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Dismissal for Bad-Faith Filing under §1112(b)(1): Whose Burden Is It, Anyway?

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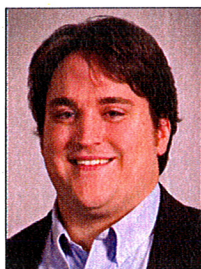
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for hearing and ruling on the motion. One amendment that has not received much press is the change from permitting dismissal or conversion "for cause" in the former §1112(b), to permitting conversion or dismissal "if the movant establishes cause" in the new §1112(b)(1).



Robert S. Brady

At first blush, this amendment may appear immaterial. Is it not axiomatic that any party seeking relief from the court must establish its entitlement to the relief sought? In jurisdictions that recognize a "bad-faith filing" as a "cause" for dismissal under §1112, this is less than clear.

Some "bad-faith filing" courts—in particular, the Third Circuit—have held that, upon a motion to dismiss for a bad-faith filing, the debtor bears the burden of establishing its good faith.¹

¹ See, e.g., *NMSBPCSLDHB LP v. Integrated Telecom Express Inc.* (In re Integrated Telecom Express Inc.), 384 F.3d 108, 118 (3d Cir. 2004).

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Restructuring Golf Courses and Country Clubs: Coping with Challenging Times

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Country clubs are caught in a perfect economic storm. From the perspective of the membership base, many club members have lost employment, and older members have seen substantial declines in retirement savings that translate into a change in their private club lifestyle. Additionally, private clubs in particular have suffered as social progress is made and many no longer see the need to join or stay at a club comprised exclusively of their religious and ethnic peers.



Laurence A. Hirsh

At the same time, reduced real estate values have caused lenders who previously believed that default was unlikely to fear that their mortgages may not be adequately covered by the value of the

underlying real estate. This change in membership demographics, the "club culture" and a glut in the marketplace of country clubs, are causing country clubs to confront an economic future of a reduction in the number of clubs to meet the declining demand.

Bear in mind that there are many constituents besides lenders and vendors that are being affected by course closures. Often programs are in place for prepaid membership. Many facilities also provide catering facilities that attract parties, weddings, bar mitzvahs and other major events that generally require deposits from customers. There is a different mindset between a "normal" vendor and a prospective bride who has made a 50 percent deposit on a wedding that is scheduled in one month. The "in house" pressure from members and catered affairs as well as the external pressure from creditors can be excruciating on club management. Jobs are also lost in all areas of operation, whether the club closes or cuts expenses to save money. If the community learns

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of a country club's financial woes, the country club will suffer the loss of anticipated revenues from potential new members, new affairs or even golf-related events as a stigma develops. In fact, fears of country club assessments will often drive out present membership due to fears that assessments under these conditions will be extraordinary.

There is no magic bullet to cure ailing country clubs. This article will provide an overview of issues and options, which

the boards of private clubs are loathe to assess membership for capital improvements or replacements. One of the justifications for this reluctance is that the balancing of a budget is often more important than maintaining or improving the product. After years of neglect, golf courses and country clubs are caught in a quandary of higher costs associated with maintenance too long delayed. In other scenarios, clubs will finance the payment of debt service with additional debt, without considering the fact that the perceived solution simply continues to deepen the "hole" and exacerbate the problem.

Declining membership and/or play/use of club. Now more than ever, clubs need to encourage facility use while competing intensively with other non-club activities. Clubs need to create ways to encourage use through quality offerings, price, programming and scheduling. The

Feature

are fact-sensitive for each country club. It will focus on four areas:

1. warning signals;
2. practical solutions and alternatives;
3. workout options; and
4. potential remedies and challenges in the bankruptcy system.

Warning Signs

Though indicators may vary, the following are some examples of warning signs of when a country club may be in financial trouble.

Excessive debt. Many clubs have the ability to generate positive (before debt service) cash flow. However, for a variety of reasons they have incurred substantial debt, which ultimately puts them "underwater." More often than not, excessive debt results from financing capital improvements (rather than assessing members), borrowing to the hilt during more fruitful times or simply overpaying for property or improvements. Like many businesses, golf courses and country clubs by nature are very debt-sensitive and are often unable to carry significant debt loads. In particular,

culture of the successful club is now a family environment and requires modern programs and facilities. A country club needs to provide more than merely golf. It should consider, for example, libraries, exercise rooms and a computer center.

Deals. Whether real or perceived, the need for special deals on rates and fees is a sure-fire sign of trouble and can surely reduce the perceived value in golf. Fee competition is so fierce now that many clubs are ignoring the cost of providing the product in favor of simply getting people on the course. Designed to protect market share, this practice can actually end up costing money due to increased stress on the golf course and the associated marketing costs to attract paying customers.

