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Hearing Date: December 16, 2010

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**UNITED STATES BANKRUPTCY COURT
THE SOUTHERN DISTRICT OF NEW YORK**

In re:

JENNIFER CONVERTIBLES, INC.,¹

Debtors.

Chapter 11

Case No. 10-13779 (ALG)

(Jointly Administered)

**DEBTORS' OBJECTION AND RESPONSE IN OPPOSITION TO MOTION
OF TMCC, INC. FOR AN ORDER COMPELLING PAYMENT OF POSTPETITION
LEASE OBLIGATIONS, DIRECTING THE TIMELY PERFORMANCE OF ALL
LEASE OBLIGATIONS OR, IN THE ALTERNATIVE, COMPELLING
DEBTOR TO IMMEDIATELY REJECT LEASE**

**To: The Honorable Allan L. Gropper
United States Bankruptcy Judge**

Jennifer Convertibles, Inc. ("Jennifer Convertibles") and its affiliated debtors, as debtors and debtors in possession (together, the "Debtors") hereby respectfully submit this *Objection and Response in Opposition to the Motion of TMCC, Inc. ("TMCC") for an Order Compelling Payment of Postpetition Lease Obligations, Directing the Timely Performance of all Lease*

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, if applicable, are: (i) Jennifer Convertibles, Inc. (4646); (ii) Jennifer Convertibles Boylston MA, Inc. (7904); (iii) Jennifer Chicago Ltd. (0505); (iv) Elegant Living Management, Ltd. (5049); (v) Hartsdale Convertibles, Inc. (1681); (vi) Jennifer Management III Corp. (3552); (vii) Jennifer Purchasing Corp. (7319); (viii) Jennifer Management II Corp. (9177); (ix) Jennifer Management V Ltd. (9876); (x) Jennifer Convertibles Natick, Inc. (2227); (xi) Nicole Convertibles, Inc. (5985); (xii) Washington Heights Convertibles, Inc. (0783).

Obligations of, in the Alternative, Compelling Debtor to Immediately Reject Lease (the “Objection and Response”). The Objection and Response is accompanied by the Declaration of Ellen V. Holloman, Esq., together with its attached exhibits, sworn to on November 22, 2010, and cited herein as “Holloman Decl.”

As and for its Objection and Response, the Debtors respectfully state as follows:

Preliminary Statement

1. TMCC, Inc. (“TMCC”) purports to bring its Motion pursuant to Section 365(d)(3) of the Bankruptcy Code, which was enacted by Congress to protect landlords from becoming the unwilling underwriters of debtors in bankruptcy by requiring the payment of rent. However, TMCC concedes that the Debtors have been paying post-petition monthly rent to TMCC. Instead, TMCC asks the Court to require the Debtors to make additional, gratuitous payments to GMM Consulting, Inc. (“GMM”) that are characterized as “additional rent” in the relevant sublease documents, but in fact are being used as compensation for alleged lost profits that supposedly arise from TMCC’s decision to sublet the premises in question to the Debtors. GMM, a corporation owned and controlled by TMCC’s principal, is not the Debtors’ landlord or sub-landlord.

2. During the discovery had thus far in these proceedings, TMCC’s and GMM’s principal—who is one and the same person—openly has acknowledged that, pre-petition, GMM had been collecting from the Debtors an additional \$20,000 per month over and above the monthly rent payment of \$32,000 due to TMCC in order to sublet the premises in question. Discovery also has confirmed that GMM provides no services whatsoever to the Debtors in exchange for the payments, and indeed, has no line of business other than to receive monthly payments from the Debtors. TMCC’s and GMM’s principal has testified that he used the

payments to GMM from the Debtors not for his own rent obligations on the premises in question, but rather to pay himself and his wife a weekly salary and a pension.

3. Simply put, TMCC's Motion presents no cognizable issue under Section 365(d)(3) of the Code. The Debtors have been paying TMCC post-petition rent, and TMCC's landlord, in turn, has been receiving its rent. GMM is not the Debtors' landlord or sub-landlord and has no right or title to the premises in question. Indeed, GMM is not a party to either the Lease or the Sublease, or even to this Motion. TMCC's attempt to shoehorn payments to GMM for supposed lost profits into any lease obligations ordinarily recognized by the Bankruptcy Code and presiding Courts should not be countenanced, and TMCC's Motion should be denied in its entirety.

