

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

IN RE:

The Cliffs Club & Hospitality Group, Inc., *et al.*,¹ d/b/a The
Cliffs Golf & Country Club,

Debtors

The Cliffs Club & Hospitality Group, Inc., *et al.*, d/b/a The
Cliffs Golf & Country Club,

Movant,

v.

The Cliffs at Glassy Inc. (Valley) - Claim No. 1251;
Keowee Investment Group, LLC - Claim No. 1252;
LaBastide Management Group, LLC - Claim No. 1253;
Keowee Falls Investment Group, LLC - Claim No. 1254;
The Cliffs at Keowee Springs, LLC - Claim No. 1255;
The Cliffs at Mountain Park, LLC - Claim No. 1258;
The Cliffs at Mountain Park, LLC - Claim No. 1259;
Keowee Falls Investment Group, LLC - Claim No. 1261;
The Cliffs at Mountain Park, LLC - Claim No. 1262;
The Cliffs at Keowee Springs, LLC - Claim No. 1263;
Cliffs Management Services, LLC - Claim No. 1268;
LaBastide Management Group, LLC - Claim No. 1270;
LaBastide Management Group, LLC - Claim No. 1271;
The Cliffs at Glassy Inc. (Valley) - Claim No. 1272;
Environmental Leasing, LLC - Claim No. 1273; and
Cliffs Management Services, LLC - Claim No. 1274;

Respondents

CHAPTER 11

Case No. 12-01220

Jointly Administered

Contested Matter

¹ The Debtors, followed by the last four digits of their respective taxpayer identification numbers and Chapter 11 case numbers, are as follows: The Cliffs Club & Hospitality Group, Inc. (6338) (12-01220); CCHG Holdings, Inc. (1356) (12-01223); The Cliffs at Mountain Park Golf & Country Club, LLC (2842) (12-01225); The Cliffs at Keowee Vineyards Golf & Country Club, LLC (5319) (12-01226); The Cliffs at Walnut Cove Golf & Country Club, LLC (9879) (12-01227); The Cliffs at Keowee Falls Golf & Country Club, LLC (3230) (12-01229); The Cliffs at Keowee Springs Golf & Country Club, LLC (2898) (12-01230); The Cliffs at High Carolina Golf & Country Club, LLC (7576) (12-01231); The Cliffs at Glassy Golf & Country Club, LLC (6559) (12-01234); The Cliffs Valley Golf & Country Club, LLC (6486) (12-01236); and Cliffs Club & Hospitality Service Company, LLC (9665) (12-01237).

DEBTORS' FIRST OMNIBUS OBJECTION TO THE ALLOWANCE OF CLAIM NOS. 1251, 1252, 1253, 1254, 1255, 1258, 1259, 1261, 1262, 1263, 1268, 1270, 1271, 1272, 1273, AND 1274 FILED BY CLIFFS DEVELOPMENT COMPANY AFFILIATES

COME NOW The Cliffs Club & Hospitality Group, Inc. and its affiliated debtors in the above-captioned Chapter 11 cases, as debtors and debtors-in-possession (the "Debtors") and hereby file an omnibus objection (the "Objection") to the allowance of the claims filed by The Cliffs at Glassy Inc. (Valley) - Claim No. 1251; Keowee Investment Group, LLC - Claim No. 1252; LaBastide Management Group, LLC - Claim No. 1253; Keowee Falls Investment Group, LLC - Claim No. 1254; The Cliffs at Keowee Springs, LLC - Claim No. 1255; The Cliffs at Mountain Park, LLC - Claim No. 1258; The Cliffs at Mountain Park, LLC - Claim No. 1259; Keowee Falls Investment Group, LLC - Claim No. 1261; The Cliffs at Mountain Park, LLC - Claim No. 1262; The Cliffs at Keowee Springs, LLC - Claim No. 1263; Cliffs Management Services, LLC - Claim No. 1268; LaBastide Management Group, LLC - Claim No. 1270; LaBastide Management Group, LLC - Claim No. 1271; The Cliffs at Glassy Inc. (Valley) - Claim No. 1272; Environmental Leasing, LLC - Claim No. 1273; and Cliffs Management Services, LLC - Claim No. 1274 (collectively, the "Cliffs Development Company Affiliates"). In support of this Objection, the Debtors show the Court as follows:

I. Relief Requested

1. By this Objection, the Debtors respectfully request the entry of an order, pursuant to Section 502 of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 3007, disallowing the claims filed by the Cliffs Development Company Affiliates in the above-styled case.

