Docket #0979 Date Filed: 5/1/2013

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re:	§	CASE NO. 13-10125-KJC
	§	
SCHOOL SPECIALTY, INC., et al.	§	Chapter 11
	§	
Debtors	§	Jointly Administered

OBJECTION OF THE TEXAS COMPTROLLER OF PUBLIC ACCOUNTS TO CONFIRMATION OF DEBTORS' AMENDED JOINT PLAN OF REORGANIZATION

The Texas Comptroller of Public Accounts ("Texas Comptroller"), through the Texas Attorney General's Office, objects to the confirmation of the Debtors' Amended Joint Plan of Reorganization (the "Plan").

1. The Texas Comptroller has filed priority tax claims in this case for unpaid pre-petition franchise taxes in the amount of $613,317.70 and for sales taxes in the amount of $35,871.49. The Comptroller's claims are entitled to priority pursuant to 11 U.S.C. § 507(a)(8).

2. The Plan contains language that purports to preclude rights of setoff. See Plan Article IX.E. Pursuant to 11 U.S.C. § 553, setoff rights survive bankruptcy and are not affected by other sections of the Bankruptcy Code, including § 1141. IRS v. Luongo (In re Luongo), 259 F.3d 323 (5th Cir. 2001); Carolco Television, Inc. v. National Broadcasting Co. (In re De Laurentis Entertainment Group, Inc.), 963 F.2d 1269, 1276-78 (9th Cir. 1992), cert. denied, 506 U.S. 918, 113 S. Ct. 330, 121 L.Ed.2d 249 (1992); Davidovich v. Welton (In re Davidovich), 901 F.2d 1533, 1537 (10th Cir. 1990); Pettibone Corp. v. United States (In re Pettibone Corp.), 151 B.R. 960, 964 (N.D. Ill. 1993); Womack v. United States (In re Womack), 188 B.R. 259 (Bankr. E.D. Ark. 1995). The Third Circuit has emphasized the importance of raising this issue prior to confirmation in order to avoid an adverse or unintended consequence. United States of America v. Continental Airlines (In re Continental Airlines), 134 F.3d 536 (3d Cir. 1998), cert.

denied, 525 U.S. 929, 119 S.Ct. 336, 142 L.Ed.2d 277 (1998). See, In re Alta+Cast, LLC, 2004 WL 484881 (Bankr. D. Del. 2004). The Plan's prohibitions against setoff do not comply with the provisions of § 553, and the Plan cannot be confirmed, pursuant to 11 U.S.C. § 1129(a)(1).

3. The Plan contains broad and expansive releases of non-debtors. The Court should not confirm a Plan requiring taxing authorities to release non-debtor parties. Texas law provides third party liability in certain circumstances for "responsible persons" and other potential parties in regard to the tax liabilities of a taxpayer. See, e.g., Texas Tax Code § 111.016. The release provisions in the Plans are contrary to the discharge limitations set forth in 11 U.S.C. § 524(e). In re Applewood Chair Co., 203 F.3d 914 (5th Cir., 2000); Feld v Zale Corp. (In re Zale Corp.), 62 F.3d 746 (5th Cir. 1995). Furthermore, specific federal law prohibits such provisions in the context of state tax claims. Under the Tax Injunction Act, 28 U.S. C. § 1341:

> The District Courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

An attempt to prevent the Texas Comptroller from pursuing a non-debtor is in violation of the Tax Injunction Act. McCrory Corp. v. Texas Comptroller of Public Accounts, 212 B.R. 229, 231 S.D.N.Y. 1997). See, also, the following cases construing the similarly worded federal statute, the Tax Anti-Injunction Act, 26 U.S.C. § 7421(a). In re: LaSalle Rolling Mills, Inc., 832 F.2d 390 (7th Cir. 1987); In re: American Bicycle Association, 895 F.2d 1277 (9th Cir. 1990); In re: Heritage Village Church and Missionary Fellowship, Inc., 851 F.2d 104 (4th Cir. 1988); A to Z Welding & Mfg. Co. v. I.R.S., 803 F.2d 932 (8th Cir. 1986). Further, the Bankruptcy Code does not confer jurisdiction to enjoin taxing authorities from pursuing third parties. United

States v. Prescription Home Health Care, Inc. (In re Prescription Home Health Care, Inc.), 316 F.3d 542 (5th Cir. 2002).

4. The Plan violates 11 U.S.C. § 1129(a)(9)(C)(iii) by proposing to pay priority tax claims in annual installment payments. Pursuant to Section 1129(a)(9)(C)(iii), priority tax claims must be paid in regular installment payments "in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan." In this case, neither class of the general unsecured claims provided for in the plan are being paid in annual installment payments and both classes are receiving treatment more favorable than priority tax claims.

5. Further, annual payments have not been justified by the Debtor as necessary to their reorganization or supported by business need. Annual payments render it difficult, if not impossible, to effectively monitor the Debtors' performance and viability. The Court should not confirm a plan in this case that permits annual payments.

6. The Plan's definition of "Claims Objection Deadline" permits the Debtors to extend the 90 day objection deadline by a motion "filed before or after such deadline and may be approved without a hearing and without notice to any party." This provision, hidden in the definition section of the Plan, violates creditors' Constitutional due process rights and is contrary to the Bankruptcy Code and Rules. Further, the ability to request unlimited extensions of time allows the Debtors to indefinitely delay payment of claims simply by failing to object. The Court should not confirm a provision that allows extensions without any notice or opportunity to be heard. The Court should also not confirm a plan that allows limitless extensions of time.

7. Article III.C describes the treatment of priority tax claims. The treatment proposed fails to make clear that the Debtors must pay post confirmation interest on priority tax

claims at the rate prescribed by state law. 11 U.S.C. § 511.

8. The Plan also does not contain adequate remedies in the event of a default in payment by the Debtors. Default remedy language similar to the following has been approved in many bankruptcy cases in this and other districts:

> A failure by the reorganized Debtor to make a payment to secured or priority tax creditors pursuant to the terms of the Plan shall be an Event of Default. If the reorganized Debtor fails to cure an Event of Default as to tax payments within ten (10) days after service of a written notice of default from a tax creditor, then a tax creditor may (a) enforce the entire amount of its claim, (b) exercise any and all rights and remedies under applicable non-bankruptcy law, and (c) seek such relief as may be appropriate in this court.

Language similar to the above should be added to the Plan or confirmation order to clarify creditors' default remedies pursuant to 11 U.S.C. § 1123(a)(5)(g), which requires that a plan provide adequate means for the plan's implementation, such as "curing or waiving any default."

WHEREFORE, the Texas Comptroller respectfully requests that the Court deny confirmation and provide such other and further relief to which the Comptroller may be entitled.

Respectfully submitted,

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I certify that on May 1, 2013, a true copy of the foregoing was served by the method and to the following parties as indicated:

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