Procedural Posture

4. On July 18, 2010 (the "Petition Date"), each of the Debtors commenced with the Bankruptcy Court a voluntary case pursuant to chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.²

5. Jennifer Convertibles was organized as a Delaware corporation in 1986, and is currently the owner of (i) the largest group of sofabed specialty retail stores and leather specialty retail stores in the United States, and (ii) six big box, full-line furniture stores operated under the Ashley Furniture HomeStore brand (the "Ashley Stores") under a license from Ashley Furniture Industries, Inc. ("Ashley").

² The factual background relating to the Debtors' commencement of these chapter 11 cases is set forth in additional detail in the Disclosure Statement with Respect to the Chapter 11 Plan of Reorganization of Jennifer Convertibles, Inc. and Its Affiliated Debtors, filed on November 19, 2010 and incorporated herein by reference.

6. On September 28, 2010, TMCC filed a Notice of Motion together with a *Motion for an Order Compelling Payment of Postpetition Lease Obligations, Directing the Timely Performance of All Lease Obligations or, in the Alternative, Compelling Debtor to Immediately Reject Lease* (the “TMCC Motion” or the “Motion”).

7. As set forth in the Motion and its accompanying exhibits, TMCC subleases the premises in question to the Debtors. (Motion ¶ 4 and Ex. B.) Although TMCC concedes that the Debtors have been making post-petition payments of rent in the amount of \$32,000 per month to TMCC (Motion ¶ 8, 11), TMCC contends that additional post-petition monthly payments of \$20,000 per month remain due and owing to GMM (Motion ¶ 11). GMM is a corporation owned by TMCC’s principal, Gerald McCrystal. (Motion ¶ 6.) TMCC also seeks rent, pro-rated from \$52,000 (the sum of payments to TMCC and GMM), for the immediate post-petition period of July 18, 2010 to July 31, 2010 (Motion ¶ 8).

8. On October 18, 2010, the Debtors served subpoenas *duces tecum* and *ad testificandum* on TMCC, GMM and Josalco, Inc. (now known as JSP Realty Group LLC) (“Josalco”). (Holloman Decl. ¶ 2.) Josalco is TMCC’s landlord and the owner of the premises that TMCC is subletting to the Debtors. (Motion ¶ 3.)

9. TMCC and GMM produced documents in response to the Debtors’ subpoenas, and Josalco made documents available for inspection in response to the Debtors’ subpoena. (Holloman Decl. ¶ 2.) Mr. McCrystal, Joseph Picone, Jr. and Victor Emanuelo (the President and General Counsel of Josalco, respectively) have provided depositions. (Holloman Decl. ¶¶ 2-3.)

10. Discovery is still on-going as of the date of this Objection and Response, and the Debtors hereby respectfully reserve the right to amend and supplement this Objection and Response as appropriate.

Background

11. On or about September 29, 2007, TMCC entered into a lease agreement with landlord Josalco (the “Lease”) for a premises located at 1821 Route 110, in Farmingdale, New York (the “Premises”). (Motion ¶ 3 and Ex. A.) The Premises is a building of approximately 20,000 square feet that is used for retail purposes. (Holloman Decl. Ex. 2 (Picone Tr. 15:4-23).) The Lease includes a schedule, bearing the title “Exhibit B”, which establishes the monthly rent due to Josalco for the Premises as \$32,000 for the time period of November 1, 2009 to October 31, 2010. (Motion Ex. A at page 15.)

12. TMCC is a holding company established by Mr. McCrystal for the Premises. (Holloman Decl. Ex. 1 (McCrystal Tr. 14:14-21; 15:14-24).) Mr. McCrystal also is the president and owner of Roma Furniture and its holding company, Roma FLI, Inc. (collectively, “Roma”). (Holloman Decl. Ex. 1 (McCrystal Tr. 15:25-16:18; 17:6-9; 17:19-18:2).) Roma is in the business of furniture retail. (Holloman Decl. Ex. 1 (McCrystal Tr. 19:6-9).) Prior to October 2009, Mr. McCrystal operated a Roma Furniture retail store at the Premises. (Holloman Decl. Ex. 1 (McCrystal Tr. 20:21-21:4).)

