B).
[19] 11 U.S.C. § 101(31)(B).
[20] 531 F.3d 1272 (10th Cir. 2008)
[21] The court explained that because the CEO-director "did not participate in any voting concerning the Creditor," delegated "all day-to-day business between Debtor and Creditor" to the Creditor's CFO, remained "sensitive to 'potential conflicts of interest' and . . . 'attended to the kinds of formalities one would expect to see in dealings between third parties at arm's length,'" the creditor did not have a sufficiently close relationship with the debtor to be classified as an insider. *Id* at 1274.

there are two types of insiders under the Code: (1) *per se* insiders (directors and officers) and (2) individuals with "a sufficiently close relationship with the debtor" (family members, creditors who control the decisions of an "independent" director).[22] Three factors are considered to determine whether "a sufficiently close relationship" exists. The court will look to (1) closeness of the relationship between creditor and debtor, (2) whether transactions between the parties were conducted at arm's length, and (3) whether the creditor asserted undue influence or control over the debtor.[23] If the court finds that a creditor controls a debtor, for instance, an "independent" director that vetoes voluntary bankruptcy based on his relationship with the creditor, without concern for his fiduciary duties to shareholders and other creditors, then the sponsor-creditor will likely be found to be an insider.

There is at least one more downside of the "independent" director model. Companies that require unanimous consent to file a voluntary bankruptcy petition still face the possibility of claims from other creditors. This leaves open the opportunity for debtor's insiders to circumvent its own corporate by-laws or a dissenting director and coordinate a "friendly" involuntary petition by its other creditors. This is precisely what happened in *In re Kingston Square Associates*.[24] In *Kingston Square*, the creditor-appointed director refused to consent to bankruptcy, despite the debtor's severe insolvency.[25] In an effort to protect the debtor-company and other creditors, one of the debtor's insiders coordinated with the other creditors for the filing of a friendly involuntary bankruptcy petition. In a seminal and frequently cited decision, the bankruptcy court denied the creditor's motion to dismiss for collusion and bad faith. The court explained that while the orchestration was "suggestive of bad faith," this fact alone was

[22] Rupp v. United Sec. Bank (*In re* Kunz), 489 F.3d 1072, 1078–79 (10th Cir. 2007).
[23] *In re* U.S. Medical, Inc., 531 F.3d at 1276–77.
[24] 214 B.R. 713 (Bankr. S.D.N.Y. 1997).
[25] The Creditor had initiated foreclosure proceedings to recover its secured assets. *Id*. at 717.

insufficient grounds for dismissal.[26] Moreover, the court "expressly declined to address whether . . . bankruptcy remote provisions might be void as against public policy."[27]

II. Pre-Petition Waivers of Rights

Although the Bankruptcy Code contains no provisions making a debtor's pre-petition waiver of bankruptcy protection unenforceable,[28] courts have almost universally held that an *absolute* waiver of the right to file a voluntary bankruptcy petition is invalid as against public policy.[29] As a result, several pre-petition waivers, or hindrance mechanisms, have been crafted to make filing a voluntary petition more difficult for debtors. As used in this article, "a 'pre-petition waiver' constitutes a contract entered into by the debtor and a creditor where the debtor voluntarily waives a right guaranteed in bankruptcy in exchange for consideration by the creditor."[30] While these waivers do not completely eliminate the risk of bankruptcy, they reduce the possibility of unwanted filings.[31]

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[26] *Id*. at 734.
[27] KLEE, *supra* note 9, at 36.
[28] *See* 11 U.S.C. (2006).
[29] *See, e.g.*, Hayhoe v. Cole (*In re* Cole), 226 B.R. 647, 651 n.6 (9th Cir. B.A.P. 1998); *In re* Detrano, 222 B.R. 685, 688 (Bankr. E.D.N.Y. 1998); *In re* Minor, 115 B.R. 690, 694–96 (D. Colo. 1990); *In re* Ethridge, 80 B.R. 581, 586 (Bankr. M.D. Ga. 1987); *In re* Halpern, 50 B.R. 260, 262 (Bankr. N.D. Ga. 1985), aff'd, 810 F.2d 1061 (11th Cir. 1987); *In re* Bisbach, 36 B.R. 350, 352 (Bankr. W.D. Wis. 1984); *In re* Kriger, 2 B.R. 19, 23 (Bankr. D. Or. 1979).
Recently, in *In re DB Capital Holdings*, No. CO–10–046, 2010 WL 4925811 (B.A.P. 10th Cir. Dec. 6, 2010), the Tenth Circuit B.A.P. found a provision in an LLC's operating agreement waiving both the members' and manager's right to file bankruptcy enforceable. I plan to write a detailed discussion of this case and its related implications in the late-fall 2012.
[30] FIELDING, *supra* note 1, at 61 n.67.
[31] *See id*. at 61–62.

