Docket #0445 Date Filed: 02/15/2022

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	: Chapter 11
SEQUENTIAL BRANDS GROUP, INC., *et al,*	: Case No. 21-11194 (JTD)
Debtors.	: **Hearing Date: February 22, 2022, at 1:00 p.m.** : **Confirmation Obj.: February 15, 2022, at 4:00 p.m.**

OBJECTION BY THE UNITED STATES TO
THE FIRST AMENDED JOINT PLAN OF LIQUIDATION

The United States, on behalf of its Internal Revenue Service ("IRS"), by and through the undersigned attorneys, objects to the First Amended Joint Plan of Liquidation of Sequential Brands Group, Inc., and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code ("Plan"). [Docket No. 402]. In support of its objection, the United States avers as follows:

BACKGROUND

1. On August 31, 2021, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

2. On December 7, 2021, the Debtors filed a Joint Plan of Liquidation. [Docket No. 338]. On January 12, 2022, the Debtors filed the Plan.

3. The United States is a creditor and a party in interest in this matter. The United States, on behalf of the IRS, filed against the Debtor, Sequential Brands Group, Inc., a pre-petition proof of claim in the general unsecured amount of $30,248.51. The IRS filed against the Debtor, Sequential Licensing, Inc., an estimated, pre-petition proof of claim in the unsecured priority amount of $200,000.

4. IRS records indicate that the Debtors have not filed a federal Form 941 tax return for the fourth quarter of 2020. IRS records also indicate that the Debtors have not yet filed federal income tax returns for the 2020 and 2021 tax years.

OBJECTIONS

5. **The Plan does not comply with 11 U.S.C § 1129(a)(9)(A) and 511(a).**

The Bankruptcy Code requires that the holder of administrative claims receive on account of such claims cash equal to the allowed amount of such claim on the effective date of the Plan. [11 U.S.C § 1129(a)(9)(A)]. The Plan fails to comply with the requirements of the Bankruptcy Code by not providing for the accrual of interest on administrative claims paid after the Effective Date. [Plan, Article II(A)]. The Bankruptcy Code gives specific guidance about the payment of interest, including the rate and method of interest that accrues on pre-petition and post-petition tax claims. [11 U.S.C. § 511]. The United States objects to the Plan to the extent that it fails to provide for the payment of an adequate rate of interest on the administrative claims of the United States. See 11 U.S.C. section 503(b)(1)(C) and section 511; United States v. Friendship College, Inc., 737 F.2d 430 (4th Cir. 1984); In re Mark Anthony Construction, Inc., 886 F.2d 1101 (9th Cir. 1989).

6. **The Plan does not comply with 11 U.S.C. § 1129(a)(9)(C) and 511(b).**

The Plan provides that each holder of an Allowed Priority Tax Claim shall receive a full and final satisfaction, settlement, release and discharge of each Allowed Priority Tax Claim, in exchange for treatment in accordance with section 1129(a)(9)(C) of the Bankruptcy Code. [Plan, Article II(B)]. The United States objects to the treatment of its priority tax claims to the extent the Plan fails to specifically provide for the payment of interest on such claims as required by sections 1129(a)(9)(C) and 511(b) of the Bankruptcy Code.

7. **The Plan does not comply with 11 U.S.C. § 1141(d)(3).**

Section 1141(d)(3) of the Bankruptcy Code provides:

> The confirmation of a plan does not discharge a debtor if –
>
> (A) The plan provides for the liquidation of all or substantially all of the property of the estate;
>
> (B) the debtor does not engage in business after the consummation of the plan; and
>
> (C) The debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

The liquidating Debtors are not entitled to a discharge. In fact, the Plan provides that in accordance with section 1141(d)(3) of the Bankruptcy Code, the Plan does not discharge the Debtors. [Plan, Article VIII(A)]. Nevertheless, the Plan contains numerous references to the discharge of obligations, including the discharge of Priority Tax Claims. The United States objects to the discharge provisions in the Plan to the extent that the Debtors have liquidated substantially all of their assets, do not engage in business after the consummation of the Plan, and would be denied a discharge if these were cases under Chapter 7 of the Bankruptcy Code.

