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.**	**CHAPTER 11** **Case No. 12-01220** **Jointly Administered**

DEBTORS' RESPONSE IN OPPOSITION TO MOTION OF KEOWEE FALLS INVESTMENT GROUP, LLC FOR AN ORDER PURSUANT TO BANKRUPTCY RULE 3018(A)

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 (collectively, the "Debtors"), by and through undersigned counsel, and hereby respond (this "Response") to the Motion of Keowee Falls Investment Group, LLC ("KFIG") for an Order Pursuant to Bankruptcy Rule 3018(a) (the "KFIG 3018 Motion"), pursuant to which KFIG requests that this Court enter an order pursuant to Bankruptcy Rule 3018(a) temporarily allowing its claims for purposes of voting on the First Amended and Restated Joint Chapter 11 Plan filed by the Debtors and the Plan Sponsor dated June 30, 2012, as amended [Docket Entry Nos. 479 and

[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 (4293) (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).

616, Ex. A] (the "Plan").[2] As indicated by the signature of its counsel below, the Official Committee of Unsecured Creditors in these Chapter 11 cases (the "Committee") joins in this Response. In support of this Response, the Debtors respectfully represent as follows:

JURISDICTION AND VENUE

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

BACKGROUND

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

3. On March 12, 2012, the United States Trustee appointed the Committee 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.

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

5. A description of the Debtors' businesses, the reasons for filing these Chapter 11 cases, and the relief sought from this Court to allow for a smooth transition into operations under Chapter 11 are set forth in the Declaration of Timothy P. Cherry in Support of First Day Motions (the "Cherry Declaration"), which has been filed with the Court [Docket Entry No. 44]

6. On July 2, 2012, the Debtors filed the Plan and the First Amended and Restated Disclosure Statement to Accompany the First Amended and Restated Joint Chapter 11 Plan

[2] Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the Plan.

filed by the Debtors and the Plan Sponsor [Docket Entry No. 480] (the "Disclosure Statement").

7. On July 12, 2012, the Debtors filed the 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 "DevCo Claims Objection"), including objections to: (i) claim number 1254 filed by KFIG in the amount of $450.00; and (ii) claim number 1261 filed by KFIG in the amount of $16,669,860.00 (collectively, the "KFIG Claims") [Docket Entry Nos. 528 and 532]. As set forth in the DevCo Claims Objection, the "Cliffs Development Company Affiliates" include: KFIG; The Cliffs at Glassy Inc. (Valley); Keowee Investment Group, LLC; LaBastide Management Group, LLC; The Cliffs at Keowee Springs, LLC; The Cliffs at Mountain Park, LLC; The Cliffs at Walnut Cove, LLC; The Cliffs at Mountain Park, LLC; The Cliffs at Keowee Springs, LLC; LaBastide Management Group, LLC; LaBastide Management Group, LLC; Environmental Leasing, LLC; and Cliffs Management Services, LLC, each of which is a non-Debtor affiliate dedicated to the development and sale of real estate in and around the sites of the Debtors' golf and country clubs (these and other similar non-Debtor affiliates are generally referred to as the "DevCos").

RELIEF REQUESTED

8. The Debtors request that the KFIG 3018 Motion be denied and that the KFIG Claims not be temporarily allowed for purposes of KFIG voting on the Plan. Alternatively, the Debtors request that the KFIG Claims be estimated at $0 or such other amount as the Court deems proper for Plan voting purposes.

A. KFIG's Motion is Moot in the Absence of the Filing of any Timely Ballot.

9. As a threshold matter, the KFIG 3018 Motion is moot because KFIG failed to submit a ballot in order to cast a vote on the Plan by the August 1, 2012 voting deadline established by this Court's Order Approving Disclosure Statement and Fixing Time for Filing Acceptances or Rejections of Plan, Combined With Notice Thereof (the "Disclosure Statement Approval Order") [Docket Entry No. 478]. Consequently, even if this Court were to grant the KFIG 3018 Motion and thereby temporarily allow the KFIG Claims for purposes of voting on the Plan, KFIG has not timely submitted any ballot in order to cast a vote, provisional or otherwise, on the Plan. Accordingly, there is no vote to provisionally allow with respect to the KFIG Claims, rendering any such potential vote a nullity and the KFIG 3018 Motion moot.