II. Jurisdiction

2. This Court has jurisdiction over this Objection under 28 U.S.C. § 1334. Venue of this proceeding is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).

III. Background

3. On February 28, 2012 (the “Petition Date”), the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

4. On March 12, 2012, the United States Trustee appointed the Official Committee of Unsecured Creditors (the “Committee”) in these Chapter 11 cases pursuant to that certain Fourth Amended Appointment of Committee of Unsecured Creditors [Docket Entry No. 141]. No trustee or examiner has been appointed in these Chapter 11 cases.

5. The Debtors are authorized to operate their businesses as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

6. On April 10, 2012, the Court established May 31, 2012 (the “Claims Bar Date”) as the deadline for non-governmental-entity creditors wishing to assert pre-petition claims against the Debtors to file their proofs of claim with BMC Group, Inc., the Debtors’ claims and noticing agent [Docket Entry No. 278].

7. On May 31, 2012, the Cliffs Development Company Affiliates filed unsecured claims against the Debtors as follows (collectively, the “Cliffs Development Company Affiliates Claims”):

Claim Number	Name of Cliffs Development Company Affiliate	Name of Debtor	Proof of Claim Amount
1251	The Cliffs at Glassy, Inc. (Valley)	The Cliffs at Mountain Park Golf & Country Club, LLC	\$35,000.00
1252	Keowee Investment Group, LLC	The Cliffs at Keowee Vineyards Golf & Country Club, LLC	\$12,780,399.00
1253	LaBastide Management Group, LLC	The Cliffs at Keowee Vineyards Golf & Country Club	\$98,089.00
1254	Keowee Falls Investment Group, LLC	The Cliffs at Keowee Vineyards Golf & Country Club	\$450.00
1255	The Cliffs at Keowee Springs, LLC	The Cliffs at Keowee Vineyards Golf & Country Club	\$1,247.00
1258	The Cliffs at Mountain Park, LLC	The Cliffs at Walnut Cove Golf & Country Club, LLC	\$50,000.00
1259	The Cliffs at Mountain Park, LLC	The Cliffs at Walnut Cove Golf & Country Club, LLC	\$15,704,833.00
1261	Keowee Falls Investment Group, LLC	The Cliffs at Keowee Falls Golf & Country Club, LLC	\$16,669,860.00
1262	The Cliffs at Mountain Park, LLC	The Cliffs at Keowee Falls Golf & Country Club	\$517,812.00
1263	The Cliffs at Keowee Springs, LLC	The Cliffs at Keowee Falls Golf & Country Club	\$80.48
1268	Cliffs Management Services, LLC	The Cliffs at Keowee Springs Golf & Country Club, LLC	\$8,887,017.00
1270	LaBastide Management Group, LLC	The Cliffs at Glassy Golf & Country Club, LLC	\$855,693.00
1271	LaBastide Management Group, LLC	The Cliffs Valley Golf & Country Club, LLC	\$75,635.00
1272	The Cliffs at Glassy, Inc. (Valley)	The Cliffs Valley Golf & Country Club, LLC	\$86,617.00
1273	Environmental Leasing,	Cliffs Club & Hospitality	\$778.00

	Inc.	Service Company, LLC	
1274	Cliffs Management Services, LLC	Cliffs Club & Hospitality Service Company, LLC	<u>\$38,916,334.00</u>
		Total	\$94,679,844.48

8. The Debtors have reviewed the proofs of claim filed by the Cliffs Development Company Affiliates in these cases and their books and records, including without limitation the Cliffs Communities, Inc. 2012 Consolidated Trial Balance showing intercompany balances among the DevCos and the ClubCos (as defined below) as of February 29, 2012. This Objection is the result of the Debtors' review.

IV. Basis for Relief Requested

9. The books and records of the Debtors indicate that the Cliffs Development Company Affiliates Claims are not truly debt obligations. None of them are evidenced by any debt instruments. At most, they are reflected by accounting journal entries as intercompany payables. Accordingly, the claims are unenforceable against the Debtors, and should be disallowed or recharacterized as equity in the Debtors. Unless the Cliffs Development Company Affiliates Claims are disallowed as general unsecured claims and recharacterized as equity interests in the Debtors, these affiliates of the Debtors will receive a larger recovery than that to which they should be entitled.

