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Sub-Par Performers: Restructuring Challenges in the Golf Course Industry

James Patrick Shea, Moderator
Armstrong Teasdale LLP; Las Vegas

Hon. Bruce T. Beesley
U.S. Bankruptcy Court (D. Nev.); Reno

Holly E. Estes
Estes Law; Reno, Nev.

Jeffrey M. Reisner
Irell & Manella; Newport Beach, Calif.

Daniel R. Williams
Fenix Financial Forensics, LLC; Scottsdale, Ariz.

Sub Par Performers: Restructuring Challenges in the Golf Course Industry

Summary: The once booming golf course industry has resorted to bankruptcy as a way to address operational and liquidity issues. This panel explores the financial challenges facing America's golf courses and selected restructuring issues that debtors and creditors face in their attempts to reorganize.

I. Intro – state of the industry

- Number of golf course bankruptcy cases filed in 2015/2016

II. Land Use Restrictions

- The current owner or purchaser of a golf course may want to repurpose the course and use it for alternative purposes, such as residential homes. In that case, the owner/purchaser must be aware of land use restrictions that can complicate the decommissioning and repositioning of a closed golf course.

- Zoning. Golf courses may be zoned as commercial, recreational or green, open or park space. The majority of golf courses are zoned as open space, which does not permit residential development.

  - The development of a golf course into a residential use may require a rezoning of the land. If the golf course is in an undeveloped area, a new use might be welcomed due to tax revenue.

  - However, in areas that have been developed, residents may protest any plan to change a golf course. The biggest concerns are:

    - Loss of open space.
    - Decline in property values due to additional homes being built in the community and/or loss of view.
    - Concerns over traffic and noise that may result from additional development.
    - Neighbors may feel a sense of possessiveness towards the golf course, especially homes sold with a view of or promises relating to the golf course.

  - If the homeowners are successful in preventing the repurposing of a golf course, especially if the property is downzoned from residential to open space, the property owner may argue that this amounts to a taking of property without the payment of just compensation.

- CC&Rs. A community's covenant conditions and restrictions may contain express restrictions on use of a golf course. For example, covenants may require an owner of a golf course to continue to operate the golf course and/or keep it as a single parcel. When faced with such covenants, an owner may seek to change or nullify the covenants.

  - Some courts are reluctant to enforce affirmative covenants that restrict a property owner from using the property in a certain way. See 328 Owners Corp. v. 330 West 86 Oaks Corp., 8 N.Y.3d 372, 383 (N.Y. 2007) (setting forth three conditions that must be met in order for a covenant to run with the land: "(1) it must appear that grantor and grantee intended that the covenant should run with the land; (2) it must appear that the covenant is one 'touching' or 'concerning' the land with which it runs; (3) it must appear that there is 'privity of estate' between the promisee or party claiming the benefit of the covenant and the right to enforce it, and the promisor or party who rests under the burden of the covenant") (internal quotations omitted).

- Doctrine of Changed Conditions. That does not mean, however, that courts will allow any use that the property owner desires. Changed conditions sufficient to justify non-enforcement of an otherwise valid restrictive covenant must be so fundamental as to thwart the original purpose of the restriction.

  - "The doctrine of changed conditions operates to prevent the perpetuation of inequitable and oppressive restrictions on land use and development that would merely harass or injure one party without benefiting the other.... [It] is an equitable doctrine which stays enforcement of unreasonably burdensome restrictions on land use, notwithstanding an agreement between the parties specifying the intended duration of the restrictions." Cortese v. United States, 782 F.2d 845, 850–51 (9th Cir.1985) (citations omitted).

  - "We have previously applied the doctrine of changed conditions in the restrictive covenant context and have concluded that the changed conditions must be so fundamental that they thwart the original purpose of the restriction." Coury v. Robison, 976 P.2d 518, 520–21 (Nev. 1999); see also Western Land Co. v. Truskolaski, 88 Nev. 200, 495 P.2d 624 (1972); Murphey v. Gray, 84 Ariz. 299, 327 P.2d 751 (1958); Sandstrom v. Larsen, 583 P.2d 971 (Hawaii 1978); South Shore Homes Ass'n v. Holland Holiday's, 219 Kan. 744, 549 P.2d 1035 (1976).. For example, in Gladstone v. Gregory, 95 Nev. 474, 478 (Nev. 1979), this required a showing that the restriction was of no appreciable value to other property owners and that it would be inequitable or oppressive to enforce the restriction.

