Golf Project Ch. 11 Ruling Is A Deal Term Negotiation Lesson

By **Daniel Lowenthal and Maxwell Weiss** (August 29, 2022)

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The original owners of an ambitious Hawaiian golf project said Aloha, or hello, to new owners and Aloha, or goodbye, to old debt obligations.

The change in personnel and financing came as a result of an adversary proceeding in a bankruptcy case, where the initial owners of the Makaha Valley Country Club,[1] golf courses and related assets avoided obligations undertaken in connection with a loan extension provided by Tianjin Dinghui Hongjun Equity Investment Partnership, or the lenders.

On Aug. 8, the U.S. Bankruptcy Court for the District of Hawaii ruled in In re: Pacific Links U.S. Holdings Inc. that the extension was constructively fraudulent and thus avoidable under Section 548 of the Bankruptcy Code.[2]

The Facts

The owners' grand project was originally slated to include two golf courses, a country club and the development of individual plots surrounding the golf courses for residential construction. There had even been talk of Tiger Woods redesigning the courses.[3]

But the owners' plans never materialized and, when they couldn't repay their creditors, they filed for Chapter 11 bankruptcy.

Among the owner's creditors were the lenders, who had originally loaned money to an affiliate of the owners. That affiliate, in turn, provided the loan proceeds to the owners for use on the Makaha Valley project.

But when the loans came due and the owners' affiliate was unable to pay, the lenders extended the maturity date of the loans. The extension, however, required the owners' property — along with the personal property of the individual behind the project, Du Sha, and his wife Du Ran's property — to become collateral for repayment of the debt.

Despite the extension, the owners were unable to develop the property or raise enough capital to repay the loans, eventually leading to their bankruptcy filing.

In the adversary proceeding against the lenders, the owners argued the loan extension was constructively fraudulent, and thus avoidable under the Section 548 of the Bankruptcy Code.

Section 548

Under Section 548, a debtor-in-possession may avoid an obligation if the debtor received less than reasonably equivalent value in exchange for the obligation, and one of four elements was also present:

1. The debtor was insolvent on the date the transfer was made or obligation incurred, or the debtor became insolvent as a result of the transfer or obligation;

2. The debtor was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

3. The debtor intended to incur, or believed that the debtor would incur, debts that would be beyond its ability to pay as such debts matured; or

4. The debtor made the transfer or incurred the obligation to, or for, the benefit of an insider under an employment contract and not in the ordinary course of business.[4]

The court found both that the owners did not receive a reasonably equivalent value for their obligation, and that two of the additional conditions under Section 548 were met, specifically, the "unreasonably small capital" and the "inability to pay" conditions.

Reasonably Equivalent Value

The court reasoned that the loan extension was worth significantly less than what the owners had provided in return.

In exchange for a deferral of payment obligations for the owners' affiliate, the owners themselves — for the first time — became responsible for the loan's repayment and put their property up as collateral.

The court found significant that the owners were left with zero loan proceeds to actually develop their land. In the adversary proceeding, the lenders attempted to value the extension at $80 million for the owners.

But $74 million of that was projected sales of golf club memberships and net proceeds from the development of residential lots. The problem with the lenders' projection was that civil engineering had yet to be completed on the lots, and even the best projections indicated that two-thirds of the sales were expected to occur after the extended loans became due.

And lacking sufficient capital, the owners themselves ceased development work shortly after the extension. Accordingly, the court found the lenders' valuation of the loan extension unsupported and the consideration provided by the owners of significantly greater value.

Therefore, the lenders did not provide reasonably equivalent value.[5]

Unreasonably Small Capital

The court found that before the loan extension the owner had "only a small chance of obtaining enough capital to fund their operations." The extension agreements "eliminated that small chance ... Therefore, the 'unreasonably small capital' criterion [was] met." [6]

Inability to Pay

The court also found that at the time of the loan extensions, the owners "intended to incur, and believed they would incur, debts that they could not pay when due."

While the individual behind the owners painted a rosy picture to the lenders, the owners' own executives expressed concern that they would not be able to make the required loan payments.[7]

Outcomes and Lessons Learned

Because the loan extension did not provide reasonably equivalent value for the consideration provided by the owners, and the owners had unreasonably small capital and no ability to repay their obligations, the court found the transaction constructively fraudulent and avoidable under the Bankruptcy Code.[8]

But for golf fanatics visiting or living in Hawaii, the Chapter 11 case also brought some positive news.

The bankruptcy court approved the sale of the property at issue to a new owner that plans to restart development. Some are skeptical of this owner's ability to succeed where others have failed.[9] But the new owner is bullish about the future of golf in the Makaha Valley.

This case reinforces a standard lesson for those looking to do business with a financially distressed counterparty: Be extra careful when negotiating deal terms.

When the prospects of a borrower's insolvency are real, then any resulting bankruptcy filing will subject prior and existing loan transactions with the debtor to significant scrutiny.

Asset valuation is always a crucial consideration. Transactions that fail to provide distressed debtors with reasonably equivalent value will jeopardize the benefit of the bargain sought by the lender.

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[1] Makaha Valley Country Club, https://www.makahavalleycc.com/ (last visited August 25, 2022).

[2] See In re Pac. Links U.S. Holdings, Inc. , 21-br-00094, 2022 WL 3221232 (Bankr. D. Haw. Aug. 8, 2022).

[3] Max Rodriguez, Makaha Valley Resort Buyer Plans to Develop the Property, KHON2 (July 7, 2022), https://www.khon2.com/local-news/makaha-valley-resort-buyer-plans-to-redevelop-property/.

[4] 11 U.S.C § 548.

[5] In re Pac. Links U.S. Holdings, Inc. , 2022 WL 3221232 at *3-4.

[6] Id. at *9.

[7] Id. at *2, 10.

[8] Id. at *10.

[9] See supra Note 3.