10. Each of the Debtors is owned, directly or indirectly, by Cliffs Communities, Inc. ("CCI"). CCI has other subsidiaries and affiliates that on the Petition Date were dedicated to the development and sale of residential real estate, unimproved company lots and finished homes at a number of Cliffs communities. CCI and these non-debtor affiliates of the Debtors are generally referred to as "DevCos" while the Debtors are generally referred to as "ClubCos." Each of the

Cliffs Development Company Affiliates is a DevCo. As of the Petition Date, CCI was a sub-chapter S corporation and substantially all of its subsidiaries are disregarded entities for corporate tax purposes. James B. Anthony owns 79.12% of the equity of CCI.

11. The Debtors' books and records when presented on a consolidated basis net intercompany payables between the ClubCos and the DevCos and show a balance due by the DevCos and James B. Anthony to the ClubCos of **\$42,234,326.04**. When presented on an unconsolidated basis, the ClubCos intercompany payables journal indicates a ClubCo balance to the DevCos totaling \$94,679,844.48 and a balance from James B. Anthony and the DevCos to the ClubCos totaling \$136,914,170.52. The Cliffs Development Company Affiliates balance owed to the Debtors is composed of the following entries:

Name of Debtor	Name of Cliffs Development Company Affiliate	Intercompany Balance Owning to Debtor
The Cliffs at Glassy Golf & Country Club, LLC	Cliffs Management Service Co.	\$15,367,523.69
The Cliffs at Valley Golf & Country Club, LLC	Cliffs Management Service Co.	\$13,439,087.35
The Cliffs at Keowee Vineyards Golf & Country Club, LLC	Cliffs Management Service Co.	\$25,336,881.26
The Cliffs at Keowee Falls Golf & Country Club, LLC	Cliffs Management Service Co.	\$9,591,193.31
The Cliffs at Walnut Cove Golf & Country Club, LLC	Cliffs Management Service Co.	\$16,483,104.26
The Cliffs at Mountain Park Golf & Country Club, LLC	Cliffs Management Service Co.	\$7,292,597.54
The Cliffs at High Carolina Golf & Country Club, LLC	Cliffs Management Service Co.	\$2,430,864.58
The Cliffs at Glassy Golf &	Cliffs Real Estate	\$2,612,715.99

Country Club, LLC		
The Cliffs at Keowee Vineyards Golf & Country Club, LLC	Cliffs Real Estate	\$2,290,853.70
The Cliffs at Glassy Golf & Country Club, LLC	Cliffs Comm. Holding	\$162.98
The Cliffs Valley Golf & Country Club, LLC	Cliffs Property Management Group	\$2,151,567.67
The Cliffs at Keowee Vineyards Golf & Country Club, LLC	Cliffs Property Management Group	\$110,415.52
The Cliffs at Walnut Cove Golf & Country Club, LLC	Cliffs Property Management Group	\$20,279.71
The Cliffs at Glassy Golf & Country Club, LLC	Cliffs Property Management Group	\$80,141.70
Cliffs Club & Hospitality Service Company, LLC	Cliffs Property Management Group	\$817.76
The Cliffs at Glassy Golf & Country Club, LLC	Cliffs at Walnut Cove	\$1,048,576.49
The Cliffs at Keowee Falls Golf & Country Club, LLC	Cliffs at High Carolina	\$10,170.11
The Cliffs at Walnut Cove Golf & Country Club, LLC	Cliffs at Keowee Springs	\$64.20
The Cliffs at Keowee Vineyards Golf & Country Club, LLC	Cliffs at Walnut Cove	\$70,000.00
The Cliffs at Mountain Park Golf & Country Club, LLC	Cliffs at Mountain Park	\$4,203,082.80
The Cliffs at Glassy Golf & Country Club, LLC	Cliffs at Glassy	\$24,495,066.53
The Cliffs at Keowee Vineyards Golf & Country Club, LLC	Cliffs at Glassy	\$3,098,935.67
The Cliffs at Glassy Golf & Country Club, LLC	Keowee Investment Group	\$150,687.50

