UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

HEARING DATE: December 21, 2010
HEARING TIME: 11:00 a.m.

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In re

JENNIFER CONVERTIBLES, INC., *et al.*,

Debtors.

Chapter 11

Case No. 10-13779 (ALG)

(Jointly Administered)

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OBJECTION OF THE UNITED STATES TRUSTEE
TO THE DEBTORS' DISCLOSURE STATEMENT

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

Tracy Hope Davis, the United States Trustee for Region 2 (the "United States Trustee"), respectfully submits her comments and objections to the proposed Disclosure Statement in connection with the above-captioned debtors' (the "Debtors") Chapter 11 Plan of Reorganization (the "Plan"). The Disclosure Statement is deficient and fails to meet the standards of containing "adequate information" in the areas set forth below.

FACTUAL BACKGROUND

On July 18, 2010 (the "Filing Date"), the Debtors commenced these cases by filing voluntary petitions under chapter 11 of the Bankruptcy Code. On July 23, 2010, the United States Trustee appointed an Official Committee of Unsecured Creditors in these cases (the "Committee"). *See* ECF Doc. No. 77.

On November 19, 2010, the Debtors filed the Plan and the Disclosure Statement. *See* ECF Doc. Nos. 338, 339. By order signed on December 1, 2010, the Court authorized the Debtors to enter into a debtor-in-possession financing agreement (the "DIP Agreement") with

Haining Mengnu Group Co., Ltd. ("Mengnu"). *See* ECF Doc. No. 359. A hearing to approve the DIP Agreement on a final basis has been scheduled for December 21, 2010, the same date as the hearing to approve the Disclosure Statement.

LEGAL STANDARDS

To be approved, a disclosure statement must contain "adequate information." 11 U.S.C. §1125(b). The precise information required in a disclosure statement is to be governed by the facts and circumstances presented in each case. *Kirk v. Texaco*, 82 B.R. 678, 681 (S.D.N.Y. 1988) (citing H.R. Rep. No. 595, 95th Cong., 1st Sess., 408-409 (1977) U.S.C.C.A.N. 1978, 5787, 6365 ("[p]recisely what constitutes adequate information in any particular instance will develop on a case-by-case basis"); *accord In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990).

Generally, however, the disclosure statement must contain all pertinent information bearing on the success or failure of the proposals in the plan of reorganization and all material information relating to the risks posed to creditors and equity interest holders under the proposed plan of reorganization. *Cardinal Congregate*, 121 B.R. at 764 (citations omitted); *In re Ferretti*, 128 B.R. 16, 19 (Bankr. D. N.H. 1991) (noting that a disclosure statement should "clearly and succinctly inform the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution"). Where the proffered disclosure statement is lacking in meaningful, necessary, and critical information, it must be disapproved as failing to meet even the minimal requirements of 11 U.S.C. § 1125. *In re Microwave Prods. of Am., Inc.*, 100 B.R. 376, 378 (Bankr. W.D. Tenn. 1989).

OBJECTIONS

The Disclosure Statement's "No Admissions" Provision Is Unduly Broad

Section 20.16 of the Disclosure Statement provides that "nothing contained in the Plan shall be deemed an admission by any party with respect to any matter set forth herein." *See* Disclosure Statement § 20.16. This provision is unduly broad, as it would prevent parties in interest, including the United States Trustee, from relying on the Plan or the Disclosure Statement subsequent to the Plan's Effective Date (including in undertaking actions seeking to enforce the Plan). The Disclosure Statement, consequently, should provide that, while the Plan may have no force or effect until the Court enters an order confirming the Plan, the Plan's provisions should be treated as admissions under the Federal Rules of Evidence following the Effective Date. *See* Fed. R. Evid. 801(d)(2).

The Disclosure Statement's and the Plan's Exculpation Provisions Violate the New York Rules of Professional Conduct

Rule 1.8(h)(1) of the New York Rules of Professional Conduct (the "New York Rule") provides that a "lawyer shall not . . . make an agreement prospectively limiting the lawyer's liability to a client for malpractice." *See* N.Y. Comp. Codes R. & Regs. tit. 22 § 1200 Rule 1.8(h)(1) (2010). Although the Plan and the Disclosure Statement carve out acts of "fraud, gross negligence, or willful misconduct" from the release afforded to the attorneys for the Debtors and the Committee, *see* Plan § 12.09, Disclosure Statement § 11.09, neither the Plan nor the Disclosure Statement contain any provision to ensure compliance with the New York Rule and ensure that the Debtor's and the Committee counsel's exculpations are appropriately limited. The Disclosure Statement and the Plan, therefore, may not be approved until they are revised to include the following provision: "Nothing in the Plan shall limit the liability of the professionals

of the Debtor or the Committee to their respective clients pursuant to Rule 1.8(h) of the New York Rules of Professional Conduct."

The Plan and the Disclosure Statement Contain Inadequate Information Regarding the Post-Confirmation Operation of the Debtors and the Litigation Trust

Section 1.01(85) of the Plan defines the Plan Supplement as any "exhibits, documents, lists or schedules not Filed with the Plan or the Plan Summary but as may be filed in connection therewith no later than the Confirmation Hearing or such as other date" as may be established by the Court. *See* Plan § 1.01(85). The Plan and the Disclosure Statement provide that the Plan Supplement is to include crucial provisions that creditors would need to know to evaluate the Plan, including, but not limited to, (i) the Litigation Trust Agreement, *see* Plan § 9.09, (ii) list of the officers of the Reorganized Debtors, *see* Plan § 6.05(b), (iii) provisions for compensation of any current insider of the Debtors who may serve as an officer of the Reorganized Debtors, *see* Plan § 6.05(b), and (iv) forms of the Management Agreements with the officers of the Reorganized Debtors, *see* Disclosure Statement § 6.03.

