



RESTRUCTURING THE PRIVATE CLUB

HOW TO DEAL WITH REFUNDABLE MEMBERSHIP LIABILITY

Private golf clubs are facing a tidal wave of challenges, from the prolonged economic downturn, to an aging population unable to continue playing the game, to a general decline in demand for golf, to financial hardships facing many of their members.

Additionally, many private non-equity golf clubs have on their books a relatively large liability from refundable membership deposits. In many cases, this liability is an anchor that drags down the club economically and causes it to be viewed by potential members as tainted and undesirable.

Historically, private non-equity clubs structured membership initiation fees as refundable deposits in order to attract members and enjoy certain tax benefits. However, refundable deposits now represent an economic burden that most clubs and buyers want to avoid. As a result, many private non-equity clubs are exploring ways to rid themselves of, or at least minimize, this economic burden.

The following example illustrates the problem that many clubs face:

Say five years ago that the membership deposit was \$50,000. At the end of 30 years,

the member would receive back 80 percent of the original deposit. If the member resigned before the end of 30 years, the membership would be placed on a seller's waiting list and sold on a 4-to-1 basis with unsold golf membership held by the club. Upon the resale that means the member would get back 80 percent.

Fast-forward to today and the membership deposit is only \$10,000 and the club is also forced to finance the deposit for new members. This means that for every fourth regular membership sold by the club, it must come out of pocket in order to repay the resigned member. Say there are also 150 members on the resigned list waiting for the club to resell their membership.

In this example, the club is effectively caught between a rock and a hard place. Prospective members are reluctant to join a club that has a substantial seller's waiting list, a significant economic liability on its books and a deficit balance between the selling price of new memberships and the refund owed to former members. Understandably, prospective buyers are not willing to purchase a membership for any sum.

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Most bought into the club with the expectation that it would remain healthy and viable and that they would receive back their membership deposit when they resigned. Existing members have different concerns.

Unfortunately, now these members are faced with the prospect that they will likely never receive a refund. Moreover, as the number of members declines, the dues paid by the remaining members in most cases continues to increase.

Finally, as this club explores ways to stabilize operations, some members may file lawsuits based on the club's actions. For example, if the club allows outside daily fee play as a way to increase revenues, members may sue claiming outside play is prohibited. If the club plans to shut down amenities to reduce costs, members may file suit claiming the club is obligated to keep all facilities open. Finally, if members are completely dissatisfied, they may organize a dues boycott and attempt to freeze-out club ownership.

Even if the members are successful, these actions still create an unhealthy situation where everyone stands to lose.

In response, many non-equity private clubs are exploring solutions to "cleanse themselves of the liability associated with the refundable membership deposit." However, as most private non-equity golf clubs are realizing, there are no easy solutions. Here are some of the alternatives:

A. Revise the Membership Program. The most logical and practical approach is for the club to revise its existing membership program to accomplish one of the following:

- Eliminate the membership deposit liability and provide that members are only entitled to receive a certain portion

(e.g. 80%) of the actual selling price of the membership.

- Retain the membership deposit liability, but create and sell new categories of memberships including, so-called non-refundable memberships that have no refund obligation associated with them and that, upon sale and issuance, do not trigger a refund obligation to the holders of memberships with a refund obligation.
- Retain the membership deposit liability, but allow members to resell their memberships on the open market with the buyer stepping into the shoes of the member.

All options carry with them some degree of potential exposure to the club and some degree of economic downside to the members.

B. Chapter 11 Reorganization. There are times when the most viable option is to restructure the membership program and reorganize the club through a Chapter 11 bankruptcy. In prior years, there was a negative stigma for clubs that went through bankruptcy. Today, that is not the case. In fact, many view a club that has gone through the process as having been cleansed, healthier and more economically viable.

In a Chapter 11 bankruptcy, the club, as the debtor, files a petition seeking a formal reorganization under applicable bankruptcy law. While the procedures, obstacles, hurdles and perils of Chapter 11 are significant, there are two primary exit strategies:

1. **Approved Plan of Reorganization.** One of the objectives of a Chapter 11 filing is to secure approval of a plan of reorganization. This may take on a variety of forms and seek to achieve a multitude of objectives, including the following:

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- A complete restructure of the club's membership program, including the elimination of the membership deposit liability with existing club ownership remaining substantially intact; or
- A sale of all or part of the club's assets to either a third-party purchaser or to an affiliate of the club, with the elimination of the club's membership deposit liability and a restructuring of the membership program.

2. **Section 363 Sale.** The sale by the club of its assets to a bona-fide third party and the elimination of its membership deposit liability.

This type of transaction is typically referred to as a Section 363 sale, named after the applicable provision in the federal bankruptcy code. A Section 363 sale generally involves a formal auction of the club. The sale may involve a "stalking horse" bidder who may be entitled to receive a "break up fee" if it is not the winning bidder.

The successful bidder is able to purchase the desired assets of the club and eliminate the undesirable and unwanted liabilities, including the membership deposit liability. The club determines the terms of the sale, subject to approval by the bankruptcy court.

What happens to the members in these circumstances? In most cases, most purchasers are reluctant to fall into the same trap and grant former members the ability to recover the membership deposit. More often than not, members can rejoin the club under different terms and conditions, which generally are more favorable than the terms and conditions offered to new members. Former members are allowed to rejoin for a modest non-refundable fee and the agreement to pay regular dues for a designated time in the future. In this manner, although they have forfeited their

membership deposits, former members can continue to play golf and enjoy the club facilities and amenities for a modest fee and the payment of normal and customary annual or other periodic dues. Similarly, the new owner creates a degree of good will with the former members and ensures there are adequate members to operate the club.

The bankruptcy process has countless pitfalls and obstacles, including potential tax liabilities associated with the elimination of the membership deposit liability. Moreover, the bankruptcy process is time consuming and potentially very expensive. The amount of legal fees involved in instituting, maintaining and successfully concluding a bankruptcy can be staggering, especially if there are legal disputes between the club and its members. As a result, for these and other reasons, extreme caution and care should be taken before embarking on a bankruptcy filing.

The duration of this economic crisis has caused many to conclude that this is not a short-term phenomenon. The golf industry has been hit especially hard and private clubs are not immune from the crisis.

While many private golf clubs are making minor adjustments and hoping this economic crisis is short-lived, others are taking immediate and decisive steps to make fundamental changes in case things do not get better. Almost everyone recognizes that some changes are necessary. The choice of the correct path to follow for each club can only be made after an exhaustive analysis of all of the facts and circumstances and weighing the pros and cons of each alternative.

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