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NOT FOR PUBLICATION

HAROLD S. MARENUS, CLERK  
U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

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In re:	)	BAP Nos.	MT-07-1389-PaDJu
	)		MT-07-1404-PaDJu
JAMES LEE HAYES and JENNIFER	)		(Cross-Appeals)
LYNN HAYES,	)		
	)	Bk. No.	07-60316-RBK
Debtors.	)	Adv. No.	07-00045-RBK
_____	)		
WATER SKI MANIA ESTATES	)		
HOMEOWNERS ASS'N, et al.,	)		
	)		
Appellants/Cross-Appellees,	)		
	)	<b>MEMORANDUM<sup>1</sup></b>	
v.	)		
	)		
JAMES LEE HAYES; JENNIFER LYNN	)		
HAYES,	)		
	)		
Appellees/Cross-Appellants.)	)		
_____	)		

Argued and submitted on March 18, 2008,  
at Helena, Montana

Filed - March 31, 2008

Appeal from the United States Bankruptcy Court  
for the District of Montana

Hon. Ralph B. Kirscher, Chief Bankruptcy Judge, Presiding.

\_\_\_\_\_  
Before: PAPPAS, DUNN and JURY, Bankruptcy Judges.

<sup>1</sup> This disposition is not appropriate for publication.  
Although it may be cited for whatever persuasive value it may have  
(see Fed. R. App. P. 32.1), it has no precedential value. See 9th  
Cir. BAP Rule 8013-1.

1 Chapter 13<sup>2</sup> Debtors James and Jennifer Hayes ("Debtors")  
2 commenced an adversary proceeding against the owners of land ("the  
3 Landowners") located adjacent to Debtors' property, seeking the  
4 bankruptcy court's determination that certain restrictive  
5 covenants relating to the Landowners' properties were invalid or  
6 executory contracts that could be rejected by Debtors in their  
7 bankruptcy case. The bankruptcy court decided that the  
8 restrictive covenants were valid property interests, not executory  
9 contracts, and therefore could not be rejected. It then made six  
10 additional rulings in its Judgment. The Landowners appealed the  
11 six additional rulings, and Debtors cross-appealed the  
12 determination that the restrictive covenants are not executory  
13 contracts.

14 We AFFIRM the bankruptcy court's order that the restrictive  
15 covenants are valid property interests and not executory  
16 contracts, and we REVERSE the bankruptcy court's six additional  
17 rulings.

18 **FACTS<sup>3</sup>**

19 In 1990, Tom and Suzanne Hanson ("Hansons") purchased four  
20 parcels of property, totaling 80 acres, near Helena, Montana. The  
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22 <sup>2</sup> Unless otherwise indicated, all chapter, section and rule  
23 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and  
24 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

25 <sup>3</sup> In this recitation, the Panel relies primarily on  
26 information taken from the Debtors' excerpts of record because  
27 Landowners did not comply with Rule 8009(b). Specifically,  
28 Landowners did not provide copies of the adversary complaint, the  
answer, the notice of appeal, the relevant entries from the  
bankruptcy court's docket, and the transcript of the trial held on  
September 7, 2007. Debtors provided the missing documents in  
their excerpts.

1 two eastern parcels, identified in the real estate records as Lots  
2 8 and 12, were developed by Hansons.<sup>4</sup> On this property they built  
3 a water ski lake known as Serenity Lake. They also established a  
4 minor subdivision on the property known as Water Ski Mania Estates  
5 ("WSME"), consisting of five lots located on the east side of  
6 Serenity Lake. Those five lots were eventually purchased by the  
7 Landowners.<sup>5</sup>

8 In conjunction with their development of WSME, Hansons  
9 prepared and executed restrictive covenants (the "Restrictive  
10 Covenants") which were recorded on November 5, 1991. The  
11 pertinent provisions of the Restrictive Covenants include the  
12 following:

- 13 • They refer to the owner of the lake as the "Lakeowner" and to  
14 the owner of any lot in WSME as a "Landowner."
- 15 • They provide for the establishment of an "Association"  
16 composed of the Landowners, and that the Association would  
control common property and coordinate other matters of  
interest to the Landowners.
- 17 • "Section VI Lake Use: A unique aspect of landownership in  
18 [WSME] is the lifetime<sup>[6]</sup> right to the use of the adjacent  
body of water presently called Serenity Lake. . . . All  
19 decisions concerning the lake will be made by [L]akeowner."
- 20 • "Section VI-a. Landowner use of the lake is subject to

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21 <sup>4</sup> Hansons also developed the western parcels. There, they  
22 built No Wake Lake. Hansons sold the western parcels to an  
23 unrelated party and those parcels are not at issue in this appeal.

24 <sup>5</sup> The five Landowners are Brian and Linda Heeny ("Heenys"),  
25 Kevin and Amy Syrvud, Frank and Dori Creasia, Edwin and Linda  
Simmons, and Robert and Nancy Jardon.

26 <sup>6</sup> Although Section VI of the Restrictive Covenants uses the  
27 term "lifetime" to refer to the duration of the right of the  
Landowners to use Serenity Lake, Section VIII provides that the  
28 covenants are binding for 30 years and are automatically renewed  
indefinitely for additional 10-year periods, unless modified by a  
majority vote of the Landowners.

