IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
GRACEWAY PHARMACEUTICALS, LLC, *et al.*,[1]	Case No. 11-13036 (PJW)
	Jointly Administered
Debtors.	**Hearing Date: April 11, 2012 at 2:00 p.m. (ET)**
	Doc. Ref. Nos. 551, 655, 656, 657, 659, 660, 661

DEBTORS' OMNIBUS REPLY TO OBJECTIONS TO CONFIRMATION OF THE FIRST AMENDED JOINT PLAN OF LIQUIDATION OF GRACEWAY PHARMACEUTICALS, LLC, ET AL.

The above-captioned debtors and debtors-in-possession (collectively, the "**Debtors**") hereby submit their omnibus reply (the "**Reply**") to the Objections (defined below) to the *First Amended Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, et al.* [Docket No. 551] (the "**Plan**").[2] In support thereof, the Debtors respectfully represent as follows:

BACKGROUND

1. On January 25, 2012, the Debtors filed the Disclosure Statement Motion seeking entry of an order (the "**Original Disclosure Statement Order**") approving, among other things, procedures for proceeding to confirmation of the Joint Plan of Liquidation of Graceway

[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] Capitalized terms used but not otherwise defined herein shall have those meanings ascribed to them in the *Debtors' Memorandum of Law in Support of Confirmation of the Debtors' First Amended Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, et al. Under Chapter 11 of the Bankruptcy Code* (the "**Confirmation Brief**"), filed contemporaneously herewith.

Pharmaceuticals, LLC, *et al.* [Docket No. 483] (the "**Original Plan**") and approving the Disclosure Statement for the Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, *et al.* [Docket No. 484] (the "**Original Disclosure Statement**").

2. Since January 25, 2012, the Debtors continued the negotiations that began prior to filing the Original Plan and have engaged in ongoing discussions and negotiations with all of their key constituencies with an economic interest in these Chapter 11 Cases, including the Creditors' Committee, the First Lien Facility Agent and the Second Lien Facility Agent (hereinafter collectively referred to as the "**Key Constituencies**") regarding the terms of the Original Plan, the Original Disclosure Statement, and the exhibits and documents relating thereto.

3. As a result of such negotiations, on February 28, 2012, the Debtors were able to file the Plan, which is supported fully by each of the Key Constituencies. On March 1, 2012, the Debtors filed the Disclosure Statement for the First Amended Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, *et al.* [Docket No. 566] (the "**Disclosure Statement**"). By Order dated March 1, 2012, the Court approved the Disclosure Statement and certain solicitation procedures. See *Order (A) Approving the Disclosure Statement, (B) Establishing the Voting Record Date, Voting Deadline and Other Dates, (C) Approving Procedures for Soliciting, Receiving and Tabulating Votes on the Plan and for Filing Objections to the Plan and (D) Approving the Manner and Forms of Notice and Other Related Documents* [Docket No. 572] (the "**Disclosure Statement Order**").

OBJECTIONS TO CONFIRMATION

4. Six (6) objections to confirmation of the Plan (collectively, the "**Objections**") were filed before the Plan Objection Deadline. Formal objections were filed by (a) the Internal Revenue Service ("**IRS**") [Docket No. 655] (the "**IRS Objection**"); (b) the

United States of America, on behalf of the Secretary of Health and Human Services, the Centers for Medicare and Medicaid Service, and TRICARE Management Activity (collectively, "**HHS**") [Docket No. 656] (the "**HHS Objection**"); (c) Cardinal Health ("**Cardinal**") [Docket No. 657] (the "**Cardinal Objection**"); (d) TRC Valley Creek Associates – C, LP ("**TRC**") [Docket No. 659] (the "**TRC Objection**"); (e) the United States Trustee [Docket No. 660] (the "**UST Objection**"); and (f) McKesson Corporation ("**McKesson**") [Docket No. 661] (the "**McKesson Objection**").[3] Additionally, an informal objection was made by the Environmental Protection Agency (the "**EPA**"). As discussed below, as of the filing of this Reply, the Debtors have resolved all Objections except for those of the United States Trustee, Cardinal, McKesson, and TRC, each of which the Debtors will continue to try to resolve prior to the Confirmation Hearing.

I. The EPA's Informal Objection Has Been Resolved

5. The informal objection of the EPA primarily relates to the potential preclusion of the EPA from being able to enforce police and regulatory liability relating to contaminated property under the Plan. To resolve this objection, the Debtors agreed to insert the following clarifying language into the Confirmation Order:

> Nothing in this Order or the Plan releases, nullifies, precludes, or enjoins the enforcement of any liability to a governmental unit under environmental statutes or regulations that any entity would be subject to as the owner or operator of real property after the date of entry of this Order or, solely with respect to the Purchaser and its affiliates, after the date of entry of the Sale Order.

[3] A chart providing a summary of the Objections and the Debtors' responses thereto is attached hereto as Exhibit A and is attached to the Confirmation Brief as Exhibit B.

6. The Debtors have received written confirmation from the EPA indicating that the inclusion of this language in the Confirmation Order resolves the EPA's informal objection.

II. The IRS Objection Has Been Resolved

7. The IRS Objection primarily relates to the treatment of setoff and recoupment rights of the IRS, the bar date for the filing of Administrative Expense Claims under the Plan and the ability of the IRS to amend proofs of Claims filed by the IRS at a later date. To resolve this objection, the Debtors agreed to insert the following clarifying language into the Confirmation Order:

> Notwithstanding any provision to the contrary in the Plan, the Order confirming the Plan, and any implementing Plan documents, nothing shall: (1) affect the rights of the United States to assert setoff and recoupment and such rights are expressly preserved; (2) require the IRS to seek Bankruptcy Court approval prior to amending any of its claims and all rights of the IRS under Sections 502 and 503 of the Bankruptcy Code with respect to a claim or an amended claim of the IRS are preserved; or (3) require the IRS to file an administrative claim in order to receive payment for any liability described in Sections 503(b)(1)(B) and (C) in accordance with Section 503(b)(1)(D) of the Bankruptcy Code.