- "The respondents had the burden to show the changed conditions have so thwarted the purpose of the one-story limitation that it is of no appreciable value to other property owners and it would be inequitable or oppressive to enforce the restriction. Exchange Nat. Bank of Chicago v. City of Des Plaines, 32 Ill.App.3d 722, 336 N.E.2d 8 (1975). The purpose of the one-story limitation is not stated in the declaration. The trial court found the height restriction evidenced an intent to prevent observation from a higher elevation to the dwelling and surrounding areas of adjoining property. In so finding, the court apparently rejected appellants' theory that the purpose also included preservation of any view enjoyed by adjoining property owners. Although the purpose of the height restriction involves a question of fact, we doubt the reasonableness of the trial court's finding that view preservation comprised no part of that purpose. See Dickstein v. Williams, 93 Nev. 605, 571 P.2d 1169 (1977); King v. Kugler, 197 Cal.App.2d 651, 17 Cal.Rptr. 504 (1961); Foster v. Nehls, 15 Wash.App. 749, 551 P.2d 768 (1976). Appellants' view over respondents' home is neither panoramic nor of the highest quality, but it nevertheless exists, is of value to him, and should be protected. Cf. Sandstrom v. Larsen, supra (where view was diminished by matter not within homeowner's control, remaining view was all the more valuable and worthy of protection)

  Even assuming the height restriction was intended only to protect privacy and not view, the foregoing evidence of changed conditions utterly fails to show that purpose has been thwarted in any manner. The privacy benefits exist just as when the declaration was recorded. See Murphey v. Gray, supra. Neither the increased monetary value of the properties without the building height limitation nor the less stringent zoning regulations justify removal of the restriction. Western Land Co. v. Truskolaski, supra ; Murphey v. Gray, supra.

  Gladstone v. Gregory, 596 P.2d 491, 494 (Nev. 1979).

- ***Even though nearby avenues may become heavily traveled thoroughfares, restrictive covenants are still enforceable if the single-family residential character of the neighborhood has not been adversely affected, and the purpose of the restrictions has not been thwarted. Burden v. Lobdell,93 Ill.App.2d 476, 235 N.E.2d 660 (1968); Gonzales v. Gackle Drilling Company, 67 N.M. 130, 353 P.2d 353 (1960); Continental Oil Co. v. Fennemore, 38 Ariz. 277, 299 P. 132 (1931). Although commercialization has increased in the vicinity of the subdivision, such activity has not rendered the restrictive covenants unenforceable because they are still of real and substantial value to those homeowners living within the subdivision. West Alameda Heights H. Ass'n v. Board of Co. Com'rs, 169 Colo. 491, 458 P.2d 253 (1969); Burden v. Lobdell, supra; Hogue v. Dreeszen, 161 Neb. 268, 73 N.W.2d 159 (1955).

The case of Hirsch v. Hancock, 173 Cal.App.2d 745, 343 P.2d 959 (1959) as well as the other authorities relied upon by the **627 appellant (Key v. McCabe, 54 Cal.2d 736, 8 Cal.Rptr. 425, 356 P.2d 169 (1960); Strong .v Hancock, 201 Cal. 530, 258 P. 60 (1927); Downs v. Kroeger, 200 Cal. 743, 254 P. 1101 (1927)) are inapposite for in those cases the trial court found many changes within as well as outside the subdivision and concluded from the evidence that the properties were entirely unsuitable and undersirable for residential use and that they had no suitable economic use except for business or commercial purposes, and the appellate courts in reviewing those cases held that the evidence supported the findings and sustained the judgments of the trial courts.

