

IN THE UNITED STATES BANKRUPTCY COURT FOR THE  
DISTRICT OF PUERTO RICO

In re: :  
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BOU CARRO, INC. : Case No. 93-00432 (GAC)  
d/b/a FARMACIA CARRO :  
 :  
Debtor : Chapter 11  
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BACKGROUND

The debtor, Bou Carro, Inc. d/b/a Farmacia Carro ("Farmacia Carro"), filed a voluntary petition under Chapter 11 of the Bankruptcy Code on February 1, 1993. In its list of creditors, Farmacia Carro listed PCS, Inc. ("PCS") as having a disputed unsecured claim in the amount of \$400,000. The relationship between Farmacia Carro and PCS is that PCS processed claim vouchers for prescription drugs sold by Farmacia Carro to policy holders of certain health plans. PCS processed the claim vouchers pursuant to a member pharmacy agreement with Farmacia Carro. PCS remitted payments received from said health plans to Farmacia Carro.

With respect to executory contracts with PCS, in its bankruptcy schedule of executory contracts and unexpired leases, Farmacia Carro listed the member pharmacy agreement, a supplemental agreement dated June 1, 1979 and an agreement dated August 7, 1992. The schedule also indicated that Farmacia Carro was specifically assuming the agreements with PCS.

On February 10, 1993, the court provided notice to all parties

in interest that the claims bar date was June 9, 1993 (Dkt.#2).

On February 12, 1993, Farmacia Carro filed an adversary complaint against PCS alleging that PCS was withholding from Farmacia Carro's receivables in violation of the automatic stay (Adv. No. 93-0016). At a hearing scheduled on February 22, 1993, the parties indicated that they had reached an agreement which would require PCS to make complete payments for three cycles and allow PCS to withhold \$5,000 per cycle beginning on the fourth cycle. On June 1, 1993, Farmacia Carro filed a motion to dismiss the adversary proceeding indicating that the controversy was settled amicably between the parties and that the complaint was moot.

On July 15, 1993, PCS filed a motion requesting that the court order the debtor to assume or reject the agreements with PCS (Dkt.# 20). PCS indicated that the debtor had been in default on the member pharmacy agreement prior to filing bankruptcy, but that they had reached a settlement agreement on August 7, 1992, providing that the balance of the \$675,000 debt would be secured by mortgage(s) on the premises of the pharmacy or other real estate and that the balance, plus interest at the rate of 7% per annum would be amortized at the rate of \$5,000 per two week billing cycle for a period of four years with the remaining balance to be made by balloon payment.

By order dated July 19, 1993, the court ordered the debtor to

assume or reject the agreement with PCS within thirty days. On August 23, 1993, Farmacia Carro filed a motion seeking an extension of time to reply to the order regarding assumption or rejection of the contract with PCS (Dkt.# 25). Farmacia Carro indicated that PCS had collected \$50,992.65 post-petition on its prepetition claims and that because PCS was withholding \$5,000 bi-monthly to amortize the pre-petition billing, PCS was adequately protected. Farmacia Carro's motion for an extension was granted.

On September 9, 1993, Farmacia Carro filed another motion for a ten day extension of time to assume or reject the executory contract with PCS (Dkt.# 27). Farmacia Carro indicated that it had met with attorneys for PCS and offered two alternatives regarding the executory contracts. Farmacia Carro requested the extension while PCS made a decision on the alternatives presented by the debtor. This motion was granted.

On November 3, 1994, Farmacia Carro filed a motion requesting an order rejecting the executory contracts with PCS (Dkt.# 30). Farmacia Carro indicated that the terms and conditions imposed by PCS could not be accepted by Farmacia Carro and that they were incompatible with the successful reorganization of Farmacia Carro. This motion was granted by court order dated November 22, 1993.

On July 22, 1994, PCS filed a motion for allowance of an unsecured claim in the amount of \$669,749.44 based on Farmacia Carro's breach of its executory contract with PCS (Dkt.# 63). PCS

indicated that during a period of approximately two years between 1990 and 1992, Manuel Bou Carro, as a corporate officer and co-owner of Farmacia Carro, engaged in a scheme to defraud the insurance underwriters in the PCS system by submitting and getting paid for false claims for prescription drugs.