8. The Debtors have received written confirmation from the IRS indicating that the inclusion of this language in the Confirmation Order resolves the IRS Objection.

IV. The HHS Objection Has Been Resolved

9. The HHS Objection primarily relates to the ability of HHS to amend the proofs of Claim filed by HHS without Court approval, particularly with respect to unliquidated portions of such Claims. To resolve the HHS Objection, the Debtors agreed to insert the following clarifying language into the Confirmation Order:

> Notwithstanding Section 9.3 of the Plan, the United States may amend its proofs of Claim after Confirmation of the Plan without court order. All rights of the United States under Section 502 of

> Bankruptcy Code with respect to a claim or amended claim of the United States are preserved.

10. The Debtors have received written confirmation from the HHS indicating that the inclusion of this language in the Confirmation Order resolves the HHS Objection.

V. The Cardinal Objection, TRC Objection and McKesson Objection Should Be Overruled

11. Cardinal objects to the Plan to the extent that the Plan constitutes a waiver or limitation of its setoff rights. The Cardinal Objection was joined by both TRC and McKesson pursuant to the TRC Objection and the McKesson Objection, respectively.

12. The Plan does not waive or limit the valid setoff rights of any party.[4] To the contrary, the Plan treats valid setoff claims as Unimpaired Other Secured Claims. Section 1.139 of the Plan provides that the term "Secured Claim" includes "any Claim of a Creditor, including for principal, interest and any other amounts, that is secured by a valid, perfected and enforceable Lien . . . or is otherwise subject to setoff under Bankruptcy Code Section 553, to the extent of the value of such Creditor's interest in such property or to the extent of the amount subject to setoff, as applicable, as determined pursuant to Bankruptcy Code Section 506(a)." To the extent that any Creditor has setoff rights, such setoff rights are classified as "Other Secured Claims" under the Plan.[5] Section 5.4 of the Plan provides for the following treatment of Other Secured Claims:

> On the Effective Date or as soon thereafter as is practicable in recognition of the applicable Claims reconciliation process set forth herein, each holder of an Allowed Other Secured Claim that was not assumed by the Purchaser in connection with the 363 Sale

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[4] Nothing contained herein or in the Plan shall be deemed an admission by the Debtors or their estates that Cardinal, TRC, McKesson, or any other party in interest possesses valid setoff rights. The Debtors expressly reserve all rights to dispute any and all such setoff Claims of any party in interest.

[5] The definition of "Other Secured Claims" includes all Secured Claims other than the First Lien Facility Secured Claim and the Second Lien Facility Secured Claim pursuant to Section 1.109 of the Plan.

> shall receive, in full satisfaction, settlement and release of and in exchange for such Allowed Other Secured Claim, (i) the collateral securing any such Allowed Other Secured Claim (to the extent such collateral does not constitute collateral securing the First Lien Facility Secured Claim, any First Lien Facility Adequate Protection Claim, the Second Lien Facility Secured Claim or any Second Lien Facility Adequate Protection Claim or, if such collateral does secure any such Claim, to the extent that the Lien securing such Allowed Other Secured Claim is senior to the Lien securing the First Lien Facility Secured Claim, any First Lien Facility Adequate Protection Claim, the Second Lien Facility Secured Claim or any Second Lien Facility Adequate Protection Claim, as applicable), (ii) Cash in an amount equal to such Allowed Other Secured Claim to the extent the collateral securing such Allowed Other Secured Claim was sold and such collateral does not constitute collateral securing the First Lien Facility Secured Claim, any First Lien Facility Adequate Protection Claim, the Second Lien Facility Secured Claim or any Second Lien Facility Adequate Protection Claim or, if such collateral does secure any such Claim, to the extent that the Lien securing such Allowed Other Secured Claim is senior to the Lien securing the First Lien Facility Secured Claim, any First Lien Facility Adequate Protection Claim, the Second Lien Facility Secured Claim or any Second Lien Facility Adequate Protection Claim, as applicable, or (iii) such other treatment that leaves such Allowed Other Secured Claim Unimpaired pursuant to the Section 1124(2) of the Bankruptcy Code.

13. Because the Plan does not waive or limit valid setoff claims; but rather treats valid setoff claims as Unimpaired Other Secured Claims, the Cardinal Objection, TRC Objection and McKesson Objection should be overruled. However, for the avoidance of doubt, the Debtors have added the following clarifying language in the Confirmation Order:

> Nothing in the Plan shall be deemed to waive, release or limit the setoff or recoupment rights, if any, of any Creditor.

14. Although the valid setoff rights of Cardinal, TRC, McKesson and all other parties in interest are not waived or limited by the Plan, Cardinal has previously contractually waived any and all of its setoff rights not expressly agreed to in writing by the Debtors. Prior to the Petition Date and in the ordinary course of business, the Debtors sold their products to

Cardinal and other large wholesale drug distributors. Cardinal and the other distributors then sold and distributed such products to various retailers, mail-order pharmacies, managed care organizations, and other institutions. The retailers and other institutions, in turn, sold the products directly to patients and end-users. Prior to the Petition Date, Cardinal and the Debtors entered into certain written agreements, including, without limitation, a Wholesale Purchase Agreement, dated as of January 1, 2011 (the "**WPA**"). The WPA, among other things, governed the terms of the sale of products from the Debtors to Cardinal, imposed certain restrictions on the sale of products by Cardinal, specified the terms regarding certain pricing discounts related to the Debtors' participation in certain rebate programs, outlined the terms of certain distribution service agreement fees that Cardinal received for the sale of the Debtors' products and detailed the product return privileges for expired or discontinued products that Cardinal shipped back to the Debtors.

