

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

GRACEWAY PHARMACEUTICALS,
LLC., *et al.*,¹

Debtors.

Chapter 11

Case No. 11-13036 (PJW)
Jointly Administered

Related to Document No. 551

**LIMITED OBJECTION OF CARDINAL HEALTH TO
CONFIRMATION OF THE DEBTORS' AMENDED CHAPTER 11
PLAN OF LIQUIDATION AND RESERVATION OF RIGHTS**

Cardinal Health (“Cardinal”)², by and through its undersigned counsel, hereby files this limited objection and reservation of rights (the “Limited Objection”) pursuant to sections 105(a), 553(a), and 1129(a) of title 11 of the United States Code with respect to the Amended Chapter 11 Plan of Liquidation [Docket No. 551] (the “Plan”) of the above captioned debtors (the “Debtors”). In support of the Limited Objection, Cardinal respectfully states as follows:

¹ The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are: Graceway Pharma Holding Corp., a Delaware corporation (9175), Case No. 11-13037 (PJW); Graceway Holdings, LLC, a Delaware limited liability company (2502), Case No. 11-13038 (PJW); Graceway Pharmaceuticals, LLC, a Delaware limited liability company (5385), Case No. 11-13036 (PJW); Chester Valley Holdings, LLC, a Delaware limited liability company (9457), Case No. 11-13039 (PJW); Chester Valley Pharmaceuticals, LLC, a Delaware limited liability company (3713), Case No. 11-13041 (PJW); Graceway Canada Holdings, Inc., a Delaware corporation (6663), Case No. 11-13042 (PJW); and Graceway International, Inc., a Delaware corporation (2399), Case No. 11-13043 (PJW). The mailing address for Graceway Pharmaceuticals, LLC is 340 Martin Luther King Jr. Blvd., Suite 400, Bristol, TN 37620 (Attn: John Bellamy). On October 4, 2011, Graceway Canada Company filed an application in the Ontario Superior Court of Justice (Commercial List) pursuant to the Courts of Justice Act, R.S.O. 1990, c. C. 43.

² As used herein, the term “Cardinal Health” means the following affiliated operating companies and subsidiaries of Cardinal Health, Inc., an Ohio corporation (“CHI”): Cardinal Health 3, LLC; Cardinal Health 104 LP; Cardinal Health 107, Inc.; Cardinal Health 107, LLC.; Cardinal Health 108, Inc.; Cardinal Health 110, Inc.; Cardinal Health 112, LLC; Cardinal Health 113, LLC; Cardinal Health 411, Inc.; Borschow Hospital & Medical Supplies, Inc. Under the Agreements (defined herein), CHI may designate any other subsidiary as “Cardinal Health”.

BACKGROUND

1. On September 29, 2011 (the "Petition Date"), the Debtors commenced these bankruptcy proceedings by filing voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code").

2. After filing for bankruptcy protection, the Debtors pursued a sale of substantially all of their assets pursuant to section 363 of the Bankruptcy Code. On November 22, 2011, an Order was entered by this Court approving a sale to Medicis Pharmaceutical Corporation, LLC (the "Sale").

3. On February 28, 2012, the Debtors filed the Plan, amending an earlier version. The Plan is a liquidating plan. The confirmation hearing is currently set for April 11, 2012.

4. Prior to the Petition Date, in the ordinary course of business, Cardinal and the Debtor Graceway Pharmaceuticals, LLC ("Graceway") entered into the Distribution Services Agreement (the "DSA") and the Cardinal Health Wholesale Purchase Agreement (the "WPA", and collectively with the DSA, the "Agreements").³ In summary, the DSA provided that Cardinal would provide distribution services to Graceway in exchange for a fee. The WPA provided that Cardinal would purchase pharmaceutical products from Graceway for resale to various entities, including, but not limited to, hospitals, supermarkets, pharmacies, nursing homes, and clinics.

5. The business relationship between Cardinal and Graceway created a series of ongoing mutual payment and credit obligations between the parties. Cardinal incurred payment

³ Cardinal anticipates filing such Agreements, which contain commercially sensitive information, under seal in connection with a motion for authorization to exercise setoff rights. Cardinal expects to file such motion prior to the confirmation hearing

obligations to Graceway for the ongoing purchase of product, while Graceway incurred payment and credit obligations to Cardinal for, among other things, distribution service agreement fees, Medicaid/Medicare rebates, chargebacks and product return credits. In the ordinary course of their dealings, Graceway settled such payment and credit obligations by issuing credit memos to Cardinal, who applied such credit memos against outstanding amounts owed to Graceway.

