SO ORDERED.

Dated: March 2, 2022

Eddward P. Ballinger Jr., Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

MINUTE ENTRY/ORDER

FOR MATTER TAKEN UNDER ADVISEMENT

Bankruptcy Judge:	Eddward P. Ballinger, Jr.
Case Name:	Continental Country Club, Inc. - Chapter 11
Case Number:	3:21-bk-00956-EPB
Subject of Matter:	Motion to Reject Amended Settlement Agreement and Judgment
Date Matter Taken Under Advisement:	January 26, 2022
Date Matter Ruled Upon:	March 2, 2022

Debtor Continental Country Club, Inc., is an Arizona non-profit that serves as the homeowners' association for a large residential community located in Flagstaff, Arizona. Among its responsibilities, Debtor operates the community golf course and tends to community amenities, including various bodies of water and, specifically relating to this matter, a man-made lake known as "Lake Elaine." When first developed, Lake Elaine was an extremely attractive and valuable amenity for Debtor's members, particularly those who incurred the extra expense of

purchasing homes adjacent to the lake. There is no dispute that at the time the lakeside properties were sold, the buyers had a reasonable expectation of being able to enjoy the long-term use of an attractive, functioning, well-maintained water habitat. Unfortunately, Lake Elaine was not adequately maintained, and its condition deteriorated dramatically. In 1987, those most affected by this development joined together and filed a class-action lawsuit against Debtor, the community's original developer, and others.[1] The Lakeside Legionnaires asserted claims for nuisance, statutory misrepresentation, misrepresentation/fraud, negligent misrepresentation, breach of fiduciary duty, breach of duty of good faith and fair dealing, consumer fraud, violation of Interstate Full Disclosure Act, breach of covenant, and promissory estoppel. The class action never made it to trial. Instead, the parties entered into a settlement agreement that was approved by the state court (the "Settlement Agreement").

The Settlement Agreement required Debtor to reconstruct and restore Lake Elaine in accordance with a plan developed by outside consultants.[2] In 1994, the consultants confirmed that Debtor had satisfied its restoration obligation. In 2017, the Lakeside Legionnaires filed an application to hold Debtor in contempt for its failure to maintain Lake Elaine, which has again deteriorated and is not the attractive, well-maintained amenity anticipated by the Settlement Agreement. While the state court made pronouncements indicating that the Lakeside Legionnaires' position had merit, no final judgment was entered regarding the matter prior to Debtor filing its bankruptcy petition.

[1] These homeowners and their successors are referred to hereafter as the "Lakeside Legionnaires."
[2] The plan developed by outside consultants is referred to hereafter as the "Consultants' Plan."

Debtor filed for Chapter 11 relief on February 9, 2021, and a day later filed the subject motion to reject the Settlement Agreement. On January 26, 2022, the Court heard evidence and took this matter under advisement.

It is important to identify the question before the Court. It is not whether the Debtor generally has an obligation to maintain Lake Elaine. It is not whether granting Debtor's pending request will give rise to a multi-million dollar claim in favor of the Lakeside Legionnaires. It is whether the Settlement Agreement contains executory commitments Debtor may reject pursuant to 11 U.S.C. § 365(a). Answering this question requires resolution of the following three issues:

1. Is the Settlement Agreement a contract?

2. If so, is it executory?

3. If it is executory, did Debtor reasonably exercise its valid business judgment in rejecting the Settlement Agreement?

The Lakeside Legionnaires contend that the fact that the Settlement Agreement was memorialized in a stipulated judgment means it is no longer a contract; it is a "merits judgment." In primary support of this claim, the Lakeside Legionnaires point to the fact that the order approving the Settlement Agreement included the language, "The Court finds that Defendants . . . ." This Court disagrees. The Settlement Agreement was prepared by class-action plaintiffs' counsel. It did not constitute findings of fact issued after consideration of the merits by the state court. It expressly provides that the parties are *stipulating* to entry of judgment. There was no evidentiary hearing or other proceeding by which the court was called upon to resolve factual disputes and reach legal conclusions. Inclusion of boilerplate language reciting that "[t]he Court finds" does not change the fact that the parties agree they reached a negotiated resolution. The record reflects no judicial resolution, but solely a compromise between the parties.