15. Section 8 of the WPA provides that "[t]here shall be no right of offset for chargebacks or any other amount believed to be due and owing under this Agreement, unless the parties explicitly agree that amounts are due and owing and further agree in writing to allow offset." Thus, Cardinal possesses valid setoff rights only to the extent expressly agreed in writing by the Debtors.

II. The UST Objection Should Be Overruled

16. The UST Objection relates to the release, exculpation, injunction, and limitation of liability provisions set forth in Article 12 of the Plan. The United States Trustee

asserts that these provisions are impermissible under applicable law,[6] namely In re Washington Mutual, Inc.[7] and In re Tribune Co.[8]

17. The Debtors respectfully disagree with the United States Trustee. As explained in the Confirmation Brief, the releases, exculpation, injunction, and limitation of liability provisions are proper because, among other things, they are the product of arm's-length negotiations, have been critical to obtaining the support of the Key Constituencies for the Plan, and, as part of the Plan, have received overwhelming support from the Creditors that voted for the Plan, including those Creditors who would benefit from the proceeds of the potential Claims and causes of action released under the Plan. These provisions are fair and equitable, are given for valuable consideration, have not been opposed by any party with an economic interest in these Chapter 11 Cases and are in the best interests of the Debtors, their estates, and their Creditors. The Debtors address below the specific arguments raised in the UST Objection:

A. The Debtor Releases

18. The United States Trustee asserts that the Debtors have not established the evidentiary predicate necessary to approve the Debtor Releases pursuant to the five-factor test set forth in In re Master Mortgage Investment Fund, Inc.[9] and applied in In re Zenith Electronics Corp.[10] As an initial matter, the Debtors do not believe that it has been clearly established by this Court that the Master Mortgage/Zenith factors apply to releases by a debtor.[11] Rather, the

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6 See UST Objection, ¶ 1.

7 442 B.R. 314 (Bankr. D. Del. 2011) (MFW).

8 464 B.R. 126 (Bankr. D. Del. 2011) (KJC).

9 168 B.R. 930, 937-38 (Bankr. W.D. Mo. 1994).

10 241 B.R. 92, 110 (Bankr. D. Del. 1999) (MFW).

11 See Transcript of Hearing Held on Jan. 18, 2006 at 44, In re AAI Pharma, No. 05-11341 (Bankr. D. Del. Feb. 22, 2006) (Docket No. 893) (PJW) (overruling the United States Trustee's objection based on Zenith and Master Mortgage to debtor releases and distinguishing debtor releases from third-party releases).

Debtors believe that the Debtor Releases are subject to the principles governing compromises under Section 1123(b)(3)(A) of the Bankruptcy Code and Bankruptcy Rule 9019.[12] Under this Court's well-established case law, the debtor is "given considerable latitude" to settle and release potential claims as part of its plan,[13] and, as explained in the Confirmation Brief, the Debtor Releases satisfy the test enumerated by the Third Circuit Court of Appeals for settlements under Bankruptcy Rule 9019: "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors."[14] The Debtor Releases fall well "within a reasonable range of litigation possibilities"[15] because there are no significant potential causes of actions that the Debtors are releasing in the Debtor Releases.[16] The Debtor Releases obviate the expense, delay, inconvenience and uncertainty that would attend any litigation regarding the Debtor Releasees and are fair, equitable, and in the best interests of the Debtors' estates. However, as set forth in the Confirmation Brief and further detailed below with respect to the Releases by Holders of Claims and Interests, the Debtor Releases are also proper under the Master Mortgage/Zenith analysis.

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12 See id.

13 See id. at 45; see also Confirmation Brief, at 14-16 n. 37-46.

14 Meyers v. Martin (In re Martin), 91 F.3d 389, 393 (3d Cir. 1996); accord Will v. Nw. Univ. (In re Nutraquest, Inc.), 434 F.3d 639, 644 (3d Cir. 2006) (finding that the Martin factors are useful when analyzing a settlement of a claim against the debtor as well as a claim belonging to the debtor); see also TMT Trailer Ferry, Inc., 390 U.S. 414, 424 (1968); In re Marvel Entm't Group, Inc., 222 B.R. 243 (D. Del. 1998) (proposed settlement held in best interest of the estate).

15 In re Penn Cent. Transp. Co., 596 F.2d 1102, 1114 (3d Cir. 1979) (citations omitted).

16 See In re Spansion, Inc., 426 B.R. 114, 143 (Bankr. D. Del. 2010) (KJC) (noting that "the record does not reflect that there is any pending litigation in [that] case that would be discontinued by such a release" and citing In re DBSD North America, Inc., 419 B.R. 114, 143 (Bankr. S.D.N.Y. 2009), which "approv[ed] a debtor's release of third parties when the debtor testified that it was unaware of any significant potential claims that were being released"); Transcript of Hearing Held on Jan. 18, 2006 at 44, In re AAI Pharma, No. 05-11341 (noting that there was "nothing in this case that would suggest that there is any serious cause of action out there that the debtor is giving up").

19. With respect to the specific arguments made in the UST Objection regarding the Debtor Releases, the Confirmation Brief outlines in detail the contributions of each of the Debtor Releasees. In particular, the substantial work of the Debtors' directors, officers, employees and professionals was critical to the $180 million purchase price increase over the original stalking horse bid (an increase of 35%), which increase ultimately led to a consensual Plan that (a) is fully supported by all the Debtors' Key Constituencies, (b) was overwhelmingly approved by each of the voting Classes, and (c) provides for a return to Unsecured Creditors. Importantly, the Debtor Releasees' contribution must be viewed in light of the potential Claims and Interests released—and the Debtors have no reason to believe that the Debtor Releases include any large or significant potential Claims or that such Claims are likely to be pursued. The Debtors settled their most significant potential Claim against the Debtor Releasees in the $6 million GTCR Settlement Agreement, which was previously approved by this Court without objection by the United States Trustee or any party in interest in these cases.

