

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

In re:

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

Debtors.

Chapter 11

Case No.: 11-13036 (PJW)
(Jointly Administered)

**Objections Due: April 30, 2012 at 4:00 p.m.
(EDT)**

Hearing Date: May 9, 2012 at 10:30 a.m. (EDT)

**TRC VALLEY CREEK ASSOCIATES-C, LP'S MOTION (I) FOR RELIEF FROM
THE AUTOMATIC STAY PURSUANT TO 11 U.S.C. § 362 TO ALLOW SETOFF
OF SECURITY DEPOSIT HELD BY LANDLORD PURSUANT TO A LEASE OF NON-
RESIDENTIAL REAL PROPERTY AGAINST REJECTION DAMAGES CLAIM, (II)
FOR WAIVER OF THE STAY IMPOSED PURSUANT TO BANKRUPTCY RULE
4001(A)(3), AND (III) FOR RELATED RELIEF**

TRC Valley Creek Associates-C, LP ("TRC" or "Landlord"), by and through its undersigned counsel, hereby submits TRC Valley Creek Associates-C, LP's Motion (i) for Relief from the Automatic Stay Pursuant to 11 U.S.C. § 362 to Allow Setoff of Security Deposit Held by Landlord Pursuant to a Lease of Non-Residential Real Property Against Rejection Damages Claim, (ii) for Waiver of the Stay Imposed Pursuant to Bankruptcy Rule 4001(A)(3), and (iii) for Related Relief (the "Motion"). In support of the Motion, TRC represents 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.

BACKGROUND

1. On September 29, 2011 (the “Petition Date”), the above-captioned debtors and debtors-in-possession (each a “Debtor” and collectively, the “Debtors”) each filed a voluntary petition for relief under chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”), in the United States Bankruptcy Court for the District of Delaware (the “Court”).

2. Pursuant to Bankruptcy Code sections 1107(a) and 1108, the Debtors continue to manage their property as debtors-in-possession.

3. On October 12, 2011, the Office of the United States Trustee for the District of Delaware appointed the official Committee of Unsecured Creditors (the “Committee”).

4. Debtor, Graceway Pharmaceuticals, LLC (“Graceway”), and TRC are parties to that certain lease agreement dated January 9, 2007 (as amended, the “Lease”) whereby Graceway leased 27,127 square feet of office space located at Building 222, Valley Creek Corporate Center, Third Floor – Suite 300, Exton, Pennsylvania 19341 (the “Property”) from TRC.

5. Pursuant to the Court’s Order Authorizing the Debtors to (i) Reject Certain Unexpired Leases of Nonresidential Real Property, (ii) Sell Certain Property Outside the Ordinary Course of Business, (iii) Abandon Certain Expendable Property and (iv) Reject Certain Executory Contracts entered December 29, 2011 [D.I. 416], the Lease was rejected effective as of December 31, 2011.

6. To date, TRC has filed the following claims in the Debtors’ bankruptcy cases: (i) claim number 176, filed as a general unsecured claim for \$12,261.48 for amounts due under the Lease before the Petition Date; and (ii) claim number 209, filed in the aggregate amount of

\$551,631.98, which is a partially secured claim representing TRC's damages related to the Debtor's rejection of the Lease (the "Rejection Damages Claim").

7. Pursuant to Lease section 3.7, the Landlord currently holds a \$198,931.32 security deposit (the "Security Deposit"). Specifically the Lease provides

As additional security for the full and prompt performance by [Graceway] of the terms and covenants of this Lease, [Graceway] has deposited with the Landlord the sum of Two Hundred Ninety-Eight Thousand Three Hundred Ninety-Six and 98/100 Dollars (\$298,396.98) [], which shall not constitute rent for any month (unless so applied by Landlord on account of and Event of Default or as provided below). Provided no Event of Default exists and it continuing, the amount of the Security Deposit shall be reduced on the first (1st) anniversary of the Rent Commencement Date such that One Hundred Ninety-Eight Thousand Nine Hundred Thirty-One and 32/100 Dollars (\$198,931.32) of the Security Deposit shall remain for the duration of the term of this Lease. Upon [Graceway's] written request, such reduction of the cash Security Deposit shall be applied against the rent due under the Lease.

Lease § 3.7.

JURISDICTION AND VENUE

8. The Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334.

9. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

10. Venue of this proceeding and this Motion is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

RELIEF REQUESTED

11. By the Motion, TRC requests that the Court enter an order, substantially in the form attached hereto, lifting the automatic stay and allowing TRC to setoff the Security Deposit against the Rejection Damages Claim pursuant to Bankruptcy Code sections 362 and 553.