Courts are split on the applicability of pre-petition waivers.[32] As the bankruptcy court in *In re 203 North LaSalle Street Partnership*[33] explained, "since bankruptcy is designed to produce a system of reorganization and distribution different from what would obtain under nonbankruptcy law, it would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply."[34] Other jurisdictions, however, enforce certain pre-bankruptcy contractual provisions based on a balancing of several judicially established considerations.[35] Those courts rationalize the enforcement of pre-petition agreements by explaining that the benefits and utilities of enforcement outweigh the concerns.[36]

This section analyzes two commonly utilized pre-petition waivers that frequently raise debate in bankruptcy proceedings. The first is the automatic stay waiver. An automatic stay waiver is a debtor's promise to waive the automatic stay protections once bankruptcy is filed.[37]

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[32] *See, e.g.*, *compare supra* note 29 *with In re* Shady Grove Tech Ctr. Assocs. L.P., 216 B.R. 386, 390 (Bankr. D. Md. 1998) ("[P]rohibitions against the filing of a bankruptcy case are unenforceable."), *In re* Madison, 184 B.R. 686, 690 (Bankr. E.D. Pa. 1995), *In re* Freeman, 165 B.R. 307 (Bankr. S.D. Fla. 1994), *and In re* Gulf Beach Dev. Corp., 48 B.R. 40, 43 (Bankr. M.D. Fla. 1985) ("[T]he Debtor cannot be preclude from exercising its right to file Bankruptcy and any contractual provision to the contrary is unenforceable as a matter of law.").

[33] 246 B.R. 325 (Bankr. N.D. Ill. 2000).

[34] *Id*. at 331

[35] *See infra* accompanying text at 8-13 for list of factors to determine the enforceability of certain pre-petition waivers.

[36] *See infra* accompanying text at 12-13 for discussion of three underlying considerations courts balance to determine the general enforceability of pre-petition waivers.

[37] Under section 362 of the Code, when a bankruptcy petition is filed, all of a debtor's creditors are *automatically* enjoined from commencing or continuing proceedings against the debtor, enforcing judgments, perfecting liens, collecting debts, and repossessing any of the bankruptcy estate's property. 11 U.S.C. §362. "Thus, the automatic stay enjoins a secured lender from taking action to realize the value of its collateral." Harold S. Novikoff & Barbara S. Kohl, *Bankruptcy "Proofing": Bankruptcy Remote Vehicles and Bankruptcy Waivers*, A.L.I.-A.B.A. COURSE MATERIALS J., June 1999, at 37, 50 n.4. The stay "continues until the bankruptcy case is closed, dismissed, or discharge is granted or denied, or until the bankruptcy court grants some relief from the stay." Maritime Electric Co. v. United Jersey Bank, 959 F.2d 1194, 1206 (3rd Cir. 1991). Any party in interest may obtain relief from the stay after notice, a hearing, and sufficient cause is provided. 11 U.S.C. §362(d).

The waiver is often formulated as a waiver of the right to defend against a motion to lift the stay. Although courts generally agree that stay waivers are not self-executing and creditors must petition the court for relief from the stay,[38] courts are split on the enforceability of these pre-petition waivers.[39]

Courts for and against enforcing automatic stay waivers frequently root their reasoning in the Code's underlying and competing public policy. Recently, in *In re Frye*,[40] the bankruptcy court in Vermont examined the enforceability of automatic stay waivers. In that case, the court set out ten factors key to determining stay waiver enforceability.[41] The factors identified include: (1) the sophistication of the party making the waiver; (2) the consideration given by the creditor for the waiver; (3) whether other parties, such as unsecured creditors, are affected by the waiver; (4) the feasibility of the debtor's plan; (5) whether there is evidence the waiver was obtained by coercion, fraud, or mutual mistake of material facts; (6) whether enforcing the agreement will further the legitimate public policy of encouraging out-of-court restructuring and settlement; (7) the likelihood of reorganization; (8) the extent to which the creditor would otherwise be prejudiced if the waiver is not enforced; (9) the proximity in time between the waiver date and the bankruptcy filing date (and whether there was a compelling change in circumstances during that time); and (10) whether the debtor has equity in the property and the creditor is otherwise

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[38] *See, e.g.*, *In re Shady Grove*, 216 B.R at 393–94; *In re* Darrell Creek Assocs., L.P., 187 B.R. 908, 910 (Bankr. D.S.C. 1995); *In re* Powers, 170 B.R. 480, 483 (Bankr. D. Mass. 1994); *see also* NOVIKOFF, *supra* note 37, at 52.