20. Additionally, the Declaration of Thomas E. Hill filed in support of the Confirmation Brief (the "**Hill Declaration**") and attached hereto as Exhibit B, evidences the absolute necessity of the Debtor Releases to the Plan. Thus, although the United States Trustee correctly points out that not all of the Creditors are receiving payment of substantially all of their Claims, the highly successful auction and resulting comprehensive settlement (including the $10 million Committee Settlement, the $6 million GTCR Settlement Agreement, and the settlement of any potential remaining Claims and Interests through the Plan) enabled the Unsecured Creditors to receive more than was expected at the outset of these Chapter 11 Cases and more

than they would be entitled to receive under the priority scheme of the Bankruptcy Code if those settlements had not been reached.[17]

21. The United States Trustee acknowledges that the Master Mortgage/Zenith "factors are neither exclusive nor conjunctive requirements, but simply provide guidance in the Court's determination of fairness," yet the United States Trustee treats the factors in argument as a rigid, conjunctive test.[18] The Hill Declaration filed in connection with the Confirmation Brief provides evidentiary support that the Debtor Releases are fair and appropriate under Bankruptcy Rule 9019 and under any analysis of the Master Mortgage/Zenith factors.[19]

22. Because the Debtors have provided in the Hill Declaration the evidentiary predicate necessary to approve the Debtor Releases under Section 1123(b)(3)(A) of the Bankruptcy Code and Bankruptcy Rule 9019, as well as under the Master Mortgage/Zenith factors, the UST Objection regarding the Debtor Releases should be overruled.

B. Releases by Holders of Claims and Interests

23. The United States Trustee similarly objects that the Debtors have not provided the evidentiary predicate necessary to approve the Releases by Holders of Claims and Interests.[20] The United States Trustee further alleges that the Ballot creates an "illusory"

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[17] See Transcript of Hearing Held on Apr. 20, 2006 at 116, In re Freedom Rings, L.L.C., No. 05-14268 (Bankr. D. Del. May 9, 2006) (Docket No. 385) (CSS) ("[T]he consideration [for the releases] is material. Even though the amounts are not particularly large, they need to be examined in the context of this case. The uncontroverted evidence is that the recovery to Unsecured Creditors is increasing three to four times as a result of the settlement. That is a material improvement.").

[18] UST Objection, ¶ 40 (citing Tribune, 464 B.R. at 186; Washington Mutual, 442 B.R. at 346).

[19] The Master Mortgage/Zenith factors include: (i) whether an identity of interest between the debtors and the releasees exists, such that a suit against the releasees is, in essence, a suit against the debtors or would deplete assets of the estates; (ii) the contribution of the releasees since the petition date; (iii) the essential nature of the releases to the approval of the plan; (iv) whether a substantial majority of the impacted creditors support the plan; and (v) whether the plan pays substantially all of the claims of the impacted creditors. In re Master Mortgage, 168 B.R. at 935-36. A detailed analysis of the Master Mortgage/Zenith factors in these cases is set forth below at Paragraphs 27-37.

[20] UST Objection, ¶¶ 27, 38.

impression that "voting creditors had some choice in whether to grant releases of non-debtor third parties, by suggesting that only those creditors who voted to accept the Plan would be giving releases."[21]

24. First, the United States Trustee is mistaken that the Releases by Holders of Claims and Interests are improper because of the Ballot. Contrary to the suggestion of the United States Trustee, the Ballot is neither misleading nor confusing. The Ballot explicitly states that claimants' rights are described in the Disclosure Statement and advises claimants to review the Disclosure Statement and Plan before voting. Claimants' rights with respect to the Releases by Holders of Claims and Interests and their voting rights are clearly explained in both the Plan and the Disclosure Statement. In particular, the injunction provision that effectuates the Releases by Holders of Claims and Interests specifically states that the provision is applicable "regardless of whether [the claimant] has voted to accept the Plan."[22] It is not the purpose of a Ballot to include all of the information set forth in the Plan and Disclosure Statement. Indeed, if that were the case, the Ballot would be hundreds of pages long and there would be no need for a Plan or Disclosure Statement.

25. Claimants were not only advised to review the Plan and Disclosure Statement in the Ballot, they were also advised to review the Plan and Disclosure Statement in other correspondence and notices. For example, the cover letter sent to the voting classes advises Claimants to review the Plan and Disclosure Statement.[23] The notice of the

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[21] Id. ¶ 23. To the extent that the United States Trustee is also arguing that *all* non-consensual third-party releases are invalid, the Debtors respectfully disagree. See Transcript of Hearing Held on Apr. 20, 2006 at 114, In re Freedom Rings, L.L.C., No. 05-14268 (approving plan with non-consensual third-party releases and noting that, once the Court determines it has jurisdiction over third-party releases, a per se rule against exercising its jurisdiction (i.e., rejecting such releases as in Zenith, 241 B.R. 92), is not appropriate).

[22] Plan, § 12.6.

[23] Disclosure Statement Order, Ex. 9.