BASIS FOR RELIEF

12. The right of setoff is of equitable origin, and has been recognized as a right under the common laws of every state, including the Commonwealth of Pennsylvania.² *See Dickerson v. Dickersons Overseas Co.*, 85 A.2d 102, 104-105 (Pa. 1952). This right is rooted in the idea that “allow[ing] entities that owe each other money to apply their mutual debts against each other ... avoid[s] the absurdity of making A pay B when B owes A.” *In re Semcrude, L.P.*, 399 B.R. 388, 393 (Bankr. D. Del. 2009) (internal citations omitted); *see also Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (same); *In re Bennett Funding Group*, 146 F.3d at 139 (same). Moreover, setoff “is not dependent on the parties’ contracts; rather, [it is an] equitable remed[y] available independent of any contractual remedy.” *CDI Trust v. U.S. Elec., Inc. (In re Commc’n. Dynamics, Inc)*, 382 B.R. 219, 226 (Bankr. D. Del. 2008).

13. Pursuant the common law right of setoff under Pennsylvania law, TRC has a right to setoff the Security Deposit against the Rejection Damages Claim. *See Bennett Funding*, 146 F.3d at 138.

A. Pre-Petition Setoff

14. Bankruptcy Code section 553(a) preserves any rights of setoff that may exist between a creditor and a debtor. *See Strumpf*, 516 U.S. at 20 (noting, 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”); *Lawndale Steel Co. v. Magic Steel Co.*, 155 B.R. 990, 992 (Bankr. N.D. Ill 1993) (observing that “[a] creditor with the pre-petition right of setoff does not lose its rights by failing to setoff before a bankruptcy petition has been filed”); *Bennett Funding*, 146 F.3d at 139 (noting that the right of setoff extends to bankruptcy, and that bankruptcy courts have long required compelling circumstances to overcome enforcement of such right).

15. Four conditions must be met in order for a creditor to have its right to setoff recognized: (i) the creditor holds a claim against the debtor that arose pre-petition; (ii) the creditor owes a debt to the debtor that also arose pre-petition; (iii) the claim and the debt are mutual; and (iv) both the claim and the debt are each valid and enforceable. *See* 11 U.S.C. § 553(a); *see also In re Garden Ridge Corp.*, 338 B.R. 627, 633 (Bankr. D. Del. 2006); *In re Pardo v. Pacificare of Tex., Inc. (In re APF Co)*, 264 B.R. 344, 354 (Bankr. D. Del. 2001).

16. Setoff is a permissive right and “lies within the equitable discretion of the bankruptcy court.” *United States v. Martinez*, Civil Action No. 1:07-CV-0687, 2008 WL 408402, at *1 (M.D. Pa. Feb. 12, 2008) (citing *United States on behalf of IRS v. Norton*, 717 F.2d 767, 772 (3d Cir. 1982)); *see also Szymanski v. Wachovia Bank, NA (In re Szymanski)*, 413 B.R. 232, 243 (Bankr. E.D. Pa. 2009) (noting that courts have disallowed valid rights to setoff only in “compelling circumstances”) (citing *In re Whimsy, Inc.*, 221 B.R. 69, 74 (S.D.N.Y. 1998)). However, setoffs in bankruptcy are generally favored and a presumption in favor of their enforcement exists. *See Kentucky Cent. Ins. Co. v. Brown (In re Larbar Corp)*, 177 F.3d 439, 447 (6th Cir. 1999); *In re De Laurentiis Entm’t Group Inc.*, 963 F.2d 1269, 1277 (9th Cir. 1992); *see also Bennett Funding*, 146 F.3d at 139 (“Cases under the prior Bankruptcy Act required ‘compelling circumstances’ to disregard state sanctioned setoff rights . . . injunction against a setoff is ‘strong medicine.’”) (internal citations omitted).

(i) TRC and the Debtors hold Pre-Petition Claims Against Each Other

17. The Bankruptcy Code’s broad definition of “claim” allows any claim to be asserted against the debtor, regardless of whether such claim is “reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed [or] undisputed . . .” and will be allowed in bankruptcy regardless of its status being contingent or otherwise. 11 U.S.C. § 101(5)

² Lease section 26.3 provides that Pennsylvania law governs the Lease in all respects.

see also Nationwide Mut. Ins. Co. v. Optel (In re Optel, Inc.), 60 Fed. Appx. 390, 394 (3d Cir. 2003) (internal citations omitted).

18. The Debtors' rejection of the Lease constitutes a pre-petition breach of the Lease "immediately before the date of the filing of the petition." 11 U.S.C. § (g)(1). Further, pursuant to the Lease, Graceway held a contingent right to repayment of the Security Agreement. Given the course of business between Graceway and TRC pursuant to the Lease, there is no doubt that each holds a claim against the other.