13. Pursuant to a sublease agreement dated August 18, 2009 (the “Sublease”), TMCC sublet the Premises to Debtors (specifically, to Hartsdale Convertibles, Inc. (“Hartsdale”). (Motion Ex. B.) After the execution of the Sublease, Mr. McCrystal relocated Roma Furniture to another storefront located at 1815 Route 110. (Holloman Decl. Ex. 1 (McCrystal Tr. 20:21-22:9).) That location is a smaller space that is also owned by Josalco, and is located “right next

door” to the Premises. (Holloman Decl. Ex. 1 (McCrystal Tr. 122:19-23); *see also* Holloman Decl. Ex. 2 (Picone Tr. 18:7-15).)

14. GMM is a corporation formed by Mr. McCrystal after the execution of the Sublease. (Holloman Decl. Ex. 1 (McCrystal Tr. 19:13-16).) According to Mr. McCrystal, GMM was formed, on the advice of his accountant, to “make up for the profit that [Mr. McCrystal] would lose by relocating” Roma Furniture next door to the Premises. (Holloman Decl. Ex. 1 (McCrystal Tr. 19:22-20:4; 123:16-124:7; 136:17-137:6; *see also* McCrystal Tr.; 128:17-25; 129:11-19).)

15. The Sublease includes a rent schedule, bearing the title “Exhibit B”, which establishes the monthly rent due to TMCC for the Premises as \$32,000 for the time period of November 1, 2009 to October 31, 2010. (Holloman Decl. Ex. 4.) That amount of monthly rent is the same amount of monthly rent due from TMCC to Josalco under the Lease for the Premises. (*Compare* Motion Ex. A at page 15 *with* Holloman Decl. Ex. 4.)

16. Exhibit B to the Sublease further calls for, under a caption of “Additional Monthly Rent paid to Roma FLI, Inc.”, a “one time up front payment paid upon execution of Agreement” of \$100,000 to Roma FLI, and additional payments monthly payments to Roma FLI the time period of October 15, 2009 to September 30, 2010. (Holloman Decl. Ex. 4.) Under a caption of “Additional Monthly Rent paid to GMM Consulting, Inc.”, Exhibit B to the Sublease also calls for payments to GMM for the October 1, 2010 to October 31, 2011 time period, and continuing thereafter. (Holloman Decl. Ex. 4.)

17. Exhibit B to the Sublease apparently was amended at some time in November 2009, resulting in a document bearing the title “Amended Exhibit B”. (Motion ¶ 4 & Ex. C; *see also* Holloman Decl. Ex. 1 (McCrystal Tr. 119:14-120:5).)

18. Amended Exhibit B also establishes the monthly rent due to TMCC for the Premises as \$32,000 for the time period of November 1, 2009 to October 31, 2010; again, that is the same amount of monthly rent due from TMCC to Josalco under the Lease for the Premises. (*Compare* Motion Ex. A at page 15 *with* Motion Ex. C.)

19. Amended Exhibit B continues to call for, under a caption of “Additional Monthly Rent paid to Roma FLI, Inc.”, a “one time up front payment paid upon execution of Agreement” of \$100,000 to Roma FLI. (Motion Ex. C.)

20. Amended Exhibit B also calls for, under a caption of “Additional Monthly Rent paid to GMM Consulting, Inc.”, a payment to GMM of \$10,000 for the time period of October 15, 2009 to October 31, 2009, and payments to GMM of \$20,000 for the time period of November 1, 2009 to September 30, 2010. Thereafter, Amended Exhibit B calls for monthly payments to GMM of \$18,000 for the October 1, 2010 to October 31, 2011 time period. (Motion Ex. C.)

21. TMCC, GMM and Roma are all owned by Mr. McCrystal. (Holloman Decl. Ex. 1 (McCrystal Tr. 94:6-13).) However, neither GMM nor Roma FLI are sub-landlords to the Debtor under the Sublease. (*See* Motion Ex. B; *see also* Holloman Decl. Ex. 1 (McCrystal Tr. 96:12-14 (“Q: Is GMM a sub landlord under the sublease? A: No.”)); Holloman Decl. Ex. 1 (McCrystal Tr. 109:2-8 (“Q: Is Roma FLI a party to the sublease? . . . A: No, it is not signed off here.”)); Holloman Decl. Ex. 2 (Picone Tr. 35:22-23 (“Q: Is GMM a tenant of Josalco? A: No.”).)