Confirmation Hearing attached as Exhibit 7 to the Disclosure Statement Order and provided to Creditors with the Ballots also explicitly highlights and explains the Releases by Holders of Claims and Interests and advises claimants "to review and consider the Plan carefully because [their] rights might be affected thereunder."[24]

26. Nowhere in the Plan, the Disclosure Statement, or the Ballot does it state that claimants could choose to accept the Plan without the Releases by Holders of Claims and Interests negotiated as part of the consensual Plan.[25] The language on the face of the Ballot regarding the release provisions does not alter the clear disclosure provided to claimants. Moreover, despite the United States Trustee's assertion now that the Ballot is misleading or unclear, the United States Trustee did not raise the issue prior to this Court's approval of the Ballot in the Disclosure Statement Order. As evidenced by the chart attached as Exhibit 3 to the *Debtors' (I) Response to the United States Trustee's Limited Objection to the Motion of the Debtors for Entry of an Order (A) Approving the Disclosure Statement, (B) Establishing the Voting Record Date, Voting Deadline and Other Dates, (C) Approving Procedures for Soliciting, Receiving and Tabulating Votes on the Plan and for Filing Objections to the Plan and (D) Approving the Manner and Forms of Notices and Other Related Documents and (II) Submission of Revised Order Approving the Disclosure Statement* [Docket No. 555], the United States Trustee provided numerous comments and requested revisions to the Original Plan, the Original Disclosure Statement, and the documents and exhibits related thereto. The Debtors worked with the United States Trustee to resolve nearly all of her comments and requested

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[24] Id., Ex. 7 at 3, 5-6.

[25] The United States Trustee compares the Ballot to the ballot in Washington Mutual. See UST Objection, ¶ 22-23 (citing Washington Mutual, 442 B.R. at 351-52). Most important, among other differences, the ballot in Washington Mutual included an opt-out provision, whereas the releases effected through a global settlement, which controlled over any conflicting provisions in the plan, included all claims regardless of whether an entity opted out. See Washington Mutual, 442 B.R. at 352. Here, there is no conflict between the Ballot and Plan with respect to treatment of the Releases by Holders of Claims and Interests.

revisions. However, the United States Trustee did not at any point prior to the UST Objection raise the possibility that the Ballot language highlighting the Releases by Holders of Claims and Interests is somehow "illusory" or misleading. The Releases by Holders of Claims and Interests are not improper because of the language on the Ballot approved by this Court without objection. Second, the Debtors have demonstrated in the Confirmation Brief and Hill Declaration that the Releases by Holders of Claims and Interests meet the fairness and necessity principles from the Third Circuit's decision in In re Continental Airlines,[26] which same principles are implicated in the Master Mortgage/Zenith factors.[27] In Continental, the Third Circuit surveyed the case law regarding plan releases but declined to establish its own rule regarding plan releases and injunctions.[28] The Third Circuit, however, focused on the fairness of releases, the necessity to the reorganization, and the specific factual findings regarding fairness and necessity.[29] Thus, this Court has held that, under Continental:

> to meet the burden of establishing that the third party releases are fair and necessary to the reorganization, . . . Plan proponents must establish by a preponderance of the evidence that, [1] there is material, specific and identifiable consideration flowing from the releasees to the releasors, either directly or through the Plan, that is a fair exchange for the releases being granted, and [2] that it is unlikely that the Debtor will be able to confirm a Plan, not necessarily the specific Plan before the Court, absent such releases.[30]

These fairness and necessity factors under Continental implicate similar concerns as the Master Mortgage/Zenith factors. The Master Mortgage/Zenith factors look to (a) whether an identity of

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26 203 F.3d 203 (3d Cir. 2000).

27 As discussed in the Confirmation Brief, there is overlap in the Continental principles and the Master Mortgage/Zenith factors. The factors cited by the United States Trustee from In re Genesis Health Ventures, 266 B.R. 591, 608 (Bankr. D. Del. 2001), and In re Spansion, Inc., 426 B.R. 114, 144 (Bankr. D. Del. 2010) (KJC), are also substantially the same. See UST Objection, ¶ 26.

28 Id. at 212-14.

29 See Transcript of Hearing Held on Apr. 20, 2006 at 114-15, In re Freedom Rings, L.L.C., No. 05-14268.

30 See id.

interest between the debtors and the releasees exists, such that a suit against the releasees is, in essence, a suit against the debtors or would deplete assets of the estates; (b) the contribution of the releasees since the petition date; (c) the essential nature of the releases to the approval of the plan; (d) whether a substantial majority of the impacted creditors support the plan; and (e) whether the plan pays substantially all of the claims of the impacted creditors.[31]

27. Here the Creditor Releasees share an identity of interest with the Debtors. The First Lien Facility Agent, the First Lien Facility Lenders, the Second Lien Facility Agent, the Second Lien Facility Lenders, and the Debtors' officers and directors are likely entitled to indemnification from the Debtors with respect to the released Claims and, in the case of the directors and officers, such Claims are likely insured under the Debtors' D&O insurance policies.[32] Moreover, the Debtors and the Creditor Releasees "share the common goal of confirming the . . . Plan," which is the culmination of negotiations among and settlements between the Debtors and their Key Constituencies from the start of these Chapter 11 Cases.[33] These Key Constituencies invested substantial time and effort in negotiating and drafting the Plan, and they stand to receive a substantial portion of the distributions made under the Plan.[34]

28. Furthermore, each of the Creditor Releasees has participated in the Plan process and provided significant value to the estates and contributions to the Plan. Such contributions include, among other things, (a) compromising Claims and accepting diminished recoveries, (b) funding the Debtors during these Chapter 11 Cases, (c) funding the Plan, (d) negotiating and supporting the Plan, (e) in the case of GTCR, making the $6 million

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31 See In re Zenith Elecs. Corp., 241 B.R. at 110-11; In re Master Mortgage, 168 B.R at 935-36.