On the other hand, in the case of West Alameda Heights, H. Ass'n v. Board of Co. Com'm, supra, the trial court decided that the changed conditions in the neighborhood were such as to render the restrictive covenants void and unenforceable. The appellate court reversed and held that the trial court misconceived and misapplied the rule as to change of conditions and said, 169 Colo. at 498, 458 P.2d at 256: 'As long as the original purpose of the covenants can still be accomplished and substantial benefit will inure to the restricted area by their enforcement, the covenants stand even though the subject property has a greater value if used for other purposes.' See also Rombauer v. Compton Heights Christian Church, 328 Mo. 1, 40 S.W.2d 545 (1931); Porter v. Johnson, 232 Mo.App. 1150, 115 S.W.2d 529 (1938); Finley v. Batsel, 67 N.M. 125, 353 P.2d 350 (1960); Southwest Petroleum Co. v. Logan, 180 Okl. 477, 71 P.2d 759 (1937); Burden v. Lobdell, supra.

Where the evidence is conflicting and the credibility of the witnesses is in issue, the judgment will not be disturbed on appeal if the evidence is substantially in support of the judgment of the lower court. Bangston v. Brown, 86 Nev. 653, 473 P.2d 829 (1970); Brandon v. Travitsky, 86 Nev. 613, 472 P.2d 353 (1970); *206 Havas v. Alger, 85 Nev. 627, 461 P.2d 857 (1969).

In another attempt to show that the restrictive covenants have outlived their usefulness, the appellant points to actions of the Reno city council. On August 1, 1968, the council adopted a Resolution of Intent to reclassify this 3.5-acre parcel from R-1 (residential) to C-1(b) (commercial). The council never did change the zoning, but the appellant contends that since the counsel did indicate its willingness to rezone, it was of the opinion that the property was more suitable for commercial than residential use. This argument of the appellant is not persuasive. A zoning ordinance cannot override privately-placed restrictions, and a trial court cannot be compelled to invalidate restrictive covenants merely because of a zoning change. Rice v. Heggy, 158 Cal.App.2d 89, 322 P.2d 53 (1958).

Even if this property is more valuable for commercial than residential purposes, this fact does not entitle the appellant to be relieved of the restrictions it created, since substantial benefit inures to the restricted area by their enforcement. West Alameda Heights H. Ass'n v. Board of Co. Com'rs, supra; **628 Cawthon v. Anderson, 211 Ga. 77, 84 S.E.2d 66 (1954).

Even if the alleged occurrences and irregularities could be construed to be violations of the restrictive covenants they were too distant and sporadic to constitute general consent by the property owners in the subdivision and they were not sufficient to constitute an abandonment or waiver. In order for community violations to constitute an abandonment, they must be so general as to frustrate the original purpose of the agreement. Thodos v. Shirk, 248 Iowa 172, 79 N.W.2d 733 (1956).

W. Land Co. v. Truskolaski, 495 P.2d 624, 626–28 (Nev. 1972)

- The owner of a golf course should therefore carefully review all CC&Rs prior to attempting to repurpose a property.

- Implied Restrictive Covenants. Even if there are no obvious restrictions on use, however, owners of golf courses should beware. Beyond restrictions that are explicitly recorded in CC&Rs, entitlement permits, development agreements and deeds, there may also be implied restrictive covenants.

    - In November 2014, the Washington Supreme Court addressed an appeal by a group of homeowners. The homeowners challenged the closure of the golf course and its modification to residential lots, arguing that they relied on advertising referencing the golf course when purchasing their homes, and sought to impose an equitable servitude on the property that would limit its use to a golf course. The court concluded that courts may require developers to provide amenities they marketed to potential buyers, even if those amenities are not formally documented in CC&Rs or deeds. Riverview Community Group v. Spencer & Livingston, et al., 181 Wash.2d 888 (Wash. 2014).

    - Similarly, in In re: Heatherwood Holdings, LLC, 746 F.3d 1206 (11th Cir. 2014), the 11th Circuit upheld a lower court's holding that the property at issue was subject to an implied restriction to be used only as a golf course, and the foreclosing lender was not entitled to market and sell the property as residential lots.

    - Under the Restatement (Third) of Property, to establish an equitable servitude, a party must show that (1) there was an express or implied representation, (2) it was reasonable for people to rely on that representation, (3) the people did rely, (4) the

reliance was reasonable, and (5) the establishment of an equitable servitude was in the interest of justice.