B. KFIG Has Failed to Establish a Valid Claim.

10. Even if this Court determines that the KFIG 3018 Motion is not moot, and that the KFIG Claims should be temporarily allowed for voting purposes, the KFIG Claims should be temporarily allowed in the amount of $0 for voting purposes. The burden of proof in estimation proceedings rests squarely with the moving party. *See In re FRG*, 121 B.R. 451, 456 (Bankr. E.D.Pa. 1990). When estimating claims, bankruptcy courts enjoy wide discretion and may use whatever method is best suited to the contingencies of the case, so long as the procedure is consistent with the fundamental policy of chapter 11 that a reorganization "must be accomplished quickly and efficiently." *In re Adelphia Bus. Solutions, Inc.*, 341 B.R. 415, 422 (Bankr. S.D.N.Y. 2003). *Collier's* commentary on Bankruptcy Rule 3018(a) notes, "There is no guidance in Rule 3018 or the Code as to the test to be applied in determining a motion for temporary allowance." 9 *Collier on Bankruptcy*, ¶ 3018.01[5] (16th ed.).

1. KFIG has Failed to Provide Documents in Support of its Claims.

11. One starting point is Fed. R. Bankr. P. 3001(f), which states that a "proof of claim executed and filed in accordance with these rules shall constitute *prima facie* evidence of the validity and amount of the claim." If the creditor files its claim in accordance with the rules, it starts out with a presumption of validity. However, before the claim receives *prima facie* validity, it must be filed in accordance with the rules, particularly Rule 3001. Among other things, Rule 3001(c) provides that if a claim is based on a writing, that writing must be attached or a statement must be provided explaining why the writing cannot be attached. Several courts have held that merely attaching a summary which lists the name of the original creditor, the last four digits of the account number and the balance claimed to be owed does not meet the requirement that the writing be attached to the claim, thus depriving the claim of *prima facie* validity. *In re Tran*, 369 B.R. 312 (S.D. Tex. 2007); *In re Cox*, 2007 Bankr. LEXIS 4048 (Bankr. W.D. Tex. 2007). KFIG's proofs of claim are not accompanied by any documents that one might customarily expect to see to evidence an obligation to pay an amount of the magnitude of the KFIG Claims. Instead of attached copies of a promissory note, an invoice or other evidence of an enforceable obligation, the KFIG Claims are supported by a few cryptic pages of accounting documents. These accounting records consist, in the case of the proof of claim against The Cliffs at Keowee Vineyards Golf & Country Club, a one page document entitled Closing Period Balances, and in the case of the proof of claim against The Cliffs at Keowee Falls Golf & Country Club, a one page document entitled Closing Period Balances and four other pages entitled Detailed G/L History from Jan. 1, 2006 to February 28, 2012, General Ledger Detail Report, and two Detail by Source Reports.

2. KFIG's Claims, if any, Should Be Recharacterized as Equity.

12. The Debtors hereby incorporate the DevCo Claims Objection. As set forth therein, the books and records of the Debtors indicate that the KFIG Claims are more properly characterized as equity than true debt obligations of the Debtors. As further described below, the evidence shows that: (i) neither of the KFIG Claims is evidenced by any debt instruments; (ii) at most, the KFIG Claims are reflected by accounting journal entries as intercompany payables by and among the Debtors and the Cliffs Development Company Affiliates; and (iii) each of the factors that Courts consider to support recharacterization of purported debt claims to equity is evident here, supporting the recharacterization of the KFIG Claims to equity interests in the Debtors.

13. The Debtors have provided sufficient reasons in the DevCo Claims Objection to overcome any presumption that these proofs of claim are valid obligations of the Debtors. As a result, upon a hearing on the DevCo Claims Objection, the Debtors submit that KFIG will not be able to meet its burden of proof and accordingly, there is a substantial likelihood that the Court will recharacterize the KFIG Claims to equity interests in the Debtors or equitably subordinate or disallow the KFIG Claims. Thus, for the purposes of estimating the KFIG Claims for Plan voting purposes, the KFIG Claims should be valued at $0.