Neither the Plan nor the Disclosure Statement contain any deadline for filing the Plan Supplement. The Disclosure Statement, therefore, should not be approved until either (i) the Disclosure Statement is revised to include information regarding the members of the Debtor's post-confirmation management and their executive compensation that is currently intended to be provided in the Plan Supplement, or (ii) the Disclosure Statement is revised to establish a strict deadline in advance of the Confirmation Hearing by when the Plan Supplement is to be filed. The United States Trustee reserves all rights to object to the confirmation of the Plan based upon the information in the Plan Supplement.

Neither the Plan nor the Disclosure Statement Contain Adequate Information Regarding Selection of a Trustee or any Successor Trustee for the Litigation Trust, Or the Litigation Trustee's Bonding.

Section 12.05(c) of the Disclosure Statement and Section 9.05(c) of the Plan provide for the selection of the Litigation Trustee by the Committee no later than ten days prior to the Confirmation Hearing. *See* Disclosure Statement § 12.05(c), Plan § 9.05(c). Neither the Plan nor the Disclosure Statement, however, contain any requirements to ensure that Litigation Trustee is adequately free of conflicts of interest to undertake this fiduciary position. Likewise, neither the Plan nor the Disclosure Statement (i) contain any provisions for the selection of a successor Litigation Trustee should the original Litigation Trustee resign or be otherwise unable to perform the relevant duties or (ii) ensure that a successor Litigation Trustee is adequately free of conflicts to undertake this fiduciary position, or (iii) disclose whether or not the Litigation Trustee will be bonded. Without this information, creditors and parties-in-interest would be unable to evaluate the propriety of the Litigation Trust and the effectiveness of any Litigation Trustee.

Consequently, the Disclosure Statement and the Plan should be revised to (i) provide that any Litigation Trustee is to file an affidavit of disinterestedness with the Court prior to the Confirmation Hearing, (ii) provide for the selection of a successor Litigation Trustee should the original Litigation Trustee resign or be incapable of serving, (iii) require any successor Litigation Trustee to file an affidavit of disinterestedness with the Court, and (iv) disclose whether the Litigation Trustee will need to be bonded.

The Plan and the Disclosure Statement Lack Deadlines for the Filing of Post-Confirmation Operating Reports

Section 6.09 of the Disclosure Statement and Section 6.08 of the Plan require the Reorganized Debtors to file and prepare post-confirmation operating reports. *See* Disclosure Statement § 6.09, Plan § 6.08. However, neither the Plan nor the Disclosure Statement establish deadlines by which such reports are to be filed. This Court's Local Bankruptcy Rule 3021-1(c) (the "Local Post-Confirmation Rule") requires that post-confirmation status reports are to be filed, first, with 45 days of the entry of a post-confirmation order, and then "every January 15th, April 15th, July 15th, and October 15th until a final decree has been entered." S.D.N.Y. R. Bankr. P. 3021-1(c). The Disclosure Statement, therefore, should be revised to comply with the provisions of the Local Post-Confirmation Rule.

The Disclosure Statement Needs to Contain a Plain-Language or Graphic Description of the Tranches of Notes

At Sections 1.01(103) – (106), the Plan defines Tranche A Note, Tranche B Note, Tranche C Note, and Tranche D Note, respectively. *See* Plan §§ 1.01(103) – (106). These definitions and the descriptions of these tranches of notes in the Plan and the Disclosure Statement are unnecessarily complex, confusing, and technical. While the Disclosure Statement contains a plain-language tabular description of the treatment of each class, *see* Disclosure Statement at 15-16, no such information is available with regard to the tranches of the notes, and the respective rights of the holders of such notes. The Debtors should revise the Disclosure Statement at pages 15 and 16 to incorporate such a tabular presentation of the four Tranche A through Tranche D Notes. *See In re Ferretti*, 128 B.R. 16, 19 (Bankr. D. N.H. 1991) (noting that a disclosure statement should "clearly and succinctly inform the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution").

The Plan and the Disclosure Statement Need to Provide for the Payment of Statutory Interest with Respect to the United States Trustee Quarterly Fees

Sections 4.02(a)(1), 6.08, and 15.13 of the Plan, and Section 5.02 of the Disclosure Statement, provide for the payment of quarterly fees to the United States Trustee pursuant to 28 U.S.C. § 1930, both prior and subsequent to the Effective Date. *See* Plan §§ 4.02(a)(1), 6.08, and 15.13, and Disclosure Statement § 5.02(5).[1] Neither of these sections, however, discuss how the Debtors plan to provide for the payment of interest on the United States Trustee quarterly fees pursuant to 31 U.S.C. § 3717. The Disclosure Statement and the Plan, therefore, should provide for the payment of interest with regard to United States Trustee's statutory fees both prior and subsequent to the Effective Date.

[1] In this regard, even though the Plan contains a "substantive consolidation" provision, *see* Plan, § 2.01at 18-19, such provision effects only a "deemed consolidation" of the Debtors under applicable law since it affects only plan-related matters. *See Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.)*, 402 F.3d 416 (3d Cir. 2005). Thus, the Debtors will not be functionally consolidated, and fees and interest pursuant to 28 U.S.C. § 1930(a)(6) and 31 U.S.C. § 3717 will be payable in each individual Debtor's case.

CONCLUSION

The Disclosure Statement is inadequate as currently drafted. Accordingly, the United States Trustee respectfully requests that the Court decline to approve the Disclosure Statement in its current form, and grant such other and further relief as this Court deems appropriate and just.

Dated: New York, New York
December 14, 2010

Respectfully submitted,

TRACY HOPE DAVIS
UNITED STATES TRUSTEE

By: ***/s/ Nazar Khodorovsky***

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