IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
GRACEWAY	:	
PHARMACEUTICALS, LLC, *et al.*,	:	
	:	Case No. 11-13036 (PJW)
	:	
	:	(Jointly Administered)
	:	
	:	**Hearing Date: April 11, 2012, at 2:00 PM**
Debtors.	:	**Objections Due: April 3, 2012, at 4:00 PM**

OBJECTION BY THE INTERNAL REVENUE SERVICE TO THE FIRST AMENDED JOINT PLAN OF LIQUIDATION OF GRACEWAY PHARMACEUTICALS, LLC, ET AL.

The United States, on behalf of its Internal Revenue Service ("IRS"), by and through the undersigned attorneys, in support of its objection to First Amended Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, et al. [Docket No. 551] ("Plan"), avers as follows:

1. On September 29, 2011, the debtors filed voluntary bankruptcy petitions seeking relief under Chapter 11 of the Bankruptcy Code.

2. IRS has filed an amended claim against Graceway Pharmaceuticals, LLC, in the amount of zero.

3. IRS objects to Article XII of the Plan to the extent it fails to preserve the setoff and recoupment rights of the IRS. Confirmation of a plan does not extinguish setoff claims when they are timely asserted. United States v. Continental Airlines (In re Continental Airlines), 134 F.3d 536, 542 (3d Cir. 1998), cert. denied, 525 U.S. 929 (1998). Like other creditors, the United States has the common law right to setoff mutual debts. "The government has the same right

which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." United States v. Munsey Trust Co. of Washington, D.C., 332 U.S. 234 (1947) (citing Gratiot v. United States, 40 U.S. (15 Pet) 336, 370, 10 L.Ed. 759 (1841)); see also Amoco Prod. Co. v. Fry, 118 F.3d 812, 817 (D.C. Cir. 1997). This right – "which is inherent in the federal government – is broad and 'exists independent of any statutory grant of authority to the executive branch.'" Marre v. United States, 117 F.3d 297, 302 (5th Cir. 1997) (quoting United States v. Tafoya, 803 F.2d 140 (5th Cir. 1986)). Hence, the United States can setoff mutual prepetition debts and claims as well as postpetition debts and claims. Zions First Nat'l Bank, N.A. v. Christiansen Bros. (In re Davidson Lumber Sales, Inc.), 66 F.3d 1560, 1569 (10th Cir. 1995); Palm Beach County Bd. Of Pub. Instruction (In re Alfar Dairy, Inc.), 458 F.2d 1258, 1262 (5th Cir.), cert. denied, 409 U.S. 1048 (1972); Mohawk Indus., Inc. v. United States (In re Mohawk Indus., Inc.), 82 B.R. 174, 178-79 (Bankr. D. Mass. 1987). The Plan makes no provision for these rights. Such treatment is impermissible, because Section 553 of the Bankruptcy Code preserves the right of setoff in bankruptcy as it exists outside bankruptcy, Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 18 (1995), neither expanding nor constricting it, United States v. Maxwell, 157 F.3d 1099, 1102 (7th Cir. 1998). "[T]he government of the United States suffers no special handicap under § 553 of the Bankruptcy Code," id. at 1103, that alters this principle. Moreover, because "[s]etoff occupie[s] a favored position in our history of jurisprudence," Bohack Corp. v. Borden, Inc., 599 F.2d 1160, 1164 (2d Cir. 1979), courts do not interfere with its exercise absent "the most compelling circumstances." Niagra Mohawk Power Corp. v. Utica Floor Maintenance, Inc. (In re Utica Floor Maintenance, Inc.), 41 B.R. 941, 944 (N.D.N.Y. 1984); see also New Jersey Nat'l Bank v. Gutterman (In re Applied Logic Corp.), 576 F.2d 952 (2d Cir. 1978) ("The rule allowing setoff ... is not one that

courts are free to ignore when they think application would be unjust."). Compelling circumstances generally entail criminal conduct or fraud by the creditor. In re Whimsy, Inc., 221 B.R. 69 (S.D.N.Y. 1998). No such compelling circumstances are present here, and accordingly, the Plan must provide for and preserve the government's setoff rights. Failure to do so violates section 1129(a)(1). ("The court shall confirm a plan only if ... the plan complies with the applicable provisions of this title".)

4. The IRS objects to Article II, section 2.5.2 of the Plan to the extent the Plan purports to set an administrative claims bar date for taxes described in 11 U.S.C. Section 503(b)(1)(B) and (C) in violation of Section 503(b)(1)(D) of the Bankruptcy Code.

5. The IRS objects to Article IX, section 9.3 of the Plan to the extent the IRS is prohibited from amending its claims without first seeking authorization from the Bankruptcy Court. Moreover, the IRS objects to the automatic disallowance of its claims if it has failed to obtain Bankruptcy Court approval prior to the filing of the amended claims.

WHEREFORE, IRS respectfully requests that the Court deny confirmation of the Plan and grant such other and further relief as the Court deems necessary and just.

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Dated: April 3, 2012

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AFFIDAVIT OF SERVICE

I, Marie Steel, an employee in the Office of the United States Attorney for the District of Delaware, hereby attest under penalty of perjury that on April 3, 2012, a copy of the **OBJECTION BY THE INTERNAL REVENUE SERVICE TO THE FIRST AMENDED JOINT PLAN OF LIQUIDATION OF GRACEWAY PHARMACEUTICALS, LLC, ET AL.** was served, as indicated, upon:

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