PCS stated that on August 7, 1992, Farmacia Carro and PCS agreed that the total amount of the discrepant claims was \$1,225,291 less the amounts which PCS has offset from claims due to Farmacia Carro from underwriters in the system. PCS indicated that the agreement between it and Farmacia Carro was that Farmacia Carro would pay \$125,000 and allow PCS to deduct \$5,000 per cycle from payments due Farmacia Carro for a period of four years with a lump sum payment at the end of the four years. Farmacia Carro explicitly assumed the agreement of August 7, 1992 in its schedules. PCS included the breakdown of payments made and amounts remaining to pay the discrepant amounts in full. PCS also included a letter by an attorney for Farmacia Carro dated November 6, 1992, which indicated Farmacia Carro's assent to the settlement agreement of August 7, 1992. The letter states:

This confirms that since August 7, 1992, PCS and Farmacia Carro have agreed to settle the matter presently being handle [sic] by us in the following manner:

Settlement Amount-- \$1,225,291

Form of payment--

Down payment-- \$125,000 . . .

Payment Plan of four years of \$5,000 per cycle to commence immediately with the running cycle, cycle 223; interest will accrue at a 7%

interest rate. . . .

PCS's motion for allowance of claim for breach of executory contract was served on the attorney for Farmacia Carro and the U. S. Trustee. No objections were filed and the motion was granted by court order dated August 25, 1994.

On September 8, 1994, Farmacia Carro filed a motion for reconsideration of the order allowing PCS's claim (Dkt.# 68). Farmacia Carro indicated that it did not respond to PCS's motion for allowance of claim because the case files were in storage during the relocation of offices of Farmacia Carro's counsel. Farmacia Carro argues that PCS's claim is a prepetition claim and based on PCS's failure to file a timely proof of claim, PCS's claim is time barred. Farmacia Carro indicates that it had a payment plan at the time of the filing of the bankruptcy petition but denies that it lawfully assumed the agreements with PCS in which case there has not been a post-petition breach of contract.

A hearing was scheduled for November 7, 1994. At said hearing, the court took the matter under advisement.

#### DISCUSSION

The Federal Rules of Bankruptcy Procedure provide that:

Any creditor or equity security holder whose claim or interest is not scheduled or scheduled as disputed, contingent, or unliquidated shall file a proof of claim or interest within the time prescribed by subdivision (c) (3) of this rule; any creditor who fails to do so shall not be treated as a creditor with respect to such claim for the purpose of voting and distribution.

Fed.R.Bankr.P. 3003(c)(2). Accordingly, a creditor that is scheduled as having a disputed claim is required to file a claim by the bar date. However, "[a] claim arising from the rejection of an executory contract . . . of the debtor may be filed within such time as the court may direct." Fed.R.Bankr.P. 3002(c)(4). This rule is made applicable to cases under Chapter 11 by Fed.R.Bankr.P. 3003(c)(3).

In the present case, PCS admits that the fraud committed by Farmacia Carro occurred prior to Farmacia Carro's bankruptcy, but a settlement agreement was reached on August 7, 1992 prior to the bankruptcy. Pursuant to the settlement agreement Farmacia Carro continued to participate in the member pharmacy agreement and allowed PCS to withhold funds toward settlement of the amount owed to PCS under the member pharmacy agreement. Upon filing bankruptcy, Farmacia Carro listed both the member pharmacy agreement and the agreement of August 7, 1992 as executory contracts.

A settlement agreement may constitute an executory contract in bankruptcy. In order for an agreement to constitute an executory contract, the agreement must be one "under which the obligations of both the debtor and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other." In re Three Star Telecast, Inc., 93 B.R. 310, 311 (D.P.R.

1988) (citations omitted).

In the present case obligations remained to be performed on the part of both parties. Pursuant to the member pharmacy agreement and the settlement agreement related to Farmacia Carro's prepetition default on the member pharmacy agreement, PCS was obligated to allow Farmacia Carro to continue to participate in the member pharmacy agreement and Farmacia Carro was obligated to continue to make payments on the settlement agreement, which entailed allowing PCS to withhold the specified sums from payments to Farmacia Carro. Both PCS and Farmacia Carro were under obligations, the non-performance of which, would have relieved the other from performance under the agreements. Prior to the rejection of the agreements in bankruptcy, if PCS had stopped allowing Farmacia Carro to submit vouchers under the member pharmacy agreement, Farmacia Carro would not have been obligated to continue the agreed upon payments of \$5,000 per cycle. If Farmacia Carro had discontinued the payments of \$5,000 per cycle to PCS, PCS would not have been obligated to allow Farmacia Carro to continue under the member pharmacy agreement. Accordingly, the settlement agreement of August 7, 1992, in conjunction with the member pharmacy agreement, constituted an executory contract between the parties in bankruptcy.