Facilities and maintenance. Despite the apparent unwillingness of members and daily-fee patrons to pay for it, they demand top conditions at all times. Not only do they expect manicured greens and fairways, but updated and clean dining and locker facilities and a high level of personal service. This not only costs money, but requires additional

¹ The author thanks Arthur Abramowitz of Cozen O'Connor in Cherry Hill, N.J., for contributions to this article on the specific legal elements of importance.

funds from operations to be set aside for replacing worn items and upgrading others. Many clubs ignore these line items to balance budgets, but they are even more critical in a competitive environment. When facilities appear worn, clubs lose their allure and patrons/members look elsewhere.

Practical Solutions

It should be made clear that the solutions to these problems are usually not easy. Typically, they take a "big swallow" on the part of club boards and owners that will directly impact their net income. The key element sought by members and patrons, as well as owners, is *value*. Value can mean two things:

1. To the golfer/patron, value equates to what he or she gets for the dues or fees. If he or she is satisfied with the experience and continues to use the facilities, then value is perceived to exist. If patrons look elsewhere, it is because value is not perceived to exist.
2. To the club owner, value refers to the value of the club upon sale and can infer either the property's value as a club or based on an alternative use.

Value to the golfer/patron is very tough to provide in a cost-conscious

environment like we are experiencing in 2009. To the property owner, value is a very different issue, as golf properties often represent something other than the highest and best use.

If the property can be developed more profitably for another use, the often inefficient use as a club is scrapped in favor of a more lucrative use, assuming appropriate zoning and entitlements can be achieved. This is often a vehicle for a struggling club to "land on its feet" and escape the golf business in an over-supplied market. In such situations, the potentially higher value for an alternative use can bail out the golf course/club operator and serve as a financial parachute.

However, when the club is restricted by zoning, covenants or other methods to continue as a golf facility, the value may be limited. The alternatives required are efficient use of the property as a club, possibly mixed with other uses, which comply. In either case, it is critical to understand the property's value in a most realistic sense to ensure that any decisions made are well informed and based on realistic market value estimates.

The first step to developing solutions is to recognize the problem. If

membership or play drops only slightly for three consecutive years, and the drop is annually attributed to "the market," and if nothing is done, it is probably too late to react. Conversely, if after a slight decline a course reacts by making improvements, enhancements or simply by applying a "fresh coat of paint," customers and members will notice, and a big step will be achieved on the competition. However, most clubs defer these actions until "better times," which often never come.

In some cases, it means repositioning the property, such as a private club allowing daily fee play or encouraging more outside functions. With a daily fee course, it may mean enhancing food and beverage options or eliminating them altogether. In some cases it could mean expanding or contracting facilities, depending on market dynamics.

In yet other cases, adding unconventional uses to the property, if allowed, such as a limited retail outlet in the clubhouse, or the subdivision and development of an outparcel may be possible to generate either rent or sale proceeds. In many instances, courses are finding excess land that can be developed

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Coping with Challenging Times for Golf Courses and Country Clubs

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into residential uses to generate revenue, reduce debt and allow for enhancement of facilities.

Debt is often the biggest problem clubs face. I have observed many instances of clubs that use cash flow (before debt service), only to be unable to handle their debt service, and this is typical with private clubs. Members, unwilling to absorb assessments to fund improvements, are satisfied deferring the payment for those improvements to the next generation. In some cases, the improvements attract members, but as older members move on and economic cycles transpire, invariably the club experiences new challenges. Many clubs today have impressive facilities but large debt, combined with declining membership.

Workout Options

The first workout option is to pay for any needed improvements through assessments and avoid debt. If it is too late to do that, there are a variety of alternatives as summarized:

- *Work with a bank to restructure debt and reduce payments.* In most cases, they are looking for ideas as well. They do not want to take back the property and be in the golf business.
- *If it is a private club, raise equity for debt reduction through equity membership.* This can give members a stake and sense of ownership and not only raise cash, but enhance the enthusiasm of the membership.
- *Member assessments for debt reduction.* This is not popular in any form but in some cases may be the only way out. A club will learn if it has "members" who take an ownership interest or simply "customers" who only care about their own individual monthly cost vs. the long term health of the club.
- *Dues and fees increases are never popular, but in many cases, dues are maintained at artificially low levels in the interest of either competition or politics.* The bottom line is that the product simply cannot be provided for less than its costs and many clubs are caught in this trap.
- *Rate incentives.* The reason for declining play/membership is often

poor playing and/or facility conditions. The inevitable budget cuts that occur when a club begins to struggle eventually lead to diminished quality and members/golfers look elsewhere. While this tactic often helps retain market share due to low cost, it can lead to long-term lower rates, even as costs increase. Sometimes rate incentives are necessary, but they must be implemented with extreme care and the knowledge that such incentives are temporary and will end on a prespecified date. There are many examples of deals and rate incentives that have been offered by clubs. The key is to avoid diminishing the value perceived in the process.

[M]any country club members ask why they would want to pay a club any appreciable amount if it is quite possible that the country club will close or be forced to liquidate. Ensuring an uninterrupted cash flow is critical in any business, and a bankruptcy filing may not advance the situation.