- Sale of Property Subject to Restrictive Covenants

  - The sale of property through a 363 sale does not necessarily eliminate implied restrictive covenants. In Skyline Woods Homeowners v. Broekemeier, 758 N.W. 2d 376, 392-93 (Neb. 2008), the Nebraska Supreme Court found that applicable case law had held that "interest" within the meaning of section 363 does not encompass implied restrictive covenants such as the one encumbering the golf course. In holding that the restrictive covenant did not constitute an "interest," the Nebraska Supreme Court affirmed the state district court's order that the implied covenant required the property to be used as a golf course.

- Water Rights. Water usage is critical to many golf courses, especially on the West Coast.

  - Water pumped from the Colorado River is apportioned according to a 1928 agreement, which annually allocates 15 million acre-feet among seven states.

  - During the California drought, water restrictions and rising water prices caused significant financial strain on golf courses. Some golf courses responded by allowing their courses to “go brown.”

  - The water usage on golf courses can be reduced by replacing turfed areas with less-thirsty forms of landscaping, using hi-tech irrigation systems, recycling water, and exploring plant species and maintenance practices that are better suited to local conditions. However, golfers may object to certain changes and these improvements may require a significant up-front investment.

IV. Cash Collateral.

- Security and Security Agreements.
    - Deed of Trust
    - Assignment of Rents
    - Commercial Security Agreement
        - Perfection of security interests
            - Recorded in the County where the real property exists
            - UCC-1 financing statement filed with Secretary of State
                - Time file continuation statement
                - Watch out for a name change of debtor where a perfected security interest can become unperfected in collateral acquired by the debtor more than 4 months after the name change. NRS 104.9503

- Do lender's security agreements sufficiently describe collateral, and do their security interests ride through (11 U.S.C. § 552).

- Commercial security agreements between parties must describe with sufficient detail the collateral that secures the transaction. The purpose of the financing statement is to provide third parties notice of the transaction.

- NRS 104.9504 provides that "a financing statement sufficiently indicates the collateral that it covers if the financing statement provides: (1) A description of the collateral pursuant to NRS 104.9108; or (2) An indication that the financing statement covers all assets or all personal property."

> NRS 104.9108 provides:
> 1. Except as otherwise provided in subsections 3, 4 and 5, a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.
> 2. Except as otherwise provided in subsection 4, a description of collateral reasonably identifies the collateral if it identifies the collateral by:
> (a) Specific listing;
> (b) Category;
> (c) Except as otherwise provided in subsection 5, a type of collateral defined in the Uniform Commercial Code;
> (d) Quantity;
> (e) Computational or allocational formula or procedure; or
> (f) Except as otherwise provided in subsection 3, any other method, if the identity of the collateral is objectively determinable.

3. A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.
4. Except as otherwise provided in subsection 5, a description of a security entitlement, securities account, or commodity account is sufficient if it describes:
(a) The collateral by those terms or as investment property; or
(b) The underlying financial asset or commodity contract.
5. A description only by type of collateral defined in the Uniform Commercial Code is an insufficient description of:
(a) A commercial tort claim; or
(b) In a consumer transaction, consumer goods, a security entitlement, a securities account or a commodity account.

- Ensure financing statement sufficiently describes all of the collateral listed in the commercial security agreement. If not, only collateral sufficiently described in financing statement is properly perfected.

- Some instructive cases are Far East National Bank v. United States Trustee (In re Premier Golf Properties, L.P.), 477 B.R. 767, 775 (9th Cir. BAP 2012); In re Wright Group, Inc., 443 B.R. 795, 802-03 (Bankr. N.D. Indiana 2011) (where the court found that revenue from a golf club's green fees and driving range fees did not constitute an "Account" or "General Intangible" because it was only a simulations transaction where no debt or monetary obligation was created.)

- Under §552(a) property acquired after the Petition Date is not subject to any lien resulting from a security agreement entered into by the Debtor prior to the case, except under §552(b) if the Debtor entered into a security agreement prior to the Petition Date that includes property acquired by the Debtor prior to the Petition Date and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired after the Petition Date to the extent provided by such security agreement.

  Read together, the provisions of §363(c)(2) and §552(b) protect a creditor's collateral from being used by a debtor post-petition if the creditor's security interest extends to one of the categories set out in §552(b). Far East Nat'l Bank v. United States Trustee (In re Premier Golf Properties, L.P.), 477 B.R. 767,771 (9th Cir. BAP 2012).