- 1 negotiations between the Association and [L]akeowner.”
- 2 • “Section VI-f. A maximum of six (6) landowners shall be  
3 allowed the use of the lake. Five (5) landowners shall be  
4 owners of lots in [WSME] and one landowner shall be the owner  
5 of a single family dwelling built on property immediately  
6 west of the lake.”
  - 7 • “Section VI-g. The Landowners shall have first collectively  
8 and then individually the right of first refusal for the  
9 purchase of the lake property.”
  - 10 • “Section VI-h. The Lakeowner may levy assessments for the  
11 purpose of maintenance of the lake structure should it become  
12 necessary. The fee should not be in excess of the cost of  
13 maintenance of the lake and requires a majority vote of the  
14 Association.”
  - 15 • “Section VI-i. Landowner’s use of the lake is subject to the  
16 bylaws of Water Ski Mania. . . . Expulsion [from lake access  
17 for violation of the bylaws] will require a majority vote of  
18 the Association and in case of tie the Lakeowner will  
19 decide.”

20 Initially, Hansons occupied Lot 1 of WSME, selling Lots 2-5  
21 between 1991 and 1994. In 1996, Hansons decided to sell Lot 1 and  
22 build a new home. They convened a meeting of the five members of  
23 WSME to seek the Landowners’ views on relocation of Hansons’  
24 proposed new home from the west side of Serenity Lake (as  
25 contemplated in Section VI-f of the Restrictive Covenants, quoted  
26 above) to the south side. Four of the Landowners gave oral  
27 consent to Hansons’ proposal; the other, Heenys, also gave oral  
28 consent after Hansons agreed to reduce the hours Hansons’  
commercial ski school used Serenity Lake.

Hansons completed construction of a home on the southeast  
side of Serenity Lake in 2002. When a conflict arose between  
Hansons and the Landowners, in April 2002, Hansons filed an  
action, Hanson v. Water Ski Mania Estates, in Montana First  
District Court, Lewis and Clark County, no. 2002-264 (the  
“District Court Action”). In the District Court Action, Hansons

1 sought a declaratory judgment that, pursuant to the parties' oral  
2 agreements, even though their new house was located on the south  
3 side of Serenity Lake, they were the sixth Landowner referred to  
4 in Section VI-f of the Restrictive Covenants and therefore had the  
5 right to use the lake. The state district court disagreed,  
6 holding instead that the Restrictive Covenants had, under state  
7 law, vested the parties with property rights. As a result, the  
8 district court ruled that any modifications of those rights would  
9 be subject to compliance with the state statute of frauds, and  
10 Hansons' purported transfer of the sixth lot rights from the west  
11 side to the south side of the lake required execution of a written  
12 instrument, or a fully executed oral agreement, to be enforceable.

13 On appeal, the Montana Supreme Court affirmed the district  
14 court's judgment:

15 We conclude the District Court correctly analyzed the  
16 written covenants. Regardless of the Hansons' intent at  
17 the time the covenants were written and executed, the  
18 Hansons are not identified as the sixth landowner. . . .  
19 Moreover, as determined by the District Court, under the  
20 covenants there is no method by which the sixth landowner  
21 lake use rights expressly granted to a parcel of "property  
22 immediately west of the lake" could be transferred to a  
23 parcel of property on the south end of the lake.

24 Hanson v. Water Ski Mania Estates, 326 Mont. 154, 158-59 (2005).<sup>7</sup>

25 In July 2004, Hansons sold their remaining interest in Lots 8  
26 and 12 to Debtors, consisting of approximately 27 acres with  
27 improvements, including Serenity Lake, a home, a dock, a boat  
28 launch, and the rights to the trade name "Water Ski Mania"

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26 <sup>7</sup> The Montana Supreme Court also affirmed the district  
27 court's determination that there was no enforceable oral agreement  
28 that could modify the Restrictive Covenants because no  
consideration had been given by Hansons to the Landowners in  
exchange for modifying the Restrictive Covenants.

1 (together, the "Property").<sup>8</sup> Of course, this sale did not include  
2 the five lots which had already been sold to the Landowners.

3 At the later trial in the bankruptcy court, both Debtors and  
4 Hansons provided evidence of troubled relations between the  
5 Landowners and the Lakeowner. Don Parsons testified that he had  
6 attempted to purchase the Property from Hansons in 1999. Mr.  
7 Parsons withdrew from the sale after he communicated with the  
8 Landowners, and came to the conclusion that they would treat his  
9 rights to use the lake as subordinate to their rights. Tom Hanson  
10 testified that, by 2004, he was forced to sell the Property below  
11 its appraised value to Debtors because of ongoing poor relations  
12 with the Landowners. Then, in 2006, Debtors attempted to sell the  
13 Property to Christopher van Sys. The Landowners allegedly made  
14 demands on Mr. van Sys to produce financial and other  
15 documentation generally not made available to the holder of a  
16 right of first refusal, and as a result, the sale was aborted.