8. Similarly, the Plan provides for the "settlement" of claims. Section 1123(b)(3)(A) of the Bankruptcy Code provides for the settlement or adjustment of any claim belonging to the Debtors or to the estates. The Debtors here are not settling their own claims. By virtue of the Plan process, the United States does not waive sovereign immunity, does not consent and objects to the settlement of its claims.

9. **The Plan does not comply with 11 U.S.C. § 503(b)(1)(D) and Rule 3002-1(a) of the Delaware Local Bankruptcy Rules.**

The Plan provides that any parties claiming administrative expense priority must file their claims by an Administrative Claim Bar Date. [Plan, Article I(A)(2)]. The creation of the administrative claim bar date in the Plan does not comply with the Bankruptcy Code or the

Delaware Local Bankruptcy Rules. The United States objects to the Plan to the extent the Plan purports to set an Administrative Expense Claim 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. [Plan, Article II(A)]. This provision violates not only Section 503(b)(1)(D) of the Bankruptcy Code but Delaware Local Bankruptcy Rule 3002-1(a). Delaware Local Rule 3002-1(a) provides in pertinent part:

> Chapter 11 Administrative Claims. Notwithstanding any provision of a plan of reorganization, any motion, notice, or court order in a specific case, the government shall not be required to file any proof of claim or application for allowance for any claims covered by Section 503 (b) (1) (B), (C), or (D).

10. **Non-Debtor Releases**.

The United States objects to the third-party non-debtor limitation of liability, discharge, injunction, exculpation and release provisions set forth in Article VIII and elsewhere in the Plan. Although this is a liquidating Plan and the Debtors are not entitled to a discharge, the Plan currently provides for third party injunctions, exculpations and releases. [11 U.S.C. § 1141(d)(3)]. While the Third Circuit stopped short of adopting a per se rule that a non-debtor release in a reorganization plan is not permissible (as other circuits have done), it held that, at most, such a provision could only be valid in "extraordinary" cases. Gillman v. Continental Airlines (In re Continental Airlines), 203 F.3d 203, 212 (3d Cir. 2000). At minimum, Continental held that such a nonconsensual release of non-debtor entities must contain all of the following "hallmarks": "fairness, necessity to the reorganization, and specific factual findings to support these conclusions." Id. at 214; see also In re Wash. Mut., Inc., 442 B.R. 314, 351-52 (Bankr. D. Del. 2011) (collecting cases). This Court has interpreted Continental's holding on non-debtor releases to mean that "limiting the liability of non-debtor parties is a rare thing that should not be considered

absent a showing of exceptional circumstances in which several key factors are present." In re Genesis Health Ventures, Inc., 266 B.R. 591, 608 (Bankr. D. Del. 2001) (emphasis added). This Court has previously held that a non-debtor release over a creditor's objection "would not pass muster." Wash. Mut., 442 B.R. at 352 ("This Court has previously held that it does not have the power to grant a third party release of a non-debtor."). Where this Court has even contemplated approval of a non-consensual release, it has required the following factors be present to justify the "rare" release: "(1) the non-consensual release was necessary to the success of the reorganization, (2) the releases have provided a critical financial contribution to the Debtor's plan, (3) the releases' financial contribution is necessary to make the plan feasible, and (4) the release is fair to the non-consenting creditors, i.e., whether the non-consenting creditors received reasonable compensation in exchange for the releases." In re Tribune Co., 464 B.R. 126, 177-78 (Bankr. D. Del. 2011); see also Genesis Health Ventures, 266 B.R. at 607-09. For the Court to infer consent from nonresponsive creditors and equity holders, the Debtors must make a showing under contract principles that the Court may construe silence as acceptance. In re Emerge Energy Services LP, et al., Case No. 19-11563, page 23, (Bankr.D.Del. 2019) [Docket No. 671]. Here, setting aside the question of whether the Debtors have made such a showing against all creditors generally (and it has not), the Debtors make no adequate showing of a single factor, let alone all of the Tribune/Genesis/Emerge factors, that justifies the extraordinary release of non-debtors in these liquidating cases with respect to their potential liability to the United States.