Farmacia argues that it did not assume the contracts with PCS because it did not follow the procedures for assumption of an

executory contract under the Bankruptcy Code. Thus, Farmacia Carro argues that because it had defaulted on the member pharmacy agreement prior to bankruptcy, notwithstanding the fact that it had reached a settlement agreement with PCS and was making payments on the agreement, PCS's claim accrued prior to bankruptcy and it was required to file its claim prior to the claims bar date.

Contrary to Farmacia Carro's assertions, in a Chapter 11 reorganization, executory contracts continue in force until they are expressly assumed or rejected. Consolidated Gas Elec. L. & P. Co. v. United Rys. & Elect. Co., 85 F.2d 799, 805 (4th Cir. 1936), *cert. denied*, 300 U.S. 663 (1937); Matter of Central Watch, Inc., 22 B.R. 561, 565 (Bankr. E.D. Wis. 1982). See also Matter of Greystone III Joint Venture, 948 F.2d 134, 141 (5th Cir. 1991), *cert. denied*, 113 S.Ct. 72 (1992) (if debtor in Chapter 11, neither assumes nor rejects lease, lease continues in effect). Thus, the executory contracts between Farmacia Carro and PCS continued in force until Farmacia Carro expressly rejected them in November of 1993.

The conduct of the parties reinforces the conclusion that the settlement agreement was sufficiently definite to be enforced and that it along with the member pharmacy agreement continued in force until Farmacia Carro expressly rejected them. Both parties honored the executory contracts between them after the bankruptcy petition was filed. Farmacia Carro continued to submit claims to PCS. PCS

continued to submit the payments received from the health plans to Farmacia Carro, less the amounts withheld toward the settlement agreement. Farmacia Carro admitted that it had a payment plan with PCS when Farmacia Carro filed bankruptcy. The numerous letters submitted as an exhibit at the hearing and particularly the letter of November 6, 1992, signed by an attorney for Farmacia Carro, indicates that the amount of the settlement was agreed upon, the down payment was agreed upon and the payments of \$5,000 per cycle were agreed to by Farmacia Carro. Farmacia Carro made the \$125,000 down payment and made the \$5,000 payments prior to and during bankruptcy. Farmacia Carro also filed an adversary proceeding against PCS regarding the bi-monthly payments of \$5,000 being withheld by PCS. Farmacia Carro ultimately requested dismissal of the adversary based on PCS's agreement to waive three payments and then continue the withholding as previously agreed. Farmacia Carro's assertion in its motion requesting an order rejecting the executory contracts further indicated that Farmacia Carro believed that it was bound by the settlement agreement. Farmacia Carro essentially indicated that it was rejecting the executory contract because it found the terms too onerous to maintain the agreement. Thus, the conduct of both parties suggested that the member pharmacy agreement and the settlement agreement continued in force after the filing of the bankruptcy petition.

The court finds that Farmacia Carro breached the member

pharmacy agreement between 1990 and 1992 by submitting false claims to PCS. The court also finds that prior to the time that Farmacia Carro filed bankruptcy, PCS and Farmacia had reached a settlement agreement, which provided for cure of Farmacia Carro's breach of the member pharmacy agreement. The parties were honoring this agreement when Farmacia Carro entered bankruptcy. Accordingly, PCS's claim against Farmacia Carro did not arise until Farmacia Carro rejected the executory contracts, including the settlement agreement of August 7, 1992, which occurred after the claims bar date. PCS filed its claim eight months later. As the court never gave PCS a deadline by which it was required to file its claim, based on rejection of the settlement agreement, the court finds that PCS's filing of its claim was timely.

#### ORDER

The order of August 30, 1994, granting PCS's motion for allowance of claim for breach of executory contract will stand. Farmacia Carro's motion to reconsider and set-aside the order of August 30, 1994 is denied. The court is explicitly finding that PCS's claim is timely, although Farmacia Carro may still object to

the amount of the claim.

IT IS SO ORDERED.

Dated at San Juan, Puerto Rico, this \_\_\_\_\_ day of December,  
1994.

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GERARDO A. CARLO  
U. S. Bankruptcy Judge