22. Similarly, neither GMM nor Roma are parties to the Lease between TMCC and Josalco. (Motion Ex. A; *see also* Holloman Decl. Ex. 2 (Picone Tr. 40:7-8 (“Q: Was GMM a party to the lease? A: No.”)); Holloman Decl. Ex. 3 (Emanuelo Tr. 45:8-46:9 (“Q: Does Josalco

do any business with GMM? A: No. . . . A: It would also be correct to say that GMM is not a tenant at any other premises that that Josalco owns.”); Holloman Decl. Ex. 3 (Emanuelo Tr. 50:50-51:5 (“Q: Does Josalco lease any property to Roma FLI? A: No. . . .Q: Does Josalco have any relationship or business arrangement with Roma FLI? A: No.”)).)

23. The Debtors made the “one time upfront payment” of \$100,000 to Roma FLI as called for on Amended Exhibit B. Mr. McCrystal has testified that the “one time upfront payment” to Roma FLI, although characterized as “additional monthly rent” on Exhibit B and Amended Exhibit B to the Sublease, was not used to pay rent, but rather was intended as assistance with moving fees associated with the rapid relocation of Roma Furniture from the Premises to the premises right next door.³ (Holloman Decl. Ex. 1 (McCrystal Tr. 114:21-115:14); *see also* McCrystal Tr. 113:24-114:6 (. . . “I don’t know the answers as to why it was worded this way, but I know it was used for, you know, it was used as a moving fee, I used it to move.”).)

24. Until May 2010, the Debtors also made payments to GMM of \$20,000 per month as called for on Amended Exhibit B. During the discovery had in these proceedings, Mr. McCrystal confirmed that those payments were never used by GMM to pay rent due to Josalco under the Lease. (Holloman Decl. Ex. 1 (McCrystal Tr. 142:22-25; *see also* McCrystal Tr. 142:8-21).) Rather, those payments, although characterized as “additional monthly rent” on Exhibit B and Amended Exhibit B to the Sublease, were intended to “compensate [Mr. McCrystal] for the dollar amount that [he] lost from [relocating Roma] from a better space to a different space.” (Holloman Decl. 1 (McCrystal Tr. 128:18-25; *see also* McCrystal Tr. 129:11-20).)

³ Mr. McCrystal also testified that he was not able to comment on the characterization of the payment to Roma FLI called for Amended Exhibit B as additional monthly rent without reference to conversations he had with counsel. (Holloman Decl. Ex. 1 (McCrystal Tr. 115:15-116:2).)

25. Mr. McCrystal further testified during discovery that:

- GMM is not the Debtors' sub-landlord. (Holloman Decl. Ex. 1 (McCrystal Tr. 96:12-14 (“Q: Is GMM a sub landlord under the [S]ublease? A: No.”)); *see also* Motion Ex. B.)
- GMM provided no services for the Debtors. (Holloman Decl. Ex. 1 (McCrystal Tr. 138:8-13).)
- “GMM Consulting” actually had no consulting business with Hartsdale. (Holloman Decl. Ex. 1 (McCrystal Tr. 143:13-21).)
- GMM’s sole source of revenue was payments made by the Debtors (specifically Hartsdale). (Holloman Decl. Ex. 1 (McCrystal Tr. 43:16-19; *see also* McCrystal Tr. 41:13-42:6).)
- Mr. McCrystal and his wife are the sole employees of GMM and were drawing paychecks for themselves from the funds collected from the Debtors. (Holloman Decl. Ex. 1 (McCrystal Tr. 38:9-39:20; 137:20-138:2).)
- The entire payment that GMM received from the Debtors was disbursed each month. (Holloman Decl. Ex. 1 (McCrystal Tr. 140:18-141:3).)
- Mr. McCrystal did “minor paperwork” in exchange for his paychecks from GMM. (Holloman Decl. Ex. 1 (McCrystal Tr. 138:15-139:7).)
- Mrs. McCrystal did “nothing” in exchange for her paychecks from GMM. (Holloman Decl. Ex. 1 (McCrystal Tr. 38:24-39:8; *see also* McCrystal Tr. 139:23-140:7).)
- Funds paid to GMM by the Debtors also were used to fund a pension fund for the benefit of the McCrystals. (Holloman Decl. Ex. 1 (McCrystal Tr. 143:2-12).)