- *Highest and best use.* Sometimes, a club simply closes and sells the property for an alternative use. This can solve financial problems, but then the members/patrons have to find another place to play golf. The option of selling the property for development is one that can be available, but membership often has a distorted and unrealistic view of the value of the property for development. In today's environment of reduced property value and limited developer interest, this is less of an option, and in many cases, the rights to develop were given up when the club was being developed. Thus, many clubs are destined to remain as golf and recreational facilities, though possibly in a different form.
- *Operational changes.* In some cases, clubs have found that

outsourcing food and beverage or golf course maintenance operations have proven economical. It can reduce management headaches and potentially provide revenues for debt service or to enhance facilities.

Bankruptcy is a last resort in many cases, since some clubs will do whatever it takes to stay in business. However, it may also be the best option for some clubs, depending on circumstances to be covered later in this article. Preferably, a workout with the lender can be accomplished and the club can recover and move on.

If a club finds itself in a workout situation, in effect it becomes a partner with the lender. With declining property values and limited alternative uses as development has slowed, the bank is reluctant to take back the property. The club, usually seeking a way to continue operations, sometimes gets concessions from the lender and formulates a plan to weather the storm and hopefully turn things around. The club is often in a position of strength because of the lender's reluctance to foreclose on a property they will have trouble selling for the debt. Conversely, the lender may take an ownership interest or foreclose on the club if there is a perceived upside. This could come from a repositioning of the club, more efficient operations or consideration that the site could have value for future development when economic conditions are improved. The lender may also call for a change in management in order to protect its interest, and the membership would lose control. While foreclosures do occur, make no mistake: Banks do not want to be in the golf course business.

Bankruptcy Issues

Unfortunately, the Bankruptcy Code does not provide country clubs with a mulligan in the event that they are forced to file for bankruptcy protection. However, there are a number of bankruptcy-related issues that are somewhat unique to golf courses.

First, is the property "single asset real estate" as it is defined under 11 U.S.C. §101(51B)? If the golf course falls within this definition, a debtor may be provided with very little time to obtain a stay and reorganize. A

golf course debtor should carefully examine the definition to determine whether its operation falls outside of this definition. For example, does it provide catering and/or a restaurant and bar that is available for outside functions? Does it operate a retail golf shop? If so, these factors may remove the course from the gambit of single asset real estate restrictions as provided in the Code.

Second, country clubs frequently have members designated as "bondholders." Even though, in their minds, bondholder status provides members with a certain "ownership status," in the event of a bankruptcy, bondholders are normally merely general unsecured creditors, since it is an unusual case where bondholders perfect their interests with liens in a club's assets.

Third, country club members are also confronted with the unique issue of whether members are parties to an executory contract. If so, members would theoretically have rights to use the course in return for the payment of their dues and charges. Moreover, in a sale of a club, their contracts could be assumed and assigned. If, however, members pay to play at the beginning of a calendar year, and the club subsequently files for bankruptcy, management could take the position that the contracts are not executory, that the members have no right to play and that any members' claims would be prepetition claims.

Lastly, unless a country club has the consent of its lender for the use of cash collateral, proving that the lender is adequately protected may be difficult on several levels. In terms of the value of real estate, the recent plunge in real estate values has probably gutted or substantially reduced any property values. In terms of valuations, aside from comparables, any cash-flow analysis should take into consideration the fact that economic conditions have had marked effects on country club members, many of whom have lost their jobs as well as savings, investments and pensions. Moreover, from a Catch-22 perspective, many country club members ask why they would want to pay a club any appreciable amount if it is quite possible that the country club will close or be forced to liquidate. Ensuring an uninterrupted cash flow is critical in any business, and a bankruptcy filing may not advance the situation.

Conclusion

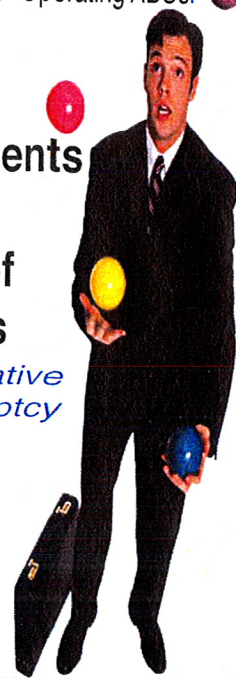
Hopefully this discussion has provided a useful summary on the practical and legal issues surrounding struggling golf courses and clubs and some of their options in turnaround, workout or bankruptcy. With those clubs that are owned by members, or where members have some bundle of rights relating to access to the property, the documentation of membership is most critical in assessing their future rights, along with the ownership structure of the club. They are complex businesses/properties and require consideration of all the relevant issues. As many clubs are governed by elected boards of anywhere from seven to 15 directors, one common problem is decentralized and fragmented leadership. In challenging times, the leadership requires more strength than ever and tough decisions need to be made that may not always be "politically" favorable. The governance of a club can often make the difference between demise and survival, and strong leadership is usually the determining factor. The fewer opinions, the better. ■

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