17 Debtors and Hansons described other problems they experienced  
18 over the years with the Landowners. They allege that the  
19 Landowners have held unauthorized water ski clinics and  
20 tournaments on Serenity Lake, have invited guests to use the lake  
21 without paying any guest fees (and caused members of Debtors' Ski  
22 Club not to renew their paying memberships), and that Heenys have  
23 constructed a dock on Serenity Lake that Debtors contend is not  
24 authorized and creates a hazard. As the bankruptcy court would

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26 <sup>8</sup> As previously noted, Water Ski Mania Estates is the name  
27 of the subdivision of five lots owned by Landowners. The trade  
28 name "Water Ski Mania," refers to the 27 acres with improvements  
of Lots 8 and 12 which remained after WSME was created. There is  
no legal relationship between WSME and Water Ski Mania.

1 conclude, the "evidence in this case overwhelmingly shows that the  
2 actions of the [Landowners] have had an adverse impact upon the  
3 debtors." Memorandum of Decision at 9 (October 3, 2007).

4 On April 4, 2007, Debtors filed a chapter 13 petition.<sup>9</sup> On  
5 June 21, 2007, Debtors commenced the adversary proceeding against  
6 the Landowners and the Association which is the subject of this  
7 appeal.<sup>10</sup>

8 The bankruptcy court conducted a pretrial conference in the  
9 adversary proceeding on August 15, 2007, at which the parties  
10 appeared through counsel. The court instructed the parties to  
11 submit a pretrial order to identify the issues and to govern the  
12 trial.

13 A Final Pre-trial Order (the "PTO"), approved by counsel for  
14 both Debtors and the Landowners, was submitted and entered by the  
15 bankruptcy court on September 4, 2007. The PTO provided that it  
16 would supersede "the pleadings filed by the parties and shall  
17 govern the course of the trial unless it appears that modification  
18 of the Pretrial Order is necessary to prevent manifest injustice."  
19 In relevant part, the PTO provided:

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21 \_\_\_\_\_  
22 <sup>9</sup> Robert G. Drummond was appointed to serve as chapter 13  
23 trustee. Mr. Drummond filed statements generally supporting  
24 Debtors' positions in the bankruptcy case, but was neither a party  
25 nor an active participant in the adversary proceeding.

26 <sup>10</sup> On May 25, 2007, Debtors had filed an ex parte motion for  
27 a temporary restraining order "disallowing the [Landowners] and  
28 the Water Ski Mania Estates Homeowners Association from using the  
ski lake until the issue of the Restrictive Covenant[s] has been  
resolved so that no liability is incurred and the bankruptcy  
estate is not put at risk." The bankruptcy court denied this  
motion because it had not been made via an adversary proceeding as  
required by Rule 7001(7) and, in any event, because Debtors'  
request would not satisfy the requirements for a temporary  
restraining order under Rule 7065.

1 VIII. Disputed Factual Issues.

- 2 1. Whether Restrictive Covenants are property rights  
3 which cannot be avoided or executory contracts  
4 which can be terminated.
- 5 2. Whether or not the covenants are valid and  
6 enforceable against the Owners of Lots 8 and 12.
- 7 3. Whether any member of the Water Ski Mania [Estates]  
8 Homeowners Association at the time that the Hayes  
9 Bankruptcy was filed owed any further performance  
10 of an obligation under the contract whereby they  
11 purchased their realty.

12 IX. Relief Sought.

13 The Debtors are seeking to have the Restrictive  
14 Covenants declared either invalid or [] executory  
15 contracts and then terminate them.

16 X. Points of Law.

- 17 1. Whether or not the restrictive covenants are valid?
- 18 2. Exclusive of Lots 8 and 12, are the restrictive  
19 covenants property interests that run with the land  
20 and therefore belong to the defendants and [cannot]  
21 be avoided by this court?
- 22 3. Whether or not Water Ski Mania Estates Restrictive  
23 Covenants constitute an executory contract that can  
24 be avoided by the Debtors?

25 The bankruptcy court conducted a trial in the adversary  
26 proceeding on September 7, 2007. At the conclusion of Debtors'  
27 presentation of evidence and testimony, at the Landowners'  
28 request, the bankruptcy court ruled orally that the Restrictive  
Covenants were not invalid and were not executory contracts that  
could be rejected in Debtors' bankruptcy case under § 365(a). Tr.  
Trial 150:18-20. The court also ruled that the Landowners' right  
of first refusal under the Restrictive Covenants was a continuing  
right that applied to subsequent sales. Tr. Trial 151:5-12. The  
court appeared to rule that "As it relates to the use  
restrictions, I find the lots are subject to that." Tr. Trial



1 151:18-19.

2 As it indicated to the parties it would, the bankruptcy court  
3 later memorialized its findings and conclusions in a Memorandum of  
4 Decision ("Memorandum") and a separate Judgment entered on October  
5 3, 2007. The conclusions of law in the Memorandum, and the relief  
6 awarded in the Judgment, were specified in seven separately  
7 numbered provisions. They stated:

- 8 1. The Restrictive Covenants at issue in this Proceeding  
9 are not an executory contract subject to rejection under  
10 11 U.S.C. § 365.
- 11 2. The landowners' right of first refusal is not a right of  
12 last approval, and merely allows the landowners to match  
13 the price and terms of any acceptable bona fide offer.
- 14 3. Commercial use of Serenity Lake by the landowners and/or  
15 their guests is expressly forbidden.
- 16 4. Any unauthorized use of Serenity Lake by the landowners  
17 and/or their guests is expressly forbidden.
- 18 5. The use of Serenity Lake by landowners for clinics and  
19 tournaments is expressly forbidden.
- 20 6. The Defendants Brian and Linda Heeny shall remove their  
21 dock from Serenity Lake on or before March 1, 2008.
- 22 7. Debtors are the sixth landowner identified in the  
23 Restrictive Covenants and as the sixth landowner and as  
24 the lakeowner, have the right to enforce the Restrictive  
25 Covenants.