TMCC’s Demand for “Additional Rent” on Behalf of GMM Should Be Denied

26. Section 365(d)(3) of the Bankruptcy Code provides that a debtor-in-possession “shall timely perform of the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of non-residential property, until such lease is assumed or rejected. . . .” 11 U.S.C. § 365(d)(3). Section 365(d)(3) thus provides landlords with additional protections over other creditors with claims entitled to administrative expense status. *In re*

Microvideo Learning Sys., Inc., 232 B.R. 602, 604 (S.D.N.Y. Bankr. 1999). In particular, Section 365(d)(3) permits landlords to make claims for post petition rent without meeting the requirements of Section 503(b)(1) of the Code, and thereby without making a showing that the amounts allegedly owed are reasonable or of a benefit to the estate. *Id.*

27. The legislative history of Section 365(d)(3) makes plain that the Section was intended to relieve burdens placed on non-residential real property lessors during the period between the time a debtor-tenant files its bankruptcy petition and the time the debtor-tenant assumes or rejects the lease. *See In re Pudgie's Dev. of NY, Inc.*, 239 B.R. 688, 692 (S.D.N.Y. 1999). As Senator Hatch explained in connection with Congress' creation of Section 365(d)(3):

[T]he *landlord* is forced to provide *current services*—the use of its property, utilities, security and other services—without current payment. No other creditor is put in this position. . . . The bill would lessen [this] problem by requiring the Trustee to perform all the obligations of the debtor under a lease of nonresidential real property at the time required in the lease. This timely performance requirement will insure that debtor-tenants pay their rent, common area and other charges on time pending the debtor's assumption or rejection of the lease.

130 Cong. Rec. § 8894-95 (daily ed. June 29, 1984) (emphasis added); *see also In re Child World, Inc.*, 161 B.R. 571, 575 (S.D.N.Y. 1993) (alterations in the Code made by enactment of Section 365(d)(3) “were intended, in Senator Hatch’s words, to ensure that landlords received ‘current payment’ for their ‘current services.’”).

28. Although TMCC is the movant here, the Motion plainly is being brought on behalf of GMM: the Motion explicitly is seeking payments of \$20,000 that TMCC contends are due to GMM pursuant to Amended Exhibit B to the Sublease. (*See* Motion ¶¶ 6-8, 11 and Ex. C.) Critically, TMCC concedes that the Debtors have been paying post-petition rent to TMCC of \$32,000 (*see* Motion ¶¶ 8, 11), and Josalco, the owner of the Premise, has confirmed that it has been receiving post-petition rent payments as well. (Holloman Decl. Ex. 2 (Picone Tr. 47:18-

48:5); Holloman Decl. Ex. 3 (Emanuelo Tr. 74:14-22; *see also* Emanuelo Tr. 73:20-74:12 (“A: . . . I did speak with Mr. McCrystal on more than one occasion about Josaclo’s view that we would not—our interest was in continuing to collect our rent, that’s our business—and if his desire to collect an amount in excess of rent provided under the terms of the lease was going to affect our ability, Josalco’s ability, that is, to collect the rent provided under the terms of the lease, that we wouldn’t be happy about it.”); Emanuelo Tr. 58:16-20 (“A: . . . I wouldn’t want these payments to interfere with Josalco’s ability to continue to receive its rental payments.”).)