32 See Hill Decl. ¶ 41.

33 See In re Tribune Co., 464 B.R. 126, 153 (Bankr. D. Del. 2011) (KJC).

34 See Hill Decl. ¶ 39.

settlement payment, and (f) in the case of directors, officers, and employees, their efforts on behalf of the Debtors prior to and throughout the Chapter 11 Cases.[35] Indeed, the significant and substantial work performed by the directors, officers, and employees was critical to the $180 million purchase price increase over the original stalking horse bid, which increase ultimately led to a consensual Plan fully supported by all the Debtors' Key Constituencies (who also represent the beneficiaries of the released potential Claims and causes of action) and a return to Unsecured Creditors.

29. Moreover, the Creditor Releases are an integral part of the Plan, and the failure to effect the release provisions set forth in the Plan would seriously impair the Debtors' ability to confirm the Plan, which would reduce the value available for distribution to Creditors potentially extinguishing any recovery to Unsecured Creditors.[36] In negotiating the Plan, the First Lien Facility Agent, the Second Lien Facility Agent and the Creditors' Committee each requested and relied on the release provisions in the Plan. Without these provisions, the Debtors may lose the support of the Key Constituencies, in which case Confirmation of the Plan, or any other plan, would be highly unlikely.

30. Indeed, the overwhelming majority of the voting Creditors voted in favor of the Plan, including those Creditors who would benefit from the potential causes of action that are being released.[37] As set forth in the *Certification and Declaration of Notice, Claims and Voting Agent Regarding Solicitation and Tabulation of Votes in Connection With the Debtors' First Amended Joint Plan of Liquidation of Graceway Pharmaceuticals, LLC, et al.* [Docket No. 671], Classes 2, 3 and 5 voted to accept the Plan. Specifically, holders of Class 2 First Lien

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35 See id. ¶¶ 33-36, 39-43.

36 See id. ¶¶ 44-45.

37 See Voting Rep. at Ex. A.

Facility Claims voting voted 100% in number and 100% in amount in favor of the Plan. Holders of Class 3 Second Lien Facility Claims voting voted 100% in number and 100% in amount in favor of the Plan. Holders Class 5 General Unsecured Claims voting voted 92.73% in number and 99.99% in amount in favor of the Plan.

31. Finally, although the Plan does not pay all Creditors substantially all of their Claims in full, the Plan pays more than was expected at the commencement of the Chapter 11 Cases due in large part to the work of the Debtors' directors, officers, employees, and other Creditor Releasees. In particular, the $180 million purchase price increase, the Committee Settlement, and the GTCR Settlement Agreement all resulted from the efforts of the Creditor Releasees. Without such achievements, the projected recoveries under the Plan would be significantly less. Thus, all of these factors and the equities of these cases weigh in favor of approval of the Releases by Holders of Claims and Interests for each of the Creditor Releasees.

32. The Confirmation Brief outlines the contributions of the Liquidating Trustee and Medicis and the necessity of these contributions and corresponding releases to the success of the Plan.[38] In particular, the Liquidating Trustee has been actively involved in the Chapter 11 Cases. Such early involvement was fully supported by all Key Constituencies. The Liquidating Trustee's actions thus far in the Chapter 11 Cases have helped ensure a smooth transition to winding down the Debtors' estates, thus maximizing value for the benefit of the Creditors. The Debtors believe—and there are no allegations to the contrary—that the Liquidating Trustee has acted in good faith.[39] Therefore, it is proper to include the Liquidating Trustee as a Creditor Releasee. The United States Trustee recognized the contribution of the First Lien Facility Lenders in agreeing to release their liens and Claims on certain assets to allow

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38 See Confirmation Brief at 21.

39 See Hill Decl. ¶ 43.

for distribution to junior classes.[40] The First Lien Facility Lenders hold $430,698,397.57 of senior, secured pre-petition debt,[41] and therefore their consent to fund the Plan in exchange for the Releases by Holders of Claims and Interests makes such releases necessary to the Confirmation of the Plan.[42] Medicis has also provided material consideration, namely the $455 million Sale Proceeds, which make up over 90% of the total Assets of the Debtors. Without this contribution, the Plan would have little chance of success and projected recoveries would be just a fraction of what they presently are.[43]

33. Regarding the United States Trustee's argument that there is no evidence regarding the identity of the Affiliates or why inclusion of the Affiliates in the Creditor Releasees is proper,[44] the Disclosure Statement clearly identifies Graceway Canada Company ("**Graceway Canada**") as a non-Debtor Affiliate of parent Debtor Graceway Canada Holdings, Inc.[45] The Disclosure Statement also explains that Graceway Canada, pursuant to the Asset Purchase Agreement and as part of the 363 Sale, sold substantially all of its assets to Medicis.[46] The Debtors expect to receive a substantial equity distribution on account of their equity interests in Graceway Canada. Such contribution constitutes significant consideration in exchange for the Releases of Graceway Canada. Furthermore, the Releases by Holders of Claims and Interests for Graceway Canada are an integral part of the Plan, as the Debtors would not support any Plan that does not provide for such releases of Graceway Canada.

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40 See UST Objection, ¶ 28.

41 See *Chapter 11 Voluntary Petition* [Docket No. 1], Annex 1 (Sale Support Agreement).

42 See Transcript of Hearing Held on Apr. 20, 2006 at 117, In re Freedom Rings, L.L.C., No. 05-14268.

43 See Hill Decl. ¶ 40.

44 See UST Objection, ¶ 32.

45 See Disclosure Statement, at 13. The other Affiliates of the Debtors are two inactive wholly owned subsidiaries which have no operations and no assets.