6. Prior to the Petition Date, Cardinal purchased pharmaceutical products from Graceway for which some payments remain outstanding (the “Graceway Prepetition Claim”). Similarly, Graceway issued to Cardinal prepetition credit memos which remain unapplied. On December 22, 2011, Cardinal filed a proof of claim (“Claim No. 144”) with respect to its prepetition claims. The obligations owed to Cardinal from Graceway, as set forth in Claim No. 144, are valid and enforceable obligations arising prepetition in the ordinary course of business between the parties (the “Cardinal Prepetition Claim”). Consistent with the course of dealings between the parties, its contractual rights under the Agreements and Section 553 of the Bankruptcy Code, Cardinal believes it may setoff the Cardinal Prepetition Claim against the Graceway Prepetition Claim.

7. After the Debtors filed for bankruptcy and up to the time of the Sale, Cardinal and Graceway continued their course of dealings under the terms of the Agreements. As a result, Cardinal owed amounts to Graceway on account of post-petition purchases of pharmaceutical products (the “Graceway Post-Petition Claim”) and Graceway owed certain amounts to Cardinal on account of distribution fees, chargebacks, rebates and product returns (the “Cardinal Post-Petition Claim”). It is Cardinal’s position that the Cardinal Post-Petition Claim, which is entitled to administrative claim status, may be setoff against the Graceway Post-Petition Claim.

8. Effective December 31, 2011, the Debtors rejected the Agreements, as they were not part of the Sale. Thereafter, Cardinal filed proofs of claim ("Claim Nos. 214 and 215", which are identical) asserting rejection damages. Cardinal believes that under applicable case law its rejection damages claim should be fully allowed and also can be setoff against the Cardinal Prepetition Claim.

9. In addition to Cardinal's setoff rights based upon the parties' course of dealings and their contractual rights which are preserved under section 553 of the Bankruptcy Code, Cardinal asserts its right of recoupment. The amounts owed to Cardinal by Graceway arise from the same transactions as the obligations of Cardinal to Graceway, and all such transactions were made pursuant to the Agreements.

LIMITED OBJECTION

10. Cardinal files this Limited Objection because certain provisions of the Plan might be construed as limiting Cardinal's setoff rights (and, as necessary, recoupment rights). This Limited Objection is being filed as a protective measure to ensure that Cardinal's rights are not prejudiced under the Plan.

11. As set forth above, Cardinal and Graceway were parties to the Agreements which gave rise to certain pre and post-petition obligations. Cardinal posits that pursuant to the Agreements and in light of the parties' course of dealing, the prepetition obligations owed by the parties to each other are subject to the right of setoff, which section 553(a) of the Bankruptcy Code preserves.⁴ In addition, to the extent applicable, Cardinal asserts that recoupment rights also exist.⁵

⁴ Section 553(a) of the Bankruptcy Code provides:

Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that

12. The Third Circuit Court of Appeals made it clear that rights of setoff are preserved in bankruptcy and do not end at confirmation. *See In re Continental Airlines*, 134 F. 3d 536, 541-42 (3rd Cir. 1998) (“We recognize that a right of setoff is preserved under § 553 in a bankruptcy proceeding. . .”). But the Plan, arguably, may circumvent Cardinal’s setoff and recoupment rights. For example, Section 12.6 of the Plan provides that “all Entities . . . shall be precluded and permanently enjoined . . . from . . . the enforcement, attachment, collection or recovery by any manner or means . . . any Claim, Interest or any other right or claim against the Debtors. . .” This broad language could be construed as enjoining Cardinal from asserting setoff or recoupment rights, which would be in contravention of section 1129(a)(1) of the Bankruptcy Code. Section 1129(a) provides, in pertinent part, that “[t]he court shall confirm a plan **only if** all of the following requirements are met: (1) The plan complies with the applicable provisions of this title. . . .” (emphasis added). 11 U.S.C. §1129(a)(1). Since setoff (and recoupment) rights are preserved in bankruptcy, if the effect of this Plan provision is to eliminate these right, then the Plan cannot be confirmed.⁶ At best, the Plan is unclear whether setoff and recoupment rights are preserved. The Plan or confirmation order must be clear they are preserved. Otherwise, it is Cardinal’s position that the Plan cannot be confirmed.

arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . .

See Citizens Bank of Maryland, 516 U.S. at 20 (As a general rule, “any right of setoff that a creditor possessed prior to the debtor’s filing for bankruptcy is not affected by the Bankruptcy Code. . .”). This Court has previously held that a rejection damages claim can be setoff against a prepetition debt owed to a debtor. *CDI Trust v. U.S. Elec., Inc. (In re Commun. Dynamics, Inc.)*, 382 B.R. 219 (Bankr. D. Del. 2008).

⁵ See Third Circuit decision in *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir. 1984) (holding that recoupment applies when mutual obligations arise from the same transaction, but due to the timing of the obligations, setoff cannot be applied under section 553 of the Bankruptcy Code). Here, all of the amounts due to either party arise out of the Agreements.

⁶ Cardinal notes that Section 15.11 of the Plan expressly preserves the Debtors’ setoff and recoupment rights.

13. Of equal concern is Section 5.5 of the Plan, which describes the treatment of General Unsecured Claims (as defined in the Plan). Under Section 5.5, Holders of General Unsecured Claims will receive a pro rata share of “Other Available Cash” which will be “in full satisfaction, settlement and release” of their claims. Again, without further clarification, it could be argued that this limits Cardinal’s recovery on its unsecured claims and effectively eliminates any setoff or recoupment rights. On the same basis as stated above, this Plan ambiguity must be clarified; otherwise, the Plan should not be confirmed because it does not comply with section 1129(a)(1).

14. A related concern is that Section 6.6 of the Plan defines General Unsecured Claims as including rejection claims. Accordingly, the same issues regarding Sections 12.6 and 5.5 of the Plan with respect to its other unsecured claims, apply to Cardinal’s rejection claim. Cardinal believes it has a substantial rejection damages claim and its ability to setoff such claim should not be eliminated by operation of the Plan.

15. The release provisions of the Plan also are problematic. Section 12.8 of the Plan provides for “Releases by Holders of Claims and Interests.” Like the injunction contained in Section 12.6 of the Plan, this release could be construed to prejudice Cardinal’s setoff (and recoupment) rights. The operative language is: “each present and former holder of a Claim or an Interest will be deemed to release forever, waive and discharge any and all Claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities . . . against any Creditor Releasee”. “Creditor Releasee” is defined under Section 1.43 of the Plan to include, among others, (i) agents of the Debtors (including their estates and beneficiaries) and (iii) the Liquidating Trustee.

16. Arguably, this release language could be construed as limiting Cardinal's claims and recovery by, among other things, precluding its rights of setoff (and recoupment) against amounts owed to the Debtors. It would be completely improper to use a debtor release to effectuate what the Bankruptcy Code prohibits – extinguishing setoff rights.

17. Additionally, Section 12.8 of the Plan purports to release claims against third parties. Cardinal is concerned that this may be construed as protecting parties entitled under the Plan to the proceeds of estate property, including the receivable owed by Cardinal. Because the proceeds from the mutual obligation owing by Cardinal to Graceway under their preexisting relationship will be distributed to a third party pursuant to the Plan should not result in Cardinal's setoff rights being eviscerated. If that is the intended meaning, Cardinal objects to the third party releases. In *Washington Mutual, Inc.*, Judge Walrath stated: “[w]hile the Third Circuit has not barred third party releases, it has recognized that they are the exception, not the rule.” 442 B.R. 314, 352 (Bankr. D. Del. 2011) (citing *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 212-14 (3d Cir. 2000), for the proposition that “non-consensual releases by a non-debtor of other non-debtor third parties are to be granted only in ‘extraordinary cases.’”).

18. Section 12.8 of the Plan needs to be clarified to avoid the possibility the release will be interpreted in this overly broad fashion, which would be in contravention of the law in the Third Circuit.

RESERVATION OF RIGHTS

19. In addition to its setoff (and, as necessary, recoupment) rights, Cardinal expressly reserves all other rights provided by the Bankruptcy Code or applicable law. Cardinal further

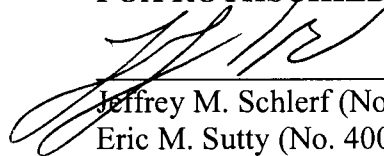
reserves the right to raise further objections to the Plan or any supplement or amendment thereto as it deems appropriate.

CONCLUSION

WHEREFORE, for the reasons set forth above, Cardinal respectfully requests that the Court deny confirmation of the Plan.

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Wilmington, Delaware

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