26 The Landowners filed a timely appeal of the provisions of  
27 paragraphs 2-7 of the Judgment on October 12, 2007 ("Additional  
28 Orders"). Debtors filed a cross-appeal of paragraphs 1-2 on  
October 24, 2007.<sup>11</sup>

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26 <sup>11</sup> Debtors' cross-appeal was late-filed under Rule 8002(a),  
27 which requires that cross-appeals be filed within 10 days of the  
28 original appeal. However, our court of appeals instructs that the  
timely filing of a cross-appeal "is a rule of practice, which can  
(continued...)



1 2. Whether the bankruptcy court erred in ruling that the  
2 Restrictive Covenants do not constitute an executory contract  
3 that may be rejected in Debtors' bankruptcy case under  
4 § 365(a).

5  
6 **STANDARDS OF REVIEW**

7 The bankruptcy court's conclusions of law are reviewed de  
8 novo and its factual findings for clear error. In re Dawson, 367  
9 F.3d 1174, 1177 (9th Cir. 2004).

10 Whether procedures employed by the bankruptcy court comport  
11 with requirements of due process is reviewed de novo. In re  
12 Garvida, 347 B.R. 697, 703 (9th Cir. BAP 2006).

13 A trial court's interpretation of contract provisions is  
14 reviewed de novo. United States v. 1,377 Acres of Land, 352 F.3d  
15 1259, 1264 (9th Cir. 2003).

16  
17 **DISCUSSION**

18 I.

19 The bankruptcy court erred by considering issues and  
20 granting relief outside the scope of the PTO and without  
21 notice to, and an opportunity to present evidence by,  
22 the Landowners.

23 In its Memorandum and Judgment, the bankruptcy court made six  
24 rulings that are challenged on appeal by the Landowners. The  
25 bankruptcy court decided that the Landowners' right of first  
26 refusal is not a right of last approval; that Landowners and their  
27 guests were forbidden from any commercial use of Serenity Lake, or  
28 from unauthorized use or clinics or tournaments; that the Heenys  
must remove their dock from the lake no later than March 1, 2008;

1 and that Debtors are the "sixth landowner" identified in the  
2 Restrictive Covenants.

3 At the time the bankruptcy court entered the PTO in this  
4 proceeding, it acknowledged on the record that "the pretrial order  
5 has been approved and will govern the proceedings." Tr. Trial  
6 12:9-11 (September 4, 2007). The only relief sought in the PTO  
7 specified that "[t]he Debtors are seeking to have the Restrictive  
8 Covenants declared either invalid or [] executory contracts and  
9 then [to] terminate them." The "Disputed Factual Issues" and  
10 "Points of Law" identified in the PTO concerned only the validity  
11 of the Restrictive Covenants and whether they were executory  
12 contracts for bankruptcy treatment purposes.

13 When the PTO is read fairly, the issues of fact and law to be  
14 decided by the bankruptcy court are narrowly circumscribed. There  
15 is no indication in the PTO that the bankruptcy court would  
16 comprehensively address or examine the nature and extent of the  
17 rights of the parties under the various Restrictive Covenants, nor  
18 that it would grant the sort of relief specified in the Additional  
19 Orders. As a result, as is explained below, the Landowners are  
20 justifiably concerned that entry of the Additional Orders exceeded  
21 the scope of the PTO.

22 In addition, it appears that the Landowners were deprived of  
23 their rights to due process at trial because, while the Additional  
24 Orders substantially affected their property rights, they were  
25 given no effective advance notice that this might occur, nor were  
26 they afforded an effective opportunity to be heard concerning the  
27 issues. We therefore conclude that the bankruptcy court erred in  
28 entering the six Additional Orders.

1 A.

2 FED. R. CIV. P. 16, made applicable in bankruptcy adversary  
3 proceedings by Rule 7016, describes the purpose and effect of  
4 pretrial orders:

5 Pretrial Orders. After any conference under this rule,  
6 the court should issue an order reciting the action taken.  
7 This order controls the course of the action unless the  
8 court modifies it.

9 Final Pretrial Conference and Orders. . . . The court may  
10 modify the order issued after a final pretrial conference  
11 only to prevent manifest injustice.

12 FED. R. CIV. P. 16(d), (e).

13 Our court of appeals has consistently ruled that, once a  
14 final pretrial order is entered pursuant to Rule 16(e), setting  
15 forth the parties and issues for trial, modifications are allowed  
16 "only to prevent manifest injustice." Byrd v. Guess, 137 F.3d  
17 1126, 1131-32 (9th Cir. 1998) (quoting Johnson v. Mammoth  
18 Recreations, Inc., 975 F.2d 604, 608 (9th Cir. 1992));  
19 AmerisourceBergen Corp. v. Dialysist West, Inc., 465 F.3d 946, 957  
20 (9th Cir. 2006). "It goes without saying that a pre-trial order  
21 controls the scope and course of trial; a claim or issue not  
22 included in the order is waived, unless presented at trial without  
23 objection." Arsement v. Spinnaker Exploration Co., 400 F.3d 238,  
24 245 (5th Cir. 2005) (cited by the Ninth Circuit in  
25 AmerisourceBergen, 465 F.3d at 957).

