

GREENBERG TRAUERIG, LLP

Proposed Hearing Date: November 30, 2010
Proposed Hearing Time: 10:00 a.m.

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

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In re:	: Chapter 11
	: :
JENNIFER CONVERTIBLES, INC.	: Case No. 10-13779 (ALG)
	: :
Debtors.	: (Jointly Administered)
	: :
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**PRELIMINARY OBJECTION OF ASHLEY HOMESTORES, LTD. AND
ASHLEY FURNITURE INDUSTRIES, INC. TO DEBTOR'S EMERGENCY MOTION
FOR ENTRY OF AN ORDER AUTHORIZING THE DEBTORS TO ENTER INTO
A DIP CREDIT AGREEMENT**

TO: THE HONORABLE ALLAN L. GROPPER,
UNITED STATES BANKRUPTCY JUDGE

Ashley HomeStores, Ltd. ("AHL") and Ashley Furniture Industries, Inc. ("AFI," and together with AHL, "Ashley") hereby respectfully submit this Preliminary Objection to the Debtor's Emergency Motion For Entry Of An Order Authorizing The Debtors To Enter Into A DIP Credit Agreement [Docket No. 335] (the "Motion")¹ filed by Jennifer Convertibles, Inc. and its affiliated debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "Debtors"). In support of this Objection, Ashley respectfully represents as follows:

¹ Capitalized terms used, but not defined, herein have the meaning set forth in the Motion.

FACTUAL BACKGROUND

As of the commencement of these chapter 11 cases, AHL and debtor Hartsdale Convertibles, Inc. ("Hartsdale") were parties to seven separate Trademark Usage Agreements (the "TUAs"), each of which governs Hartsdale's use of certain Ashley trademarks (the "Trademarks") at a specific store location (collectively, the "HomeStores"). The TUAs contain terms and conditions regarding Hartsdale's use of the Trademarks. The TUAs have five (5) year terms, commencing on October 27, 2006 (for the first location) through April 9, 2010 (for the most recently established location).

All seven of the HomeStores originally operated by Hartsdale are located in New York. Hartsdale closed one HomeStore location post-petition, and the other six remain in operation.

AFI is the primary vendor to Hartsdale for the HomeStores. AFI also supplies a limited amount of product to the Jennifer Convertibles locations operated by the other Debtors.

PRELIMINARY OBJECTION

For purposes of the proposed interim hearing, Ashley has two objections to the Motion: (a) the Debtors have not made a *prima facie* showing that the proposed DIP financing is necessary or otherwise in the best interests of the Hartsdale estate; and (b) any approval of DIP financing, including any liens and superpriority claims granted to Mengnu, cannot obviate AHL's rights regarding the Trademarks.

A. The Debtors Have Not Made A *Prima Facie* Showing That The Proposed DIP Financing Is Necessary Or Otherwise In The Best Interests Of The Hartsdale Estate.

Ashley objects to the Motion because the proposed DIP financing would encumber the Hartsdale estate and its assets with up to \$6.5 million in senior secured post-petition debt despite the fact that (i) the HomeStores operated by Hartsdale are not in need of any immediate liquidity infusion, even after they are allocated a significant portion of the Debtors' general and

administrative (G&A) and chapter 11 expenses; and (ii) valuations set forth by the Debtors in their Schedules and in Exhibit C to their Disclosure Statement demonstrate that the Hartsdale estate has significant equity value while the other Debtors' estates are woefully insolvent.

In the Motion, the Debtors repeatedly contend that the proposed DIP financing is necessary to pay the Debtors' "day-to-day operating costs". Motion at 20 (¶ 53). See also Motion at 5 (¶ 16), 6 (¶ 17), 8 (¶ 24), 10 (¶ 30) and 16 (¶ 40). However, the Amended DIP Budget [Docket No. 348] filed by the Debtors proves that this statement is not true with respect to Hartsdale's day-to-day operation of the HomeStores. As set forth in the following chart, which summarizes the actual financial information for the weeks ending October 1, 2010 through November 19, 2010 provided by the Debtors in the Amended DIP Budget, the six HomeStores operated by Hartsdale are producing a cash surplus even after being allocated a significant portion of the Debtors' G&A and chapter 11 expenses:

Summary of HomeStore Actual Results per Amended DIP Budget	
HomeStore Revenue	\$ 4,859,423
Allocation of Misc. Revenue (@25%)	\$ 112,388
HomeStore Purchases	\$ (2,369,553)
HomeStore Refunds	\$ (15,010)
HomeStore Bank Fees	\$ (72,547)
Allocation of G&A/Ch. 11 Expense (@25%)	\$ (2,213,058)
HomeStore Net Cash Flow	\$ 301,644

The HomeStores operated by Hartsdale are allocated 25% of the Debtors' G&A and chapter 11 expenses in the above summary. This 25% allocation is conservative in light of the fact that there are only six (6) HomeStores being operated by Hartsdale as compared to approximately eighty (80) Jennifer Convertibles stores being operated by the other Debtors (a ratio of over 10:1). Moreover, this summary also allocates miscellaneous revenue to Hartsdale at

the same 25% ratio despite the fact that HomeStore revenue actually comprised nearly 40% of total HomeStore/Jennifer revenue during this period. Therefore, the HomeStores operated by Hartsdale likely are generating an even greater profit than this summary suggests.