14. As set forth in the DevCo Claims Objection, most of the appellate courts, including the Fourth Circuit Court of Appeals, that have considered the issue of recharacterizing debt claims to equity have determined that bankruptcy courts have the power to recharacterize what is ostensibly debt to equity. The court's power to do so is based on its equitable authority under Bankruptcy Code Section 105 to take actions in a manner consistent with the priority scheme for the distribution of the debtor's assets pursuant to 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).

15. 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.

16. The application of these eleven factors to the Cliffs Development Company Affiliates claims reveals that all of the factors support the recharacterization of these claims (including the KFIG Claims) to equity.

17. On July 30, 2012, in furtherance of the DevCo Claims Objection, the Debtors conducted the deposition of KFIG by and through its designated representatives under Rule 30(b)(6) of the Federal Rules of Civil Procedure which is incorporated by reference into bankruptcy cases by Bankruptcy Rule 7030. With their consent, KFIG designated two representatives. Mr. James B. Anthony, who at all times has been the principal equity owner (holding at least 79.12% of the equity) of The Cliffs Communities, Inc. ("CCI") and which, in turn, is the 100% owner of KFIG, and of CCHG Holdings, Inc., which is one of the ClubCo Debtors and is also the upper tier parent of the remaining ClubCo Debtors testified. Mr. Timothy P. Cherry, the former Chief Financial Officer of The Cliffs Communities, Inc., and a former member of the board of directors of, and the former Chief Executive Officer of, the Debtors, also testified on KFIG's behalf.

18. Notably, Mr. Anthony confirmed under oath that there were no promissory notes attached to the proofs of claims filed by the Cliffs Development Company Affiliates (including KFIG) and further admitted that he was not aware of the execution of any promissory notes by the ClubCos to evidence an obligation to pay the intercompany payables that are the basis of the Cliffs Development Company Affiliates proofs of claim (Deposition Transcript of KFIG through its designated representative Mr. James B. Anthony, p. 51, lines 19 – 23, p. 79, lines 8 – 25 and p. 80, lines 1 - 3). When asked what record was made in the intercompany payables ledger when KFIG transferred capital assets to The Cliffs at Keowee Falls Golf & Country Club, Mr. Anthony replied: "I'm not sure. I don't know." When asked

whether he conducted an appraisal to determine the fair market value of the capital assets when he transferred them on the books from KFIG to The Cliffs at Keowee Falls Golf & Country Club to determine how much of a liability to create, Mr. Anthony replied: "I don't know." (Deposition Transcript of KFIG through its designated representative Mr. James B. Anthony, p. 29, lines 9 – 19). When asked whether at the time the intercompany payable accounts on which he based the Development Company Affiliates Claims arose and were tracked, the ClubCo transferee did not have cash to pay the transferor for the capital assets, Mr. Anthony replied, "I'm not sure." When asked why he didn't get a bank loan so that the ClubCo transferee could pay cash for the capital asset when it was transferred, Mr. Anthony replied: "I'm not sure. It could have been no bank would have loaned to us, but I'm not sure." (Deposition Transcript of KFIG through its designated representative Mr. James B. Anthony, p. 30, lines 18 – 22). When asked if he knew whether the ClubCo that received the capital asset from his development company affiliate had the ability to pay cash for that asset, Mr. Anthony replied: "I don't know." Mr. Anthony identified Mr. Cherry as the person who may know whether any of the Cliffs Development Company Affiliates including KFIG made a demand for payment of any of the intercompany payables that were owed by any of the ClubCo debtors. (Deposition Transcript of KFIG through its designated representative Mr. James B. Anthony, pp. 55, lines 23 – 25 and 56, lines 1 - 10).

