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Hearing Date: January 14, 2011 (2:30 p.m. ET)

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
JENNIFER CONVERTIBLES, INC., *et al.*[1]	Case No. 10-13779 (ALG) (Jointly Administered)
Debtors.	

STATEMENT OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS IN SUPPORT OF DEBTORS' MOTION PURSUANT TO 11 U.S.C. § 365 FOR APPROVAL OF THE ASSUMPTION OF EXECUTORY CONTRACTS WITH LICENSOR, EFFECTIVE AS OF THE EFFECTIVE DATE OF A PLAN OF REORGANIZATION

The Official Committee of Unsecured Creditors (the "Committee") of Jennifer Convertibles, Inc., *et al.*, the above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), by and through its counsel, Kelley Drye & Warren LLP, hereby submits this Statement (the "Statement") In Support Of Debtors' Motion Pursuant To 11 U.S.C. § 365 For Approval Of The Assumption Of Executory Contracts With Licensor, Effective As Of The Effective Date Of A Plan Of Reorganization (the "Assumption Motion").[2] In support of this Statement, the Committee respectfully states as follows:

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1 The Debtors in these chapter 11 cases are: (i) Jennifer Convertibles, Inc.; (ii) Jennifer Convertibles Boylston MA, Inc.; (iii) Jennifer Chicago Ltd.; (iv) Elegant Living Management, Ltd.; (v) Hartsdale Convertibles, Inc.; (vi) Jennifer Management III Corp.; (vii) Jennifer Purchasing Corp.; (viii) Jennifer Management II Corp.; (ix) Jennifer Management V Ltd.; (x) Jennifer Convertibles Natick, Inc.; (xi) Nicole Convertibles, Inc.; and (xii) Washington Heights Convertibles, Inc.

2 Docket Entry No. 362.

PRELIMINARY STATEMENT

1. By the Assumption Motion, Hartsdale Convertibles, Inc. ("Hartsdale"), in the exercise of its business judgment, seek to assume, but not assign, six separate trademark usage agreements (the "TUAs") between Hartsdale Ashley HomeStores, Ltd. ("Ashley"). The TUAs provide Hartsdale with a license to operate six stores under the Ashley Furniture HomeStore brand (the "Ashley Stores"). The revenue generated at the Ashley Stores constitutes a substantial portion of the overall revenue generated by the Debtors. The assumption of the TUAs, which the Committee fully supports, is one of the cornerstones of the Debtors' plan of reorganization. The Debtors' proposed plan is the culmination of extensive negotiations among the Debtors, the Committee and other critical parties in interest which will allow for the Debtors to emerge from bankruptcy, preserve jobs and provide for a meaningful recovery to general unsecured creditors.

2. On January 4, 2011, Ashley filed an objection (the "Objection") to the Assumption Motion.[3] If the Objection is granted, Hartsdale would no longer be able to operate the Ashley Stores and the Debtors' reorganization efforts would be irreparably damaged, ultimately leading to the Debtors' liquidation. However, the Objection is completely without merit. Ashley's legal argument that section 365(c) of the Bankruptcy Code prevents assumption of the TUAs is quite simply wrong. The bankruptcy courts of the Southern District have clearly rejected the so-called "hypothetical test" championed by Ashley and have held that section 365(c) of the Bankruptcy Code is not applicable to a debtor that seeks to assume, but not assign, a non-assignable contract. Ashley does not cite a single Southern District of New York or Second Circuit case to the contrary.

[3] Docket Entry No. 412.

3. In the absence of any sustainable legal argument, Ashley attempts to make numerous factual arguments stemming from the practical effects of the Debtors' plan. None of these arguments survive scrutiny. Ashley's primary argument is that Hartsdale will incur secured debt under the plan and that this will "utterly transform the Hartsdale entity that currently is party to the TUAs" requiring Ashley's consent.[4] This is patently incorrect. Ashley fails to identify a single provision in the TUAs that would either prevent Hartsdale from incurring secured debt or would require consent. Furthermore, at the time the parties entered into the first two TUAs, Hartsdale was a joint obligor under a $10 million secured credit facility from the Debtors' then primary supplier of "Jennifer" products. Given that Ashley had no problems with such secured debt then, it is disingenuous for Ashley to now argue that similar debt now is a problem.

4. Ashley provides no valid legal or factual basis for its Objection to the assumption of the TUAs, which assumption is critical to the ultimate success of the Debtors' chapter 11 cases. Accordingly, the Committee supports, and respectfully requests that the Court enter an order approving, the Assumption Motion.

BACKGROUND

5. On July 18, 2010 (the "Petition Date"), each of the Debtors filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Since the Petition Date, the Debtors have continued to operate their businesses and manage their properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these cases.

[4] Objection at ¶18.

6. On July 23, 2010, the United States Trustee appointed Klaussner Furniture Industries, Inc., Creative Television Marketing, Brent Associates, Inc., Caye Home Furnishings, LLC, Fata Equities, LLC, PIC Management Group d/b/a PIC Media Group, PS Promotions, Inc., 301 East 66 LLC and Ayisha Combs to the Committee.[5] On the same date, the Committee selected Kelley Drye to serve as counsel to the Committee.

7. On November 19, 2010, the Debtors filed the (i) Joint Chapter 11 Plan of Reorganization of Jennifer Convertibles, Inc. and its Affiliated Debtors (