26 Even if an issue is pleaded in the complaint, "[a] pretrial  
27 order generally supersedes the pleadings, and the parties are  
28 bound by its contents." Patterson v. Hughes Aircraft Co., 11 F.3d  
948, 950 (9th Cir. 1993); United States v. Joyce, 511 F.2d 1127,  
1130 n.1 (9th Cir. 1975) ("The parties are bound by their

1 agreement to limit the issues to be tried.”).

2 Under Rule 7016 and this case law, the bankruptcy court was  
3 empowered to modify the issues of fact and law, and relief to be  
4 granted, specified in the PTO, but only to “prevent manifest  
5 injustice.” FED. R. CIV. P. 16(e); DP. Aviation v. Smiths Indus.  
6 Aero. & Def. Sys., 268 F.3d 829, 841 (9th Cir. 2001) (“A pretrial  
7 order should be liberally construed to permit any issues at trial  
8 that are embraced within its language. However, particular  
9 evidence or theories which are not at least implicitly included in  
10 the order are barred unless the order is first modified to prevent  
11 manifest injustice.”).

12 The record does not show that, before or at trial, either  
13 party requested that the PTO be modified so that the bankruptcy  
14 court could consider and grant relief concerning the subject  
15 matter of the Additional Orders. Also, it does not show that the  
16 bankruptcy court decided, sua sponte, that it was necessary to  
17 prevent a “manifest injustice” that it grant additional relief not  
18 specified in the PTO.

19 The Ninth Circuit has instructed that a trial court consider  
20 four factors in determining whether manifest injustice requires  
21 modifying a final pretrial order:

22 (1) the degree of prejudice or surprise to the defendants  
23 if the order is modified; (2) the ability of the  
24 defendants to cure any prejudice; (3) the impact of the  
25 modification on the orderly and efficient conduct of the  
26 case; and (4) any degree of willfulness or bad faith on  
27 the part of the party seeking the modification.

28 Byrd, 137 F.3d at 1132. There is no evidence in this case that  
the parties engaged in bad faith, so Factor 4 is not relevant  
here. Factor 3 could arguably support an expansion of the issues

1 set forth in the PTO, in that such a modification could allow  
2 settlement of issues that would otherwise require another trial.  
3 However, Factors 1 and 2 clearly do not favor any modification of  
4 the PTO under these facts, because the Landowners would presumably  
5 be surprised and prejudiced by a post-trial modification of the  
6 PTO without an opportunity to be heard concerning these issues.

7 It therefore appears that the issues decided, and the relief  
8 granted, by the bankruptcy court in the Additional Orders exceeded  
9 the PTO.

10 B.

11 Entry of the Additional Orders by the bankruptcy court under  
12 this procedure also implicates the due process rights of the  
13 Landowners. As the Panel wrote in Educ. Credit Mgmt. Corp. v.  
14 Repp (In re Repp),

15 the cornerstone of modern due process analysis is Mullane  
16 v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950).  
17 "Notice must be reasonably calculated, under all the  
18 circumstances, to apprise interested parties of the  
19 pendency of the action and afford them an opportunity to  
20 object. It must be of such a nature as reasonably to  
21 convey the required information and afford a reasonable  
22 time for response." Id. at 314.

23 307 B.R. 144, 148 (9th Cir. BAP 2004).

24 The Ninth Circuit expanded on this requirement of notice and  
25 opportunity to be heard. "It is well settled that 'the root  
26 requirement of the Due Process Clause [is] that an individual be  
27 given an opportunity for a hearing before he is deprived of any  
28 significant property interest.' Cleveland Bd. of Educ. v.  
Loudermill, 470 U.S. 532, 541, 105 S.Ct. 1487, 1493, 84 L.Ed. 494  
(1985)." Clements v. Airport Auth. Of Washoe County, 69 F.3d 321,  
333 (9th Cir. 1995).

1           Our due process analysis mandates consideration of three  
2 factors: 1) Were "significant property interests" of the  
3 Landowners implicated in the Additional Orders? 2) Did the  
4 Landowners have adequate notice of the issues? 3) Did the  
5 Landowners have an opportunity to be heard on those issues? The  
6 answer to the first question is, arguably, in the affirmative; the  
7 second and third questions must be answered in the negative.

8           In the District Court Action, the district court ruled that  
9 "the right to use the Lake was a right that, under the express  
10 terms of the Restrictive Covenants, ran with the land, and  
11 therefore was an interest in real property." Hanson, 326 Mont. at  
12 484. This ruling was effectively affirmed when the Montana  
13 Supreme Court decided that the state statute of frauds applied to  
14 modifications of the Restrictive Covenants. Id.