The Cliffs at Keowee Falls Golf & Country Club, LLC	LaBastide Management Group	\$394.00
The Cliffs at Walnut Cove Golf & Country Club, LLC	LaBastide Management Group	\$1,995.87
Cliffs Club & Hospitality Service Company, LLC	LaBastide Management Group	\$219,852.33
ClubCos	James B. Anthony	\$5,707,138.00
ClubCos	James B. Anthony	\$700,000.00
	Total	\$136,914,170.52

12. While the Bankruptcy Code does not expressly provide for the recharacterization of debt to equity, most of the appellate courts that have considered the issue, including the Fourth Circuit Court of Appeals, have determined that bankruptcy courts have the power to recharacterize what is ostensibly debt to equity based on their equitable authority under Bankruptcy Code Section 105 in a manner consistent with the priority scheme for the distribution of the debtor's assets found in Bankruptcy Code Section 726. The Fourth Circuit precedent is *In re Dornier Aviation*, 453 F.3d 225 (4th Cir. 2006) (Implementation of the Code's priority scheme requires a determination of whether a particular obligation is debt or equity and given the broad language of section 105(a) and the larger purpose of the Bankruptcy Code, a bankruptcy court's power to recharacterize is essential to the proper and consistent application of the Code.) and *In the Matter Of: Lothian Oil Inc. v. Lothian Oil Inc.*, 650 F.3d 539 (4th Cir., 2011) (recharacterization extends beyond insiders and is part of the bankruptcy courts' authority to allow and disallow claims under 11 U.S.C. § 502). *See also, In re Tiger Aircraft, LLC*, 2010 Bankr. LEXIS 2353, 7-13 (Bankr. N.D. W. Va. 2010); *Vieira v. AGM II, LLC (In re Worldwide Wholesale Lumber, Inc.)*, 378 B.R. 120, 125 (Bankr. D.S.C. 2007); *but see Carolina Shores, LLC*

v. Dixon (In re Daufuskie Island Props., LLC), 431 B.R. 649, 655-56 (Bankr. D.S.C. 2010) (recharacterization denied where debtor had executed a note with a fixed maturity date and other factors demonstrated denial was proper).

13. The Fourth Circuit has joined other circuits that use an eleven factor test, stating, “None of these factors is dispositive and their significance may vary depending upon circumstances.” *In re Dornier*, at page 233. The factors that a court may consider in determining whether it should recharacterize a claim include:

(1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation’s ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claim of outside creditors; (10) the extent to which the advances were used to acquire capital assets; (11) the presence or absence of a sinking fund to provide repayments. *AutoStyle Plastics*, 269 F.3d at 749-506. These factors all speak to whether the transaction ‘appears to reflect the characteristics of ... an arm’s length negotiation.’ *Id.* at 750 (quoting *Cold Harbor*, 204 B.R. at 915) (amendment in original). This test is a highly fact-dependent inquiry that will vary in application from case to case.

14. The application of these eleven factors to the Cliffs Development Company Affiliate claims reveals that all of the factors support the recharacterization of these claims to equity. For example, none of the Cliffs Development Company Affiliates Claims is based upon debt instruments, there is no maturity date, no security, no interest payments have ever been made, no interest accrued, and there exist no principal or interest repayment terms. The Cliffs Development Company Affiliates’ claims are more properly considered equity investments among affiliates of the Debtors whose ultimate owner, James B. Anthony, moved cash and capital assets between his various subsidiaries without documenting the transfers as loans.

15. Alternatively, as is demonstrated by the charts above indicating the level of overlapping claims of the ClubCos and the DevCos, the Debtors seek to offset the intercompany claims.

16. Alternatively, the Debtors seek to “equitably subordinate” these claims. See, Bankruptcy Code Section 510(c). *See, In re ASI Reactivation, Inc.*, 934 F.2d 1315 (4th Cir. 1991) (“Generally, equitable subordination involves a number of inquiries: 1) whether the claimant engaged in fraudulent conduct, 2) whether the conduct resulted in injury to creditors and 3) whether subordination would be consistent with other bankruptcy law.”)