(ii) The Obligations between TRC and Graceway are Mutual

19. The pre-petition claims and debts owed between a creditor and a debtor must be "mutual" to apply Bankruptcy Code section 553. 11 U.S.C. § 553. Courts have found that mutuality exists as long as the claim and debt are between the same parties, and the parties are acting in the same capacity. *See Semcrude*, 399 B.R. at 396; *Szymanski v. Wachovia Bank, N.A. (In re Szymanski)*, 413 B.R. 232, 242 (Bankr. E.D. Pa. 2009); *In re Ne. Enters.*, 318 B.R. 625, 627 (Bankr. E. D. Pa. 2005). To meet the "capacity requirement," the parties must each owe the other something in his or her own name, and not as a fiduciary. *In re Nuclear Imaging Sys., Inc.*, 260 B.R. 724, 735 (Bankr. E. D. Pa. 2000); *see also Semcrude, L.P.*, 399 B.R. at 396 (noting "each party must own his claim in his own right severally, with the right to collect in his own name against the debtor in his own right and severally.") (internal quotations and citations omitted); *see also In re Garden Ridge Corp.*, 338 B.R. 627, 633 (Bankr. D. Del. 2006) (same). Furthermore, mutuality will exist even though the obligations to be setoff did not arise out of the same transaction "since the test is mutuality, not similarity, of obligation." *In re Elsinore Shore Assocs.*, 67 B.R. 926, 936 (Bankr. D.N.J. 1986) (permitting depository bank to setoff its claim against the debtor for reimbursement under open letters of credit against amounts held in the

debtor's general account at the bank). Mutuality exists here where TRC, acting as Graceway's landlord, is the counter-party to the Lease and the same legal entity holding the Security Deposit.

(iii) The Obligations Between TRC and the Debtors are Valid and Enforceable

20. The pre-petition claims and debts owed between a creditor and a debtor must constitute valid and enforceable obligations under applicable non-bankruptcy law in order for Bankruptcy Code section 553 to apply. 11 U.S.C. § 553(a)(1). TRC's claims against the Debtors and the Debtors' claims against TRC are each valid and enforceable under both the Bankruptcy Code and non-bankruptcy law. Specifically, the rights of the parties regarding the Security Deposit as a result of the Lease are subject to, and governed by, Pennsylvania non-bankruptcy contract and real property law.

(iv) Cause Exists for Relief from the Automatic Stay

21. Pursuant to Bankruptcy Code section 362(d)(1), a party with an interest in property of the estate may request relief from the stay "for cause." 11 U.S.C. § 362(d)(1). The existence of the right of setoff, alone, constitutes "cause" sufficient to grant relief from the automatic stay to permit the setoff of mutual claims and debts. *See In re Nuclear Imaging Sys. Inc.*, 260 B.R. at 730 (noting "[c]ourts have generally concluded that the existence of mutual obligations subject to set-off constitute sufficient 'cause' to meet the creditor's initial evidentiary burden in seeking relief from the automatic stay"). A creditor can establish a *prima facie* showing of "cause" under section 362(d)(1) simply by demonstrating its right to setoff. *See Szymanski*, 413 B.R. at 243 (observing that "[c]ourts generally recognize that, by establishing a right of setoff, the creditor has established a *prima facie* showing of 'cause' for relief from the automatic stay") (citing *In re Ealy*, 392 B.R. 408, 414 (Bankr. E.D. Ark. 2008)); *see also In re Whitaker*, 173 B.R. 359, 361 (Bankr. S. D. Ohio 1994); *United States v. Parrish (In re Parrish)*,

75 B.R. 14, 16 (N.D. Tex. 1987) (reversing the denial of motion to lift stay where the creditor had established right to setoff).

22. Courts have broad discretion to lift the stay and should “balance potential prejudice to the bankruptcy debtor’s estate against the hardships that will be incurred by the person seeking relief from the automatic stay if the relief is denied.” *Robbins v. Robbins (In re Robbins)*, 964 F.2d 342, 345 (4th Cir. 1992). Granting the Motion will not prejudice the Debtors, as it will simply permit TRC to exercise its rights as an undersecured creditor under Bankruptcy Code section 506(a)(1), and offset the Security Deposit it already holds pursuant to the Lease against the Rejection Damages Claim. Therefore, having established that TRC has a non-bankruptcy right to setoff enforceable in these cases under Bankruptcy Code section 553(a) and a perfected security interest in the Security Deposit, “cause” exists to grant relief from the automatic stay under Bankruptcy Code section 362(d)(1) for purposes of exercising such right in accordance with the Lease and Pennsylvania common law.

NOTICE AND NO PRIOR REQUEST

23. Notice of this Motion has been provided to (i) the Office of the United States Trustee for the District of Delaware, (ii) Debtors’ counsel, (iii) the Committee’s counsel, and (iv) all parties requesting notices pursuant to Bankruptcy Rule 2002. TRC submits that no other or further notice need be provided.

24. No previous request for the relief sought by the Motion has been made to this or any other court.

WHEREFORE, TRC, requests the Court (i) lift the automatic stay in order to permit TRC to setoff the Security Deposit against the Rejection Damages Claim and (ii) grant such additional relief as it deems just and proper.

Dated: April 12, 2012

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