15           The Montana Supreme Court rulings in Hanson were declared  
16 "law of the case" by the bankruptcy court "as it relates to  
17 anything that was in dispute between the parties at District Court  
18 level." Tr. Trial 57:7-8. We agree. Moreover, Debtors admit  
19 that one purpose for filing the adversary proceeding was to obtain  
20 a judicial declaration that Debtors were the "sixth Landowner,"  
21 and as a Landowner had a property right of access to the lake  
22 during the 35 hours per week provided in the Restrictive Covenants  
23 for exclusive use of Landowners. Therefore, there can be little  
24 doubt that "property interests" of the Landowners were implicated  
25 when the bankruptcy court entered the Additional Orders. As such,  
26 the Landowners had a right to fair and effective notice and a  
27 right to be heard before the bankruptcy court could deprive them  
28 of, or limit, their interests in their property.



1           The Landowners were given no advance notice that the  
2 bankruptcy court intended to grant relief of the sort provided in  
3 the Additional Orders. As discussed above, the PTO clearly made  
4 no reference to the issues upon which the court would grant the  
5 Additional Orders. The PTO superseded the other pleadings,  
6 including the complaint.<sup>12</sup> And the parties had the right to rely  
7 on the statement of issues in the PTO to prepare for trial.  
8 "Because parties rely on [the] pretrial conference to inform them  
9 precisely what is in controversy, [a] pretrial order is treated as  
10 superseding the pleadings and establishing issues to be considered  
11 at trial." Erff v. MarkHon Indus., Inc., 781 F.2d 613 (7th Cir.  
12 1986). The Landowners did not have adequate notice before, or  
13 even during, the trial that the bankruptcy court would consider  
14 the issues upon which it based its Additional Orders.

15           While there is considerable argument in the parties' briefs  
16 concerning whether the Landowners had a fair opportunity to  
17 present evidence and testimony, and otherwise to be heard, our  
18 examination of the trial transcript shows that the bankruptcy  
19 court did not offer the Landowners a sufficiently clear  
20 opportunity to meet the needs of due process, nor did the  
21 Landowners waive any right to be heard.

22           During the testimonial phase of the trial, the bankruptcy  
23 court heard from Don Parsons, Hanson, Hayes, and Bill Bahney, the

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24  
25           <sup>12</sup> Even if the PTO did not supersede the complaint under Rule  
26 16(e) and case law, the Debtors' complaint did not request the  
27 sorts of relief granted in the Additional Orders. The only relief  
28 requested in the complaint, besides a declaration that the  
Restrictive Covenants were either invalid or executory contracts,  
was entry of a temporary restraining order "terminating the  
homeowners use of the lake and being in any contact with the  
Debtor(s) until this matter is finalized."

1 realtor appointed by the court to market the Property. The  
2 transcript shows the following testimonial evidence was adduced  
3 that relates to the Additional Orders:

- 4 • Regarding Order 2 (right of first refusal), Hanson testified  
5 that he offered Landowners, individually and collectively,  
6 right of first refusal on Parsons' offer and then again on  
7 Hayes' offer. Tr. Trial 78:2 - 80:14.
- 8 • Regarding Order 3 (forbidding commercial use of the lake by  
9 Landholders), Hayes testified on both direct and cross-  
10 examination as to his belief that only the Lakeholder had the  
11 right to commercial use. Tr. Trial 116:7-9, 117:22-24.
- 12 • Regarding Order 4 (forbidding unauthorized use), Hayes  
13 testified that there were numerous infractions of the rules  
14 in the bylaws, that he sent 40-50 emails to different  
15 Landowners complaining about infractions, but did not specify  
16 any particular examples of unauthorized use, nor did he ever  
17 make a formal complaint to the Association. Tr. Trial 119:17  
18 -120:21.
- 19 • Regarding Order 5 (forbidding clinics and tournaments), Hayes  
20 testified that there were unauthorized clinics and  
21 tournaments held on Serenity Lake in 2007, but did not  
22 provide details. He also stated that in 2005 and 2006, he  
23 funded tournaments that the Heenys arranged and managed. Tr.  
24 Transcript 119:1-16.
- 25 • Regarding Order 6 (ordering Heenys to remove their dock),  
26 there is no discussion of this topic in the trial transcript.
- 27 • Regarding Order 7 (Debtors are the sixth Landowner), there  
28 was extended testimony from Hanson about why he decided to

1 move his house from the west side of Serenity Lake (as  
2 contemplated in Section VI-f of the Restrictive Covenants) to  
3 the southeast side, and his reasons for believing that the  
4 sixth Landowner use rights should attach to that location.  
5 Tr. Trial 31:24 - 37:18. Hayes simply stated that he agreed  
6 with Hanson's testimony regarding the sixth Landowner issue.  
7 Tr. Trial 113:1.

8 Following the close of testimony, Landowners asked the  
9 bankruptcy court to dismiss Debtors' claim that the Restrictive  
10 Covenants be voided.<sup>13</sup> Before the court announced its ruling,  
11 there was a colloquy among counsel and the court which considered  
12 whether Debtors had presented a prima facie case on the executory  
13 contract issue and there was no discussion about the issues which  
14 resulted in the Additional Orders. Tr. Trial 139:18 - 147:20.  
15 After this discussion, the bankruptcy court announced its intent  
16 to rule that the Restrictive Covenants were not invalid, and were  
17 not executory contracts subject to rejection in Debtors'  
18 bankruptcy case. Tr. Trial 150:18-19.