29. It is an undisputed fact that GMM is not the Debtors’ sublandlord. Indeed, GMM is not a party to either the Lease or the Sublease. (*See* Motion Exs. A &B; *see also* Holloman Decl. Ex. 1 (McCrystal Tr. 96:12-14 (“Q: Is GMM a sub landlord under the sublease? A: No.”)); McCrystal Tr. 109:2-8 (“Q: Is Roma FLI a party to the sublease? . . . A: No, it is not signed off here.”)); Holloman Decl. Ex. 2 (Picone Tr. 35:22-23 (“Q: Is GMM a tenant of Josalco? A: No.”); Picone Tr. 40:7-8 (“Q: Was GMM a party to the lease? A: No.”)); Holloman Decl. Ex. 3 (Emanuelo Tr. 45:8-46:9 (“Q: Does Josalco do any business with GMM? A: No. . . . A: It would also be correct to say that GMM is not a tenant at any other premises that that Josalco owns.”); Emanuelo Tr. 50:50-51:5 (“Q: Does Josalco lease any property to Roma FLI? A: No. . . . Q: Does Josalco have any relationship or business arrangement with Roma FLI? A: No.”)).) Accordingly, GMM has no status under, and no recourse to, Section 365(d)(3) of the Bankruptcy Code to compel the Debtors to make payments to it, however those payments are characterized.

30. Moreover, the discovery had thus far has shown that *GMM provides no services whatsoever* to the Debtors. Rather, GMM’s only line of business is to receive monthly checks from the Debtors. Mr. McCrystal testified that GMM was established in order to “make up for

profits [he] would lose by relocating” (Holloman Decl. Ex. 1 (McCrystal Tr. 19:22-20:4)), and moreover, that he and the Debtors understood that the payments were intended as compensation for his supposed loss, rather than as rent (Holloman Decl. Ex. 1 (McCrystal Tr. 90:9-19; 123:9-124:7)).

31. TMCC insists that the monthly payments to GMM are rent, but that contention exalts form over substance. Mr. McCrystal admitted at his deposition that the \$100,000 payment to Roma FLI called for in the Sublease documents, even though described as “additional monthly rent,” was in fact used for relocation expenses and not for monthly rent at all. The Court similarly should look past the characterization of the monthly payments of GMM as “additional monthly rent” to the substance of the transaction. Mr. McCrystal explicitly testified that the payments to GMM were not being used to pay rent:

Q: The payments that are characterized as additional monthly rent that are set forth on [Amended Exhibit B] to GMM are intended to compensate for a loss?

A: Yes

(Holloman Decl. Ex. 1 (McCrystal Tr. 123:16-23).)

32. Whether masquerading as “additional rent” or otherwise, the payments to GMM admittedly are not being used by GMM to pay any rent. As this Court has noted, “rent is the primary obligation” of which Section 365 requires performance. *In re Pudgie’s Dev. of NY, Inc.*, 202 B.R. 832, 835 (S.D. N. Y. Bankr. 1996). Here, the rent due to both the sublandlord—TMCC—and the landlord—Josalco—is being paid. Only the payment to GMM—which is not the Debtors’ landlord, and is not a party to the Lease, the Sublease or the Motion—is not being paid. The payments sought by TMCC on GMM’s behalf are not to compensate for current services that GMM (or even TMCC) is providing, but rather is intended to address Mr. McCrystal’s so-called lost profits. There is no obligation under Section 365(d)(3) or otherwise

that requires the Debtors to pay GMM \$20,000 per month in lost profits under the guise of post-petition “additional rent.” Particularly in light of TMCC’s concession that the Debtors have been paying post-petition rent to TMCC, GMM, at best, may only have an unsecured claim for such payments. For all of the foregoing reasons, the Debtors also submit that any “stub rent” due for the immediate post-petition period of July 18, 2010 to July 31, 2010 should be calculated based on the monthly rent due to TMCC, which is \$32,000, and not on any compensatory payments to GMM.

Notice

33. No trustee or examiner has been appointed in these chapter 11 cases. Notice of this Objection and Response has been provided to: (i) Office of the United States Trustee for the Southern District of New York; (ii) counsel to the Official Committee of Unsecured Creditors; (iii) the SEC; and (iv) any other party who has filed a notice of appearance in these cases. The Debtors submit that such notice is sufficient under the circumstances.

No Previous Request

34. No previous request for the relief sought herein has been made to this or any other Court.

WHEREFORE the Debtors respectfully request that the Court deny TMCC's Motion in its entirety and grant the Debtors any such other and further relief as the Court may deem just and appropriate.

Dated: New York, New York
November 22, 2010

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