19. Mr. Cherry admitted that to his knowledge, the Cliffs at Keowee Falls Golf & Country Club did not execute a promissory note in favor of KFIG when the intercompany payable was created or at any other time. (Deposition Transcript of KFIG through its designated representative Mr. Timothy P. Cherry, p. 22, line 18 – 25). Moreover, Mr. Cherry acknowledged, to the extent the intercompany payables are treated as debt and not equity, that

they were contingent on the completion of all development and construction and subordinated to the payment of third party claims. Mr. Cherry testified that it was always the intent that intercompany payables would be paid over the course of time once development and construction ceased stating: "So they were really subordinated to the other cash flow requirements between the entities, that's why the language in the [note in the income projections attached as Exhibit 3 to the Private Placement Memorandum] was to say there will be no payments back and forth during the pendency of these notes so that the note holders investing knew they weren't, if you will, taking care of an old problem; nor did they expect to be paid any time during the note offering, or the – again, the period of time the notes were outstanding, as originally projected." (Deposition Transcript of KFIG through its designated representative Mr. Timothy P. Cherry, p. 49, lines 9 – 18).

20. The testimony of Mr. Anthony further confirms that, with respect to the Cliffs Development Company Affiliates Claims (including the KFIG Claims): (i) there is no maturity date for any purported debt obligation, (ii) no security, (iii) no interest payments have ever been made, (iv) no interest has accrued, (v) the claims are merely reflected by accounting journal entries as intercompany payables by and among the Debtors and the Cliffs Development Company Affiliates, and (vi) there exist no principal or interest repayment terms. (Deposition Transcript of Mr. James B. Anthony, pp. 52, line 4 through 55, line 21). The testimony of Mr. Cherry likewise confirms that recharacterization of the intercompany payables from debt to equity is appropriate under governing law.

Q. At the time KFIG transferred the golf course to The Cliffs at Keowee Falls Golf & Country Club, why didn't CCI cause Keowee Falls Golf & Country Club to pay cash in an amount equal to the transfer amount, the $18 million that was placed on the intercompany payable amount?

A. I don't know, again, as stated, whether the club had that requisite cash at that point in time.

Q. Do you know if The Cliffs at Keowee Falls Golf & Country Club, at the time of the transfer, had the ability to obtain third-party arm's length financing to pay for that asset?

A. I don't know that. It is important though, I think to understand the global business model of what Jim Anthony envisioned and embraced as he created these communities and these clubs.

Q. Why don't you describe that so we have a clear understanding of it.

A. Well, this is my understanding of his goal. While recognizing each of these subsidiary companies exist for legal liability and their own organizational structure purposes, Mr. Anthony's vision was the creation of eight different communities but each sharing the right to use these various clubs and recognizing that at various time in the life cycle of the development there would be times when cash was required to build amenities, and then there would be other times when cash was provided and available from the generation of membership fees.

Q. Thank you for that explanation. Would it be fair to say that it really didn't matter to Jim Anthony whether cash moved from a Club Co to a development company affiliate at the time an asset was transferred because he controlled both sides of the transaction?

A. I think that certainly was a factor in the analysis. The other aspect dealt with the ability to obtain financing in a larger pool of assets as opposed to looking at each club standing – or each entity standing on its own for its financing purposes.

(Deposition Transcript of KFIG through its designated representative Mr. Timothy P. Cherry, pp. 17, lines 16 – 25 and 17, lines 1 – 25 and 18, lines 1 – 25 and 19, lines 1 - 6).

Mr. Cherry's testimony, in fact, could not be more clear that the claims are subject to recharacterization:

Q. There is no written obligation to pay interest on the intercompany payable amount?

A. Not to my knowledge.

Q. There's no written maturity date.

A. Not to my knowledge.

Q. Are there's no written agreement regarding any terms of repayment?

A. Not to my knowledge.

Q. There's no schedule of payments to be made?

A. Not to my knowledge.

Q. There are no default provisions?

A. Not to my knowledge.

Q. No collateral has been pledged to security for the intercompany payables between Keowee Falls Investment Group and The Cliffs at Keowee Falls Golf & Country Club?

A. Not to my knowledge.

Q. There is no security agreement relating to this intercompany payable?

A. Not to my knowledge.

Q. There's no mortgage, deed of trust, or security deed relating to this intercompany payable?

A. Not to my knowledge.

Q. Would it be true to say that there are no rates of interest payable on any of the intercompany payables between the DevCos and the ClubCo debtors?