- The lender has the burden of establishing the existence and extent of its interest in the property it claims as cash collateral. Premier Golf Properties, 477 B.R. at 773; 11 U.S.C. §363(p)(2); In re Las Vegas Monorail Co., 429 B.R. 317, 328 (Bankr. D. Nev. 2010).
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    - it is the lender's burden to show that (1) its security agreement extends to a debtor's post-petition revenue from green fees, annual passes, tournaments, restaurant revenue including beverage cart and snack bar, golf lessons, junior clinics, and money generated by use of the driving range and (2) that the

green fees, annual passes, tournaments, restaurant revenue including beverage cart and snack bar, golf lessons, junior clinics, and money generated by use of the driving range are proceeds, products, rents or profits of its pre-petition collateral. *Premier Golf Properties,* 477 B.R. at 773; *In re Bering Trader, Inc.,* 944 F.2d at 501; *In re cafeteria Operators, L.P.,* 299 B.R. 400, 405 (Bankr. N.D. Tex. 2003).

- The Ninth Circuit BAP has articulated a general test for determining whether income from real property constitutes rents– If the income is produced by the real property, it is considered rents, but if the income is the result of services provided or the result of the specific business conducted on the property, then it does not constitute rents. Premier Golf Properties, 477 B.R. at 773 (citing In re Zeeway Corp., 71 B.R. at 211-12) (where the court held that gate receipts generated by post-petition races at the debtor's race track were not within the scope of rents subject to the creditor's deed of trust because the income was not produced by the occupancy or use of the real property, but by the services that the raceway provided.) The Panel in Zeeway, noted in dicta that income generated by a restaurant or retail store, although produced in part by the use of the real property upon which business is conducted, was the result of the services provided by the business, and therefore not rents. Zeeway, 71 B.R. at 211-12. The Panel in Premier Golf Properties properly determined that where generation of income is not produced from the land, but rather from services that are performed on the land, that revenue is not "rents." Premier Golf Properties, 477 B.R. at 774.

- Accordingly, where a golf course's revenue is derived from green fees, annual passes, tournaments, restaurant revenue including beverage cart and snack bar, golf lessons, junior clinics, and money generated by use of the driving range -- those revenues are generally the result of services provided by the debtor, rather than the property itself, and the post-petition revenue derived therefrom is not "rents" subject to any pre-petition security interest the lender may have had.

V. Filing for Bankruptcy

- Single Asset Real Estate. One issue that may arise in a bankruptcy case involving a golf course is whether the property is "single asset real estate" as defined under 11 U.S.C. § 101(51B). If the debtor falls within this definition, a debtor may have very little time to reorganize.

    - A "single asset real estate" case is defined generally as a case in which the debtor owns real property that is its sole asset and has no operations other than operating the real estate. In such a case, the debtor, within 90 days of the bankruptcy filing, must either start making payments to the secured creditor or file a plan that has a reasonable possibility of being confirmed within a reasonable time. 11 USC § 362(d)(3).

- Factors that may go into this determination include whether the debtor also provides other services, such as operating a retail golf shop or operating a restaurant and bar with catering available for outside functions.

- Ownership Interests. Some golf courses designate their members as "bondholders". However, while bondholder status provides members with certain ownership rights, they are still typically treated as unsecured creditors in a bankruptcy, since in most cases the bondholders do not have a perfected interest and lien in the debtor's assets.

- 363 Sale. One of the most common means of quickly disposing of assets is under section 363 of Chapter 11 bankruptcy code. A Chapter 11 debtor has the fiduciary duty to achieve the highest and best price for its assets.

    - A debtor golf course may be faced with the issue of whether members are parties to executory contracts. If the membership agreements are executory contracts, these agreements could be assumed or rejected upon a sale.

    - As noted above, the sale may not be free and clear of certain restrictive covenants.

VI. Structured Dismissals

- *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 197 L. Ed. 2d 398, 2017 U.S. LEXIS 2024, 85 U.S.L.W. 4115, 77 Collier Bankr. Cas. 2d (MB) 596, 63 Bankr. Ct. Dec. 242, Bankr. L. Rep. (CCH) P83,082, 41 I.E.R. Cas. (BNA) 1613, 26 Fla. L. Weekly Fed. S 495 (U.S. Mar. 22, 2017)

VII. Plans of Reorganization