19 The court next ruled that the Landowners' had a right of  
20 first refusal and this right continued with each sale of the  
21 Property, Tr. Trial 151:5-7, and that the Landowners were subject  
22 to use restrictions in the Restrictive Covenants.<sup>14</sup> Tr. Trial

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24 <sup>13</sup> We construe the Landowners' motion to have been a motion  
25 for judgment on partial findings. Rule 7052 (incorporating FED.  
R. CIV. P. 52(c).

26 <sup>14</sup> It is not clear in the transcript which "use" restrictions  
27 the bankruptcy court concludes are binding on the Landowners. The  
28 court discusses an apparent ambiguity between Section VI-a of the  
Restrictive Covenants, which provides that use is subject to  
(continued...)

1 151:18-19.<sup>15</sup> The court then stated, "Anything? Any question? Any  
2 concern? Any -- not misunderstanding; but do you understand what  
3 I'm saying?" Tr. Trial 154:1-3. The Landowners' attorney then  
4 asked the court for clarification that sale of the Property was  
5 subject to the Restrictive Covenants. Upon the court's reply that  
6 any sale would be subject to the Restrictive Covenants, the  
7 Landowners' attorney replied, "So other than that, my clients will  
8 step back from anything like that." Tr. Trial 154:12-19. The  
9 court indicated that it would take the matters under submission,  
10 and would provide a written ruling and Judgment. Tr. Trial  
11 156:21-25.

12 We do not believe this brief exchange or the earlier colloquy  
13 effectively advised the Landowners about the extent of relief the  
14 bankruptcy court was considering, nor did it adequately offer the  
15 Landowners an opportunity to offer testimony or evidence on the  
16 other issues dealt with in the Additional Orders. We also do not  
17 believe the Landowners waived their rights in this exchange to  
18 submit evidence or be heard on those issues.<sup>16</sup>

19 \_\_\_\_\_  
20 <sup>14</sup>(...continued)  
21 negotiation between the Association and Lakeowner, and Section VI-  
22 i which states that the bylaws of Water Ski Mania control lake  
23 use. The court stated that, if a particular use had a detrimental  
24 effect on possible sale of the Property, the court was prepared to  
25 entertain an action for damages. Tr. Trial 152:5-9.

26 <sup>15</sup> At that point, the bankruptcy court also granted Debtors'  
27 separate motion filed in the bankruptcy case for authority to list  
28 and market the Property for sale. Tr. Trial 153:4-7. The  
Landowners did not appeal this ruling or order.

<sup>16</sup> Following the court's rulings on the record, Debtors twice  
asked for clarification regarding whether Landowners had a right  
to commercial use of Serenity Lake. Both counsel briefly  
addressed that issue. The court made several comments: "Yeah, I  
(continued...)

1 For these reasons, the Panel concludes that the bankruptcy  
2 court erred by considering issues and granting relief in the  
3 Additional Orders beyond the scope of the PTO and, in doing so,  
4 the Landowners' due process rights were violated.

5  
6 II.

7 The bankruptcy court did not err in ruling that the  
8 Restrictive Covenants do not constitute an executory  
9 contract.

10 Debtors raise two issues on cross-appeal: that the bankruptcy  
11 court erred in ruling that the Restrictive Covenants did not  
12 constitute an executory contract that could be rejected under  
13 § 365(a); and that it erred in concluding that the "right of first  
14 refusal" was still in effect. The former issue is examined below.  
15 However, as discussed in the previous section concerning the  
16 Additional Orders, the bankruptcy court's ruling about the  
17 Landowners' right of first refusal was not encompassed in the PTO,  
18 nor did the Landowners have adequate notice that the bankruptcy  
19 court would grant relief concerning the issue. Since we reverse  
20 all six of the Additional Orders, the Panel need not consider the  
21 cross-appeal's objection to the second, "right of first refusal"

22 <sup>16</sup>(...continued)

23 don't think that [Landowners] are prohibited [from commercial  
24 use]." Tr. Trial 156:10-12. "You know, I'm not sure that there  
25 is that exclusive use to the lake owner of the commercial." Tr.  
26 Trial 159:22-23. "See, I don't see that it [Restrictive Covenant]  
27 says "exclusive right" [of the Lakeowner] like it does with some  
28 other things." Tr. Trial 160:13-14. Given these comments and  
that there was never a request in the PTO or in any pleading in  
this case for a permanent prohibition on commercial use by the  
Landowners, the Landowners clearly did not have notice or  
effective opportunity to address the commercial use issue before  
the bankruptcy court entered its order forbidding commercial use  
by the Landowners.

1 order.