A. I believe that's true.

Q. And there is no sinking fund to repay intercompany payables?

A. That is true.

Q. Would it be fair to say that The Cliffs at Keowee Falls Golf & Country Club has never made any payments to Keowee Falls Investment Group to satisfy any part of the intercompany payable?

A. I believe that's correct.

Q. And before filing the proofs of claim in the debtors' Chapter 11 cases, did any of the DevCos, including Keowee Falls Investment Group, make a demand for payment of any of the intercompany payables to any of the ClubCo debtors?

A. Not to my knowledge.

(Deposition Transcript of KFIG through its designated representative Mr. Timothy P. Cherry, pp. 23, lines 7 – 25, and 24, lines 1-11).

21. The CCI financial statements that were attached as exhibits to a private placement memorandum that was used to obtain $64,050,000 in secured financing from certain of the club members, were prepared on a consolidated basis, and therefore netted out the intercompany payables, leaving only what appeared to be a liability to affiliates and not

disclosing the $96 million in Cliffs Development Company Affiliate claims that have been filed in these Chapter 11 cases. Mr. Cherry testified, "Intercompany accounts in a combined balance sheet are eliminated." (Deposition Transcript of KFIG through its designated representative Mr. Timothy P. Cherry, p. 42, lines 1-11).

22. Furthermore, Mr. Cherry testified about the consolidated balance sheet of the ClubCo entities as of December 30, 2011 (which is Exhibit 2 to the private placement memorandum), as follows:

Q. The point is, there were approximately $137 million of intercompany payables owed by development company affiliates and Mr. Anthony to the ClubCos, and there were apparently approximately $94 or $95 million worth of intercompany payables owed by the ClubCos to The Cliffs Development Company Affiliates.

A. Yes.

Q. That's summarized on page 5 in front of that list. It's the listing of all of the claims added up, and when you net those two, you come up with a difference of about $42 million in favor of the ClubCos; is that right?

A. Yes.

Q. And assuming my math is right, that's generally consistent with the $42,288,000 number that appears in the September actual on the consolidated balances sheet for the ClubCos?

A. That's the intent, yes.

23. By presenting the information in this fashion, the presence of the Cliffs Affiliate Company Claims was obscured because the ClubCo statements reflected only as an asset the net amount of receivables from affiliates and did not disclose a significant liability of the ClubCos of about $94 or 95 million as now presented in the proofs of claim evidencing the Cliffs Company Affiliates Claims.

24. Portrayal of such information in that fashion is much more consistent with treating the Cliffs Company Affiliates Claims as equity. Debtors respectfully submit that given Mr. Anthony's significant ownership as a shareholder of The Cliffs Communities, inc. and his

role as a member of the board of directors of that entity, these claims if not recharacterized as equity should be equitably subordinated or equitably disallowed.

25. The KFIG Claims are more properly considered equity investments among affiliates of the Debtors whose ultimate owner, Mr. Anthony, moved cash and capital assets between his various subsidiaries without documenting the transfers as loans.

26. Accordingly, the Debtors respectfully submit that KFIG has failed to meet its burden of proof that the KFIG Claims are enforceable against the Debtors. Therefore, for the reasons set forth above, the KFIG Claims should be disallowed or recharacterized as equity in the Debtors or in the alternative should be equitably subordinated or equitably disallowed. Accordingly, the Debtors respectfully submit that the KFIG Claims should be estimated at $0 or such other amount as the Court deems proper for voting purposes.

NOTICE OF THIS RESPONSE

27. No trustee or examiner has been appointed in these Chapter 11 cases. Notice of this Response will be served pursuant to the Order Establishing Certain Notice, Case Management and Administrative Procedures [Docket Entry No. 121], and upon KFIG. The Debtors submit that, under the circumstances, no other or further notice is required.

NO PRIOR REQUEST

28. No previous request for the relief sought in this Response has been made to this Court or any other court.

WHEREFORE, the Debtors respectfully request that the KFIG 3018 Motion be denied and that this Court grant such other and further relief as the Court may deem just and proper.

Dated: August 3, 2012

Respectfully submitted,

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