46 See id. at 17.

34. The Releases by Holders of Claims and Interests are also proper with respect to the Debtors' directors, officers, employees, and professionals. If the Debtors were seeking to distribute the proceeds of the original stalking horse bid as opposed to the Medicis Bid, which was $180 million higher, the Debtors could not have a feasible, consensual plan that provides for distributions to Unsecured Creditors. Indeed, but for the substantial efforts of the directors, officers, and employees, there would be substantially less distribution, if any, to the Unsecured Creditors. Knowing that a successful auction was critical to providing a recovery to the Second Lien Facility Lenders and Unsecured Creditors, the Debtors sought and obtained the First Lien Lenders' support for the Releases by Holders of Claims and Interests relating to the Debtors' directors, officers, and employees in exchange for such key persons' efforts during the Chapter 11 Cases.[47] Thus, the Releases by Holders of Claims and Interests were essential to keep these key persons with the Debtors and to incentivize them to provide substantial work and effort for the benefit of the Debtors' estates.

35. Furthermore, the releases applicable to the Debtors' directors must be viewed in conjunction with the GTCR Settlement Agreement—in which GTCR settled with the Debtors all potential Claims and causes of action relating to certain equity payments except against current directors and officers.[48] Pursuant to the GTCR Settlement Agreement, GTCR paid $4.5 million to the First Lien Facility Agent for the benefit of the First Lien Claimholders (satisfying substantial First Lien Claims that otherwise would have reduced distributions to Unsecured Creditors) and paid $1.5 million directly to the Debtors' estates to constitute "Other

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[47] See *Chapter 11 Voluntary Petition* [Docket No. 1], Annex 1 (Sale Support Agreement), ¶ 4d; Hill Decl. ¶ 39.

[48] See GTCR Settlement Order, Ex. A (Settlement Agreement) at 2 (defining "Releasees" to exclude "any person that is an officer or director of the Debtors as of the Settlement Effective Date, in such person's capacity as an officer or director of the Debtors").

Assets" under the Plan.[49] The releases for current directors and officers now sought under the Plan were explicitly raised and contemplated when negotiating the GTCR Settlement Agreement, and the parties to the GTCR Settlement Agreement and the Key Constituencies agreed that such releases would be effected through the Plan rather than the GTCR Settlement Agreement.[50] Indeed, the current directors and officers whose efforts have created substantial value for the Unsecured Creditors relied on such Plan provisions as part of overall global negotiations that led to the consensual Plan. The Releases by Holders of Claims and Interests therefore are an integral part of the overall negotiations between the Debtors, GTCR, and the Key Constituencies for settlement of Claims and development of a consensual Plan.

36. Due to the work of the directors, officers, employees, and professionals, the auction was extraordinarily successful and the Debtors were able to provide for a distribution to the Second Lien Facility Lenders and Unsecured Creditors. The United States Trustee argues that the estimated 1 to 1.4% recovery for Unsecured Creditors cannot be reasonable compensation in exchange for the Releases by Holders of Claims and Interests.[51] However, in comparison to what the Unsecured Creditors would have received in the absence of the Committee Settlement and a consensual Plan (i.e., nothing at all), the recovery is reasonable compensation for such releases. Additionally, as discussed in the Confirmation Brief, there is no evidence suggesting that the Releases by Holders of Claims and Interests include significant potential causes of action. Indeed, there are no significant potential causes of actions that are being released through the Creditor Releases. The Debtors' most significant potential causes of action are those related to distributions to equity holders, which have already been settled with

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49 See GTCR Settlement Order, at ¶ 5.

50 See Hill Decl. ¶¶ 41-42.

51 See UST Objection, ¶ 29.

GTCR pursuant to a settlement agreement approved by this Court without objection. See GTCR Settlement Order. Under the circumstances and equities of these Chapter 11 Cases, particularly the absence of objection from any Creditor (impaired or unimpaired) or party with an economic interest in the Chapter 11 Cases, the Releases by Holders of Claims and Interests for the Debtors' directors, officers, employees, and professionals are proper.

37. Moreover, GTCR also contributed $6 million pursuant to the GTCR Settlement Agreement. The settlement with GTCR was part of the continuum of negotiations in these Chapter 11 Cases, and it was expressly contemplated that the Plan necessarily would include the Releases by Holders of Claims and Interests.[52] Indeed the GTCR Settlement Agreement itself included releases for

> (a) each GTCR Entity and its respective current or former officers, directors, advisors, shareholders, members and/or enrollees and employees (and each of the foregoing entity's or person's respective successors, assigns and representatives) and (b) any other person or entity not otherwise identified in the preceding sub-clause (a) that directly or indirectly has received or in the future may receive any portion of the Distributions (other than any person that is an officer or director of the Debtors as of the Settlement Effective Date, in such person's capacity as an officer or director of the Debtors).[53]

38. Finally, the United States Trustee relies almost exclusively on the decision in Washington Mutual.[54] That case, however, is readily distinguishable, and, as the Court in Washington Mutual itself stated, "[d]etermining the fairness of a plan which includes the release of non-debtors requires the consideration of numerous factors and the conclusion is often

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[52] See *Debtors' Motion for an Order Authorizing the Debtors to Enter Into a Settlement Agreement with GTCR* [Docket No. 524], ¶¶ 17-20; Hill Decl. ¶ 40.

[53] See GTCR Settlement Order, Ex. A (Settlement Agreement) at 1.

[54] 442 B.R. 314.

dictated by the specific facts of the case."[55] The plan in Washington Mutual was opposed by numerous significant constituencies, including an equity committee, holders of certain securities, certain warrantholders, certain noteholders, several individual shareholders and creditors, and the United States Trustee.[56] The debtors in Washington Mutual received multiple objections relating to the releases to their original plan as well as to their modified plan, and the Court found the release modifications "internally inconsistent and potentially ineffective."[57] The objectors argued with respect to the modified plan that (1) the settlement and plan "releases substantial claims of the estate for no value," (2) "the Debtors agreed to settle only for sufficient funds to pay creditors, ignoring their fiduciary duty to shareholders," (3) the Debtors' lead counsel and chief restructuring officer had a conflict of interest, and (4) certain parties "used their position in the negotiations to gain non-public information about the Debtors which permitted them to trade in the Debtors' debt."[58]

39. There are no similar allegations or facts in these Chapter 11 Cases. Here, only the United States Trustee objects to the Releases by Holders of Claims and Interests; nobody with an economic stake in the released potential Claims objects that the releases are not supported by reasonable consideration. Indeed, the causes of action at issue in Washington Mutual required the appointment of an examiner to assess the merits of such potential claims,[59] whereas here there is no examiner and no evidence or suggestion that the Releases by Holders of Claims and Interests include any pending or asserted Claims or any significant potential

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55 Id. at 345.