[39] *Compare e.g.*, *In re Shady Grove*, 216 B.R. at 386 (automatic stay waivers are enforceable), *In re* Atrium High Point L.P., 189 B.R. 599 (Bankr. M.D.N.C. 1995), *In re Darrel Creek*, 187 B.R. at 910, *In re* Cheeks, 167 B.R. 817 (Bankr. D. S. C. 1994), *and In re Powers*, 170 B.R. at 480, *with In re* Pease, 195 B.R. 431, 433 (Bankr. D. Neb. 1996) (automatic stay waivers are not enforceable), *In re* Jenkins Court Assocs., 181 B.R. 33, 37 (Bankr. E.D. Pa. 1995), Farm Credit, ACA v. Polk, 160 B.R. 870, 873–74 (M.D. Fla. 1993), *and In re* Sky Int'l, Inc., 108 B.R. 86, 89 (Bankr. W.D. Pa. 1989).

[40] 320 B.R. 786 (Bankr. D. Vt. 2005).

[41] *Id.* at 789–91.

entitled to relief from stay under section 362(d).[42] The court also noted that "[t]he weight given to each factor will vary on a case-by-case basis and must be left to the sound discretion of the court."[43]

The factors set forth in *In re Frye* were recently applied in *In re DB Capital Holdings, LLC*,[44] a Colorado bankruptcy court case. In *DB Capital*, the creditor agreed to forego exercising remedies against its collateral, to extend the debtor's deadline for completion of a creditor financed project, and to provide debtor an addition $11,964,331 to fund debtor's obligations.[45] As consideration, the debtor agreed not to oppose any creditor motion for relief from an automatic stay.[46] The court granted the creditor's motion for relief, explaining that although stay waivers should seldom be enforced, the factors for granting the creditor relief outweighed those against enforcement.[47]

Unfortunately, the conflicting views among courts regarding the enforceability of automatic stay waivers cannot be reconciled. There is a sharp divergent view among courts regarding the utility, benefits, and desirability of enforcing automatic stay waivers.[48] As a result, the applicability of a stay waiver relies heavily on the specific facts of each individual case.

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[42] *Id*. at 790–96.
[43] *Id*. at 790–91. In addition, courts against enforcing stay waivers often cite factors such as: (1) the ipso facto clause effect of the stay waiver; (2) debtor's lack of capacity to bind the bankruptcy estate; (3) the Code's prohibitions on pre-petition agreements to forego any *essential* provision of the Code; and (4) that granting stay relief would "ignore[] the fact that [the Code] is also designed to protect all creditors and to treat them equally" and creditors' reliance on their Code-provided rights when contracting with debtor. Ass'n of St. Croix Condominium Owners v. St. Croix Hotel Corp., 682 F.2d 446 (3d Cir. 1982); KLEE, *supra* note 9, at 33 n.57. *See also supra* note 39.
[44] 454 B.R. 804 (Bankr. D. Colo. 2011).
[45] *Id.* at 807–14.
[46] *Id.*
[47] *Id.* at 812–24. It should be noted that *DB Capital* is a single asset real estate case. Historically, courts will often enforce automatic stay waivers in single asset real estate cases. *See id.* at 814.
[48] *See* KLEE, *supra* note 9, at 33.

The second pre-petition waiver is a bad faith agreement. A bad faith agreement is a stipulation that any bankruptcy petition subsequently filed shall be considered made in "bad faith" and warrant *for cause* dismissal of the case. Although not *per se* enforceable,[49] many courts enforce "bad faith" agreements based on the underlying facts and circumstances that would otherwise warrant a finding of bad faith.[50] Therefore, to increase the likelihood that a court will grant a motion to dismiss for bad faith, creditors will often have debtors stipulate to factual findings of bad faith filings.[51]

The principle that a bankruptcy case can be dismissed for a bad faith filing is a "judge-made doctrine."[52] "Grounds for dismissal exist if it is clear on the filing date that 'there was no reasonable likelihood that the debtor intended to reorganize and no reasonable probability that it would eventually emerge from bankruptcy proceedings.'"[53] Typically, "a bankruptcy petition will be dismissed if *both* objective futility of the reorganization process *and* subjective bad faith in filing the petition are found."[54] "No one factor is determinative of good faith." Instead courts "examine the facts and circumstances of each case in light of several established" factors,[55] such as: (1) the number of unsecured creditors; (2) the existence of a previous bankruptcy petition by the debtor or a related entity; (3) whether the debtor has more than one asset; (4) whether the timing of the petition filing evidences an intent to delay or frustrate legitimate efforts of secured

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[49] *See, e.g.*, *In re* Aurora Invs., Inc., 134 B.R. 982 (Bankr. M.D. Fla. 1991); *In re* Orange Park S. P'ship, 79 B.R. 79 (Bankr. M.D. Fla. 1987).
[50] *See* NOVIKOFF, *supra* note 37, at 50 (citing *In re* S. E. Fin. Assocs., 212 B.R. 1003, 1005 (Bankr. M.D. Fla. 1997)).
[51] *See In re Jenkins Court Assocs.*, 181 B.R. at 36. When filing for a motion to dismiss for bad faith, creditors and debtors should be wary of the possibility of being accused of a Rule 11 violation for misrepresentations made to the court. *See* Fed. R. Civ. P. 11(b).
[52] *In re* Gen. Growth Props., 409 B.R. 43, 55–56 (Bankr. S.D.N.Y. 2009).
[53] *Id*. at 56 (citing C-TC 9th Ave. P'ship v. Norton Co. (*In re* C-TC 9th Ave. P'ship), 113 F.3d 1304 (2d Cir. 1997).
[54] *Id*. (citing *In re Kingston Square Assocs.*, 214 B.R. at 725 (emphasis in original)).
[55] *Id*.

creditors to enforce their rights; (5) whether the petition was filed on the eve of foreclosure of debtors sole or major asset; (6) whether the petition effectively allows the debtor to evade court orders; (7) whether there was improper pre-petition conduct by debtor; (8) whether reorganization essentially involves the resolution of a two-party dispute; (9) whether there is any possibility of reorganization; (10) whether the debtor has little or no cash flow; (11) whether the debtor has insufficient income to operate or meet current expenses; (12) whether the debtor has any employees; and (13) whether the debtor filed solely to create the automatic stay.[56] Moreover, courts have historically given considerable weight to the presence of pre-petition "bad faith" stipulations and automatic stay waivers in findings of bad faith. Nonetheless, "[i]t is the totality of circumstances, rather than any single factor," that will determine whether bad faith exists.[57]

The factors critical to determining the enforceability of bad faith agreements were discussed at length in *In re Jenkins*.[58] In *In re Jenkins*, the creditor failed to introduce any factual evidence of bad faith, besides the debtor's pre-petition bad faith stipulation. As a result, the court refused to dismiss the case based on the lack of good faith.[59] The court explained that the determination of whether a bankruptcy petition has been filed in bad faith is fact intensive.[60] Although a bad faith stipulation may be a contributing consideration, alone it is not sufficient to find that good faith is absent.

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[56] *See, e.g.*, *id.*; Carolin Corp. v. Miller, 886 F.2d 693 (4th Cir. 1989); *In re* Phoenix Piccadilly, 849 F.2d 1393, 1394–95 (11th Cir. 1988); *In re* Little Creek Dev. Co., 779 F.2d 1068, 1073 (5th Cir. 1986).
[57] *In re Kingston Square*, 214 B.R. at 725.
[58] 181 B.R. 33, 37 (Bankr. E.D. Pa. 1995).
[59] *Id*. at 36.
[60] *Id*.

In the end, the enforceability of pre-petition waivers relies on a balancing of three important considerations.[61] First and most important is public policy. This is usually measured by evaluating the abovementioned factors to determine whether lifting a stay or dismissing a bankruptcy petition outweighs the potential social and economic harm to other creditors, stakeholders (i.e. employees, the community, etc.), and judiciary dockets. Second is reliance on contractual agreements. The debtor specifically agreed to the waiver, often with the advice of counsel who is market-wise and knowledgeable of the ramifications of pre-petition agreements.[62] The waiver is a basis for part of the creditor's bargain;[63] therefore, the debtor should be held responsible and not be given a free pass by filing for bankruptcy. Third and final consideration is bad faith. The debtor contractually agreed (and received reciprocal consideration) to waive certain rights if plagued with insolvency, but filed a petition for bankruptcy or sought protection under the stay anyways. Thus the debtor agreed to a contract in bad faith or filed a petition in bad faith.[64]

Conclusion

The enforceability of pre-petition hindrance mechanisms and agreements is questionable at best. Debtors, creditors, and practitioners should be wary of the local jurisdiction's stance on agreements where consideration is given in exchange for the waiver of certain Bankruptcy Code provided rights.

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[61] *See* Edward S. Adams & James L. Baillie, *A Privatization Solution to the Legitimacy of Prepetition Waivers of the Automatic Stay*, 38 ARIZ. L. REV. 1, 10 (1996).
[62] *See id.*
[63] If creditor knew bankruptcy court would not enforce creditor's end of bargain with debtor, creditor would likely have charged higher interest or entirely reconsidered his dealings with debtor.
[64] *See id.*