17. Alternatively, the Debtors seek to “equitably disallow” these claims. *See, Adelphia Communications Corp. v. Bank of America NA (In re Adelphia Communications Corp.)*, 365 B.R. 24, 71-73 (Bankr. S.D.N.Y. 2007) *aff’d in relevant part*, 390 B.R. 64, 74-76 (S.D.N.Y. 2008) (equitable disallowance of claims is “permissible in those extreme circumstances – perhaps very rare – where it is necessary as a remedy”); *In re Washington Mutual Inc.*, 461 B.R. 200, 257 (Bankr. D. Del. 2011) (accepting rationale of Adelphia), *vacated in relevant part on nonsubstantive grounds*, 2012 WL 1563880, pages 31-35, Case No. 08-12229 (Bankr. D. Del. Feb. 24, 2012).

V. Reservation of Rights

18. The Debtors reserve the right to supplement this Objection and to subsequently object to the Cliffs Development Company Affiliates Claims on any other appropriate ground, whether or not stated herein. In addition, the Debtors reserve the right to object to any and all other claims filed in the Debtors’ cases, and any other claims asserted by the Cliffs Development Company Affiliates.

VI. Notice

19. Notice of this Objection has been provided to the Cliffs Development Company Affiliates and each other party entitled to notice, as listed in the certificate of service filed in connection herewith. In light of the nature of the relief requested, the Debtors submit that no other or further notice is necessary.

WHEREFORE, the Debtors respectfully request that this Court:

1. enter the proposed order attached hereto as Exhibit "A";
2. recharacterize the Cliffs Development Company Affiliates Claims as equity interests in the Debtors;
3. disallow or set off the Cliffs Development Company Affiliates Claims;
4. equitably subordinate the Cliffs Development Company Affiliates Claims;
5. equitably disallow the Cliffs Development Company Affiliates Claims; and
6. grant the Debtors such other and further relief as is just and proper.

[signature follows]

This 12th day of July, 2012.

/s/ Däna Wilkinson
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EXHIBIT "A"

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA**

Case No. 12-01220

**ORDER APPROVING DEBTORS' FIRST OMNIBUS OBJECTION TO THE
ALLOWANCE OF CLAIM NOS. 1251, 1252, 1253, 1254, 1255, 1258, 1259, 1261, 1262,
1263, 1268, 1270, 1271, 1272, 1273, AND 1274 FILED BY CLIFFS DEVELOPMENT
COMPANY AFFILIATES**

The relief set forth on the following pages, for a total of 4 pages including this page, is hereby **ORDERED**.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

IN RE:

The Cliffs Club & Hospitality Group, Inc., *et al.*,¹ d/b/a The
Cliffs Golf & Country Club,

Debtors

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CHAPTER 11

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Jointly Administered

Contested Matter

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**ORDER APPROVING DEBTORS' FIRST OMNIBUS OBJECTION TO THE
ALLOWANCE OF CLAIM NOS. 1251, 1252, 1253, 1254, 1255, 1258, 1259, 1261, 1262,
1263, 1268, 1270, 1271, 1272, 1273, AND 1274 FILED BY CLIFFS DEVELOPMENT
COMPANY AFFILIATES**

Upon the Objection (Docket Entry # _____) (the "Objection") of The Cliffs Club & Hospitality Group, Inc. and its affiliated debtors in the above-captioned Chapter 11 cases, as debtors and debtors-in-possession (the "Debtors"), requesting the entry of an order disallowing the claims filed by the Cliffs Development Company Affiliates in the above-styled cases, the Court having jurisdiction to consider the Objection and the relief requested therein; a hearing having been held on _____, 2012 to consider the Objection; due notice of the Objection and hearing having been given to all parties entitled thereto, as listed in the certificate of service attached to the Objection and filed with the Court; it appearing that no other or further notice need be provided; no objections having been filed or asserted; the Court having determined that the relief sought in the Objection is in the best interests of the bankruptcy estates, their creditors, and all parties in interest; and after due deliberation and sufficient cause appearing therefor, it is hereby ORDERED as follows:

1. The Objection is GRANTED.
2. Claim numbers 1251, 1252, 1253, 1254, 1255, 1258, 1259, 1261, 1262, 1263, 1268, 1270, 1271, 1272, 1273, and 1274 filed by the Cliffs Development Company Affiliates in the above-styled cases are disallowed as unsecured claims and are recharacterized as equity interests in the Debtors.
3. This Court shall retain jurisdiction to hear and determine all matters arising from the implementation of this Order.

AND IT IS SO ORDERED.

PREPARED AND PRESENTED BY:

/s/ Dána Wilkinson
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