56 Id. at 321-22; see also Spansion, 426 B.R. at 145 (disallowing third-party release when the objecting parties were not receiving anything under the plan but noting that "secured creditors receiving a full recovery under the Plan and unsecured creditors receiving value in the form of equity (which is more than they would receive in a liquidation) may provide, under appropriate circumstances, sufficient value in exchange for the releases").

57 Id.

58 Id. at 326, 349.

59 Id. at 325.

Claims.[60] There are no other objections to Releases by Holders of Claims and Interests, and no voting class has rejected the Plan.[61] Although the equity classes did not vote and are not receiving a distribution, they support the Plan because the equity holders are, by and large, recipients of the Releases by Holders of Claims and Interests due to the closely held nature of the Debtors.[62] Additionally, it has been clear since prior to the Petition Date that the Debtors' estates have no value below the Second Lien Facility. Finally, there are no assertions of a conflict in interest or any impropriety by any parties.

40. Unlike Washington Mutual in which the Court found that the evidence did not support the third-party releases, the Debtors have shown that the Releases by Holders of Claims and Interests meet the fair and equitable standards of Continental and that the facts and circumstances of this consensual Plan justify the Releases by Holders of Claims and Interests. Therefore, the UST Objection regarding the Releases by Holders of Claims and Interests should be overruled.

C. Exculpation and Limitation of Liability

41. The United States Trustee also objects to the exculpation and limitation of liability provisions in Section 12.5 of the Plan and argues that (1) exculpation must be limited to post-petition actions of estate fiduciaries in the bankruptcy case and (2) the exculpation and limitation of liability provisions are largely duplicative of each other and the Debtor Releases and Releases by Holders of Claims and Interests.[63]

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[60] Cf. id. at 351 (carving out asserted post-petition claim against the debtors' directors and officers from the exculpation).

[61] In contrast to Washington Mutual, there is no argument here that the acceptance of the Plan by the Creditor classes is because the Creditors are being paid in full. Cf. id. at 350. Here, some Creditor classes are not being paid in full yet all Creditor classes accepted the Plan with the Releases by Holders of Claims and Interests.

[62] Cf. id. (noting that the equity classes had not voiced any support for the plan).

[63] See UST Objection, ¶¶ 47, 50, 52.

42. First, the exculpated parties largely include the estate fiduciaries, including the Debtors' directors, officers, employees, attorneys, financial advisors and other estate professionals, as well as the Creditors' Committee, its members (in their capacity as members only), and its professionals.[64] Second, the Debtors respectfully disagree with the analysis in Washington Mutual[65] and Tribune[66] that exculpation must be limited to estate fiduciaries.

43. Washington Mutual and Tribune both relied on the Third Circuit's decision in In re PWS Holding Corp.[67] PWS addressed the objection of a subordinated noteholder that argued that the releases in that case violated Section 524(e) of the Bankruptcy Code because they affected the liability of the committee and estate professionals to third parties for their participation in the debtor's reorganization.[68] The Third Circuit concluded that the release in question did not violate Section 524(e) because the release provision did "not affect the liability of these parties, but rather states the standard of liability under the Code," namely that such persons are liable for their actions taken in relation to the bankruptcy cases only for willful misconduct or gross negligence.[69] Thus, the Third Circuit addressed and approved the limited releases at issue in PWS. PWS therefore stands for the proposition that where a release (or exculpation) does not alter a party's standard of liability under the Bankruptcy Code, it should be approved without further analysis. However, the Third Circuit did not hold in PWS that the limited releases in that case were the only releases that could ever be approved. Rather,

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64 See Plan, § 12.5.

65 442 B.R. at 350-51.

66 464 B.R. at 189.

67 228 F.3d 224 (3d Cir. 2000).

68 Id. at 245.

69 Id. at 245-46.

where a release (or exculpation) changes the releasee's liability from the standard of liability under the Bankruptcy Code, the proponents of the release must show that the release meets the principles of fairness and necessity set forth in the Continental case. Because the Debtors have demonstrated above that the exculpated parties have met the Continental principles of fairness and necessity, the exculpation provision should be approved for all exculpated parties and not just estate fiduciaries.

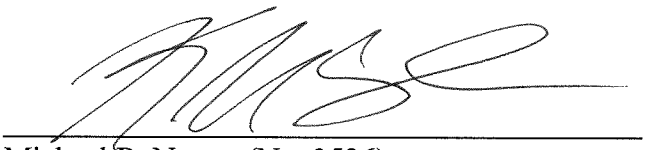
44. Finally, the United States Trustee objects that the releases, exculpation, limitation of liability and injunction are duplicative. Regardless of any overlap, all provisions are consistent with one another, are proper under the Bankruptcy Code and are the result of lengthy negotiations among the Debtors and all Key Constituencies throughout the Chapter 11 Cases. Such objection by the United States Trustee should not upset the carefully negotiated consensual Plan, particularly when no party in interest with an economic stake has objected.

CONCLUSION

WHEREFORE, the Debtors respectfully request that the Court overrule the Objections, confirm the Plan, enter the Confirmation Order and grant such other and further relief as the Court may deem just and proper.

Dated: April 9, 2012
Wilmington, Delaware

Respectfully Submitted,



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