2 Both parties agree that the controlling law on whether the  
3 Restrictive Covenants constitute an executory contract is In re  
4 Robert L. Helms Constr. & Dev. Co., Inc., 139 F.3d 702 (9th Cir.  
5 1998). In Helms, the court of appeals considered whether an  
6 option was an executory contract for purposes of § 365(a). It  
7 began its analysis with the oft-cited "Countryman definition": a  
8 contract is executory if "the obligations of both parties are so  
9 unperformed that the failure of either party to complete  
10 performance would constitute a material breach and thus excuse the  
11 performance of the other." Vern Countryman, Executory Contracts  
12 in Bankruptcy, 57 MINN. L. REV. 439, 450 (1973), quoted in Griffel  
13 v. Murphy (In re Wegner), 839 F.2d 533, 536 (9th Cir. 1988). In  
14 applying that definition to the facts, the Ninth Circuit was  
15 troubled by the contingent nature of option contracts, because  
16 performance by the optionor is only obligated if the paid-for  
17 option was exercised. It noted that some courts have ruled that  
18 an optionee had fulfilled its only true obligation by paying for  
19 it; the creation of any further obligation lies within the  
20 optionee's sole discretion, so the contract cannot be executory.  
21 Helms, 139 F.3d at 705 (citing Brown v. Snellen (In re Giesing),  
22 96 B.R. 229, 232 (Bankr. W.D. Mo. 1989); Travelodge Int'l, Inc. v.  
23 Cont'l Props, Inc. (In re Cont'l Props., Inc.), 15 B.R. 732, 736  
24 (Bankr. D. Haw. 1981)). Partly based upon these concerns, the  
25 court in Helms ruled that a contract is not executory unless the  
26 contract requires further performance by both parties at the time  
27 the bankruptcy petition is filed.

28 Although not binding authority, the Seventh Circuit's

1 analysis in Gouveia v. Tazbir, 37 F.3d 295 (7th Cir. 1994), is  
2 also instructive. In that decision, the court directly addressed  
3 whether a restrictive covenant on real property was an executory  
4 contract that could be rejected in a bankruptcy case. The Seventh  
5 Circuit reasoned that, although restrictive covenants contain the  
6 characteristics of both a contract and an interest in land, the  
7 primary nature of such covenants is preservation of a land  
8 interest, not future duties in contract. Although there will  
9 almost always be some incidental continuing obligations under a  
10 restrictive covenant, those duties were not the kind of  
11 obligations Congress intended to impact in enacting § 365. Thus,  
12 the court decided that restrictive covenants on real estate are  
13 not executory contracts subject to termination under § 365.  
14 Gouveia, 37 F.3d at 298-99.

15 In this case, the Landowners argue that they had no  
16 obligations on the petition date remaining to be performed under  
17 the Restrictive Covenants. In their view, they completed their  
18 performance of their real estate contracts by purchasing parcels  
19 of land between 1991 and 1994, many years before the bankruptcy  
20 petition was filed, and by agreeing to be bound by the Restrictive  
21 Covenants in effect on the purchase date.

22 Debtors counter in their Reply Brief that there were numerous  
23 obligations imposed on the Landowners by the Restrictive  
24 Covenants. However, of those alleged obligations, only two (to  
25 maintain insurance on their boats, and to abide by the bylaws<sup>17</sup> of

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27 <sup>17</sup> The other obligations of the Landowners appear to be  
28 derivative of the alleged obligation to abide by the bylaws. The  
(continued...)

1 Water Ski Mania) were contained in the Restrictive Covenants. And  
2 if a particular landowner failed to perform these alleged  
3 obligations, the only relief available to Debtors under the  
4 Restrictive Covenants was to request that the Association expel  
5 the offending landowner for a set period of time. Clearly,  
6 though, even if the Landowners' duties contained in the  
7 Restrictive Covenants were ignored by one or more of them, Debtors  
8 were not excused from performance of their obligations under the  
9 Restrictive Covenants for such breaches.

10 The bankruptcy court concluded that "given my review of the  
11 covenants, they're not executory. I find that they may have  
12 unilateral obligations and do have unilateral obligations which  
13 can be enforced." Tr. Trial 150:18-21 (emphasis added). In  
14 short, the bankruptcy court determined that there were no mutual  
15 obligations, either at the time of filing of the petition or  
16 later. Consequently, the bankruptcy court's determination that  
17 the Restrictive Covenants were not executory contracts is  
18 consistent with Helms.

19 The bankruptcy court memorialized this finding in its written  
20 Memorandum:

21 In the case sub judice, this Court does not believe that

22 \_\_\_\_\_  
23 <sup>17</sup>(...continued)  
24 bylaws are not included in the record on appeal. The Landowners  
25 moved to strike any testimony or reference to the bylaws at trial  
26 because they were not listed as an exhibit in the PTO and were  
27 never introduced into evidence. Tr. Trial 81:18. The court  
28 responded, "I'm going to reserve on your objection. I think it  
raises a good point." Tr. Trial 85:11-12. When counsel later  
repeated his objection, the court ruled, "you may have a  
continuing objection." Tr. Trial 107:14-15. There is no  
indication in the transcript that the court finally ruled on this  
evidentiary objection.



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the Restrictive Covenants meet the definition of executory contracts . . . as discussed in [Helms]. Accordingly, Debtors are not allowed to reject or breach the restrictive covenants under 11 U.S.C. § 365.

We agree with the bankruptcy court's analysis and conclude that the bankruptcy court did not err in ruling that the Restrictive Covenants were not executory contracts that could be rejected in Debtors' bankruptcy case.

**CONCLUSION**

We REVERSE the six Additional Orders in the court's Judgment and AFFIRM the bankruptcy court's decision that the Restrictive Covenants are not executory contracts.