In contrast, a similar summary of the operating results for the Jennifer Convertibles stores operated by the other Debtors demonstrates a corresponding cash drain over this same eight-week period:

Summary of Jennifer Actual Results per Amended DIP Budget	
Jennifer Revenue	\$ 7,648,356
Allocation of Misc. Revenue (@75%)	\$ 337,165
Jennifer Purchases	\$ (2,941,823)
Jennifer Refunds	\$ (59,562)
Jennifer Bank Fees	\$ (120,305)
Allocation of G&A/Ch. 11 Expense (@75%)	\$ (6,639,173)
Net Jennifer Cash Flow	\$ (1,775,343)

The foregoing summaries clearly demonstrate that the HomeStores operated by Hartsdale do not have any imminent need for a cash infusion. To the contrary, they (apparently) have been propping up the poor performance of the Jennifer Convertibles stores since these cases were filed (and probably before).

However, even with the offsetting profits from the HomeStore segment, the Jennifer Convertibles stores require additional liquidity—in large measure due to the cash-in-advance payments demanded by Mengnu and the expense of negotiating a chapter 11 plan with Mengnu and the Official Committee of Unsecured Creditors. So the Debtors propose to obtain DIP financing from Mengnu and to secure it with all of the assets of all of the Debtors' estates. In

doing so, the Debtors seek to mortgage significant value in the Hartsdale estate at the expense of Hartsdale creditors purely for the benefit of Mengnu and the other Debtors' constituents:

	<u>Jennifer Debtors</u>		<u>Hartsdale</u>	
Per Schedules	Pre-petition Claims	\$41,346,847	Pre-petition Claims	\$1,603,118
	Asset Value	\$22,903,738	Asset Value	\$3,029,711
	Equity Cushion	(\$18,443,109)	Equity Cushion	\$1,426,593
Per Disclosure Statement Ex. C	Asset Value	\$17,180,485	Asset Value	\$7,485,491
	Equity Cushion	(\$24,166,362)	Equity Cushion	\$5,882,373

As the foregoing chart illustrates, approval of the \$6.5 million in senior secured DIP financing as currently proposed would threaten to unceremoniously demote unsecured creditors of the Hartsdale estate from being protected by a significant equity cushion to being out of the money. Particularly since the Debtors have not made a *prima facie* case that the proposed DIP financing is necessary or beneficial to the Hartsdale estate, there is no basis to saddle the Hartsdale estate with \$6.5 million in senior secured DIP liens and superpriority claims. The burden of the proposed DIP financing should be limited to the estate(s) that it will benefit, which is not the Hartsdale estate and its creditors.

B. Any Approval Of DIP Financing, And Any Liens And Superpriority Claims Granted To Mengnu, Cannot Obviate AHL's Rights Regarding The Trademarks.

Pursuant to the TUAs, Hartsdale uses the Trademarks, which are the property of AHL. Ashley has been building the value of the Trademarks for over 50 years, and they represent the lifeblood of Ashley's business. The Ashley brand is successful because of the quality in product and service that it represents to the consumer. In licensing the Trademarks to operators of HomeStores, such as Hartsdale, Ashley takes great care to ensure that each HomeStore will be run by an operator who will maintain this same level of service to consumers, thereby preserving the value of the Trademarks.

The TUAs require AHL's consent before Hartsdale can assign, transfer, mortgage, encumber, lease, or sublicense any TUA, the right to use the Trademarks, or any interest in the Trademarks.² These protections against encumbrances and assignments are in furtherance of Ashley's rights under applicable non-bankruptcy law to protect the value of its Trademarks. Consistent with this Preliminary Objection, AHL does not consent to Hartsdale encumbering the TUAs and/or Hartsdale's right to use the Trademarks in connection with the proposed DIP financing. Accordingly, Ashley hereby reserves (and any approval of the proposed DIP financing must not obviate) its rights under the TUAs and applicable law regarding the Trademarks.

RESERVATION OF RIGHTS

Ashley reserves its rights to raise additional and further objections to the Motion at any further interim or final hearing(s).

CONCLUSION

WHEREFORE, Ashley respectfully requests that the Court: (i) sustain this Preliminary Objection; (ii) deny approval of the proposed DIP financing unless Hartsdale's estate is excluded from the proposed senior liens and superpriority claims; (iii) provide in any order approving DIP financing that nothing therein obviates Ashley's rights under the TUAs and applicable law with respect to the Trademarks; and (iv) grant such other and further relief as the Court deems to be just and proper.

Dated: November 29, 2010
New York, New York

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² The TUAs reference, contain and/or constitute confidential information that is protected from disclosure by the agreement of the parties and applicable law. Accordingly, to the extent that it becomes necessary or relevant for the Court to review the TUAs, Ashley will seek to have the TUAs filed or introduced under seal.

By: /s/ Nathan A. Schultz

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