11. **Exclusive Jurisdiction.**

The United States objects to the Plan to the extent that it provides for the retention of exclusive jurisdiction. [Plan, Article XII]. See 28 U.S.C. 1334. While "the bankruptcy court plainly [may retain] jurisdiction to interpret and enforce its own prior orders," Travelers Indem.

Co. v. Bailey, 129 S. Ct. 2195, 2205 (2009), it may not divest other courts of their concurrent jurisdiction to interpret bankruptcy court orders. Rather, if for example, the United States, post-confirmation, asserts liabilities in a non-bankruptcy court of competent jurisdiction, that court may hear and determine all issues raised in the action, including whether the defendant can rely on the confirmation order as an affirmative defense. Adjudication of such a defense is a proceeding over which the bankruptcy court, as a unit of the district court, has "original but not exclusive jurisdiction." 28 U.S.C. § 1334(b) (emphasis added); see also Stern v. Marshall, 131 S.Ct. 2594 (2011); In re Mystic Tank Lines Corp., 544 F.3d 524 (3d Cir. 2008) ("No provision of the Bankruptcy Code requires the Bankruptcy Court to hear all 'related to' claims . . . the only aspect of the bankruptcy proceeding over which the district courts and their bankruptcy units have exclusive jurisdiction is 'the bankruptcy petition itself.'") (citing In re Wood, 825 F.2d 90, 92 (5th Cir.1987)); In re Combustion Eng'g, Inc., 391 F.3d 190, 224-225 (3d Cir. 2004), as amended (Feb. 23, 2005) ("Section 105(a) permits a bankruptcy court to 'issue any order, process or judgment that is necessary or appropriate to carry out the provisions' of the Bankruptcy Code. But as the statute makes clear, § 105 does not provide an independent source of federal subject matter jurisdiction."); In re Skyline Woods Country Club, 636 F.3d 467 (8th Cir. 2011); Whitehouse v. LaRoche, 277 F.3d 568, 576 (1st Cir. 2002). The imposition of these restrictive jurisdictional provisions impairs creditors.

12. **Setoff and Recoupment.**

The United States objects to the Plan to the extent it fails to preserve the setoff and recoupment rights of the United States. The Plan provides that creditors are barred from asserting any setoff or recoupment rights of any kind unless the creditor has timely asserted such setoff right before confirmation in a proof of claim or document filed with the Bankruptcy Court explicitly

preserving such setoff, and notwithstanding an indication of a claim, Cause of Action or interest or otherwise that such creditor asserts, has, or intends to preserve any right of setoff pursuant to applicable law or otherwise. [Plan, Article VIII(D)]. This setoff injunction is especially egregious because the government bar date in these cases (February 28, 2022) will not expire prior to the date of the confirmation hearing and the Debtors have not filed federal tax returns for pre-petition periods. Confirmation of a plan does not extinguish setoff claims when they are timely asserted. In re Continental Airlines, 134 F.3d at 542 (3d Cir. 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." Niagara 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 federal 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.").

13. Similarly, the Plan improperly fails to preserve recoupment rights of the United States. [Plan, Article VIII(F)]. Recoupment is unaffected by discharge even where it is available to Debtors who are not liquidating. Megafoods Stores, Inc. v. Flagstaff Realty Assocs. (In re Flagstaff Realty Assocs.), 60 F.3d 1031, 1035-36 (3rd Cir. 1995) (holding that recoupment survives discharge following confirmation and implementation of chapter 11 plan even if creditor did not object to plan or seek a stay pending appeal); see also Beaumont v. Dep't of Veteran Affairs (In re Beaumont), 586 F.3d 776 (10th Cir. 2009); Saif Corp. v. Harmon (In re Harmon), 188 B.R. 421, 425 (B.A.P. 9th Cir. 1995) ("Because recoupment only reduces a debt as opposed to constituting an independent basis for a debt, it is not a claim in bankruptcy, and is therefore unaffected by the debtor's discharge."); Lunt v. Peoples Bank (In re Lunt), 500 B.R. 9, 16 (D. Kan. 2013); Mercy Hosp. of

Watertown v. New York, 171 B.R. 490, 495 (N.D.N.Y. 1994); Brown v. General Motors Corp., 152 B.R. 935, 938 (W.D. Wis. 1993) (holding right of recoupment not a claim or debt to be discharged in bankruptcy). For the same reasons as stated above with respect to setoff rights, this Plan provision restricting creditors' recoupment rights is impermissible and impairs creditors.