This Court finds persuasive the analysis provided by the Third Circuit in *In re Columbia Gas Sys. Inc*., 50 F.3d 233, 238 (3d Cir. 1995):

> Although settlement agreements may be judicially approved, they share many characteristics of voluntary contracts and are construed according to traditional precepts of contract construction. *cf. Fox v. United States Dep't of Housing & Urban Dev.,* 680 F.2d 315, 319 (3d Cir.1982) (observing this point for consent decrees). In a nonbankruptcy context, we have treated a settlement agreement as a contract. *See Halderman v. Pennhurst State Sch. & Hosp.,* 901 F.2d 311, 318 (3d Cir.), *cert. denied,* 498 U.S. 850, 111 S.Ct. 140, 112 L.Ed.2d 107 (1990).
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> We see nothing special in this bankruptcy that counsels a different approach. The core of this settlement agreement was consensual obligations. The parties crafted the agreement and the court approved it. There is no judgment on the merits, a factor that distinguishes cases cited by the bankruptcy court. Furthermore, the rights and obligations of the parties do not derive solely from the court's judgment, but depend at least in part on the performance of the other party. What is especially significant in this case is that there remains an agreement that the debtor can breach which could give rise to a claim against it. Although we recognize that not all settlement agreements should be considered contracts, we believe the factors already enumerated are sufficient to consider this settlement agreement as a contract for purposes of § 365.

See also In re W.B. Care Ctr., LLC, 419 B.R. 62, 65, 67 (Bankr. S.D. Fla. 2009)(holding court order approving settlement agreement was a contract "notwithstanding the court's imprimatur," noting that the settlement agreement language was left entirely to the parties, the core of the settlement was consensual obligations, and the rights and obligations of the parties do not "derive solely from the court's judgment."); *U. S. v. ITT Cont'l Baking Co.,* 420 U.S. 223, 238, 99 S.Ct. 926, 935, 43 L.Ed.2d 148 (1975)(stating "a consent decree or order is to be construed for enforcement purposes basically as a contract.").

The next question is whether this contract is executory, which requires determining whether "performance is due to some extent on both sides." *See In re Robert L. Helms Constr. & Dev. Co., Inc.,* 139 F.3d 702, 705 (9th Cir. 1998) (quoting *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 523 n.6, 104 S.Ct. 1188, 1194 n.6, 79 L.Ed.2d 482 (1984)). Both contracting parties

must have a material obligation due the other, such that a breach by one excuses the other. Neither party disputes that Debtor had numerous continuing obligations under the Settlement Agreement as it related to restoring and maintaining Lake Elaine. The Lakeside Legionnaires also had a continuing duty that cannot be characterized as insignificant. In particular, the Lakeside Legionnaires had a continuing duty to cooperate in addressing and implementing any necessary modifications to the Consultants' Plan to accommodate changing conditions such that Lake Elaine could be operated and maintained consistent with the Settlement Agreement's objectives. At trial the Lakeside Legionnaires' representative acknowledged this fact. A duty to cooperate in consummating a contract or agreement is an executory obligation. *See In re High Voltage Eng'g Corp.,* 397 B.R. 579, 598 (Bankr. D. Mass. 2008); *In re Helm*, 335 B.R. 528, 537 (Bankr. S.D.N.Y. 2006); *Cf. In re Boates*, 551 B.R. 428, 434-35 (9th Cir. BAP 2016)(recognizing that a duty to cooperate can be an executory obligation as long as it is a bargained-for term contained in the written agreement). This Settlement Agreement was not simply an agreement by Debtor to restore and maintain the lake. As the parties were well aware, Debtor's obligations were subject to change based on unknown but anticipated impediments that likely would arise in the future relating to access to water, the cost of water, and deterioration to the lake substrate. The Consultants' Plan specifically recognized several major factors could prevent the achievement of the Plan's goals and that the Plan may need to be modified in the future. The Settlement Agreement expressly included this continuing duty in its terms.

Last, the parties agree that this Court must apply the business judgment rule to determine whether to approve a debtor's rejection of an executory contract. *In re Pomona Valley Med. Group, Inc.,* 476 F.3d 665, 670 (9th Cir. 2007). In resolving the question, the Court "need engage in 'only a cursory review of a [debtor-in-possession]'s decision to reject the contract.

Specifically, a bankruptcy court applies the business judgment rule to evaluate a [debtor-in-possession]'s rejection decision." *Id.* at 670 (quoting *Durkin v. Benedor Corp (In re G.I. Indus., Inc.)*, 204 F.3d 1276, 1283 (9th Cir. 2000)). "Thus, in evaluating the rejection decision, the bankruptcy court should presume that the debtor-in-possession acted prudently, on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the bankruptcy estate." *Id.* The motion should be denied only if the debtor's "conclusion that rejection would be 'advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.'" *Id*. (citing *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers*, 756 F.2d 1043, 1047 (4th Cir. 1985)).

In this case, Debtor's witness and the other evidence provided, established that Debtor carefully considered a number of options regarding how to resolve the Lake Elaine situation, conducted numerous meetings to gain input from consultants and interested parties, and considered the potential, significant, adverse consequences that rejection may visit upon the Debtor.

Based upon the foregoing,

IT IS ORDERED granting Debtor's Motion to Reject Amended Settlement Agreement and Judgment. Counsel for Debtor shall lodge and serve a form of order consistent with this ruling.