14. **No prospective tax relief.**

The Plan contains unacceptable provisions that characterize the tax attributes of Plan transactions. For example, the Plan provides that for all federal tax purposes, all parties shall treat the Liquidating Trust, other than any portion thereof in respect of the Disputed Claims, as a liquidating trust under Treasury Regulation Section 301.7701-4 and that the trust be owned by the Liquidating Trust Beneficiaries. [Plan, Article IV(B)(13)]. The United States objects to the Plan to the extent it provides for prospective tax relief

15. **Section 505 of the Bankruptcy Code.**

The Plan provides that the Liquidating Trustee may request an expedited determination of taxes of the Liquidating Trust under section 505(b) of the Bankruptcy Code for all returns filed for, or on behalf of, the Liquidating Trust for all taxable periods through the dissolution of the Liquidating Trust. [Plan, Article IV(B)(13)]. The Plan further provides that the Debtors and the Liquidating Trustee shall have the right to request an expedited determination of the tax liability of the Debtors, if any, under section 505(b) of the Bankruptcy Code with respect to any tax returns filed, or to be filed, for any and all taxable periods ending on or before the filing of a certificate of cancellation or dissolution for Sequential Parent. [Plan, Article IV(J)]. The United States objects to the Plan to the extent that the relief sought under section 505 of the Bankruptcy Code is overly broad and prejudicial to creditors.

16. **The immediate binding effect provisions in the Plan are inconsistent with the Federal Rules of Bankruptcy Procedure.**

The Plan provides in pertinent part that notwithstanding Bankruptcy Rules 3020(e), 6004(h), 7062, or otherwise, upon the occurrence of the Effective Date, the terms of this Plan and the Plan Supplement shall be immediately effective and enforceable and deemed binding upon the Debtors, the Liquidating Trustee, all Holders of Claims or Interests (irrespective of whether such Claims or Interests are deemed to have accepted the Plan), all Entities that are parties to or are subject to the settlements, compromises, releases, discharges and injunctions described in this Plan, each Entity acquiring property under the Plan, and any and all non-Debtor parties to Executory Contracts and Unexpired Leases with the Debtors. [Plan, Article XIII(A)]. The United States does not consent to the truncation of its statutory protections. This provision negatively affects the United States' appeal rights. If the Debtors consummate the Plan immediately after confirmation, the Debtors are effectively requesting that the Court shorten the time for appeal afforded by the federal bankruptcy rules. Pursuant to Rules 6004(h), 7062 and 3020(e) of the Federal Rules of Bankruptcy Procedure, unless otherwise ordered by the Court, an automatic fourteen-day stay is imposed from the date of entry of the order. Under the Debtors' proposed scheme, if the United States is unable immediately to obtain a hearing before the appropriate Court to seek a stay, its appeal may be contended to be moot. Particularly in light of the appellant being a government agency, with a chain of command to be consulted, this unilateral ability of the Debtors to shorten the stay period would be unfair and prejudicial to the government.

17. **The Plan does not comply with Section 1129(a)(1) of the Bankruptcy Code.**

For the reasons stated above, the Plan does not comply with the applicable provisions of Title 11 and therefore cannot be confirmed pursuant to section 1129(a)(1) of the Bankruptcy Code.

CONCLUSION

WHEREFORE, the United States 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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BY: */s/ Ellen Slights*
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Dated: February 15, 2022

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FOR THE DISTRICT OF DELAWARE

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SEQUENTIAL BRANDS GROUP, INC., *et al,*	: Case No. 21-11194 (JTD)
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AFFIDAVIT OF SERVICE

I, Kimberly Rechner, an employee in the Office of the United States Attorney for the District of Delaware, hereby attest that on February 15, 2022, I caused to be served a copy of the **OBJECTION BY THE UNITED STATES TO THE FIRST AMENDED JOINT PLAN OF LIQUIDATION** by electronic service on the registered parties via the Court's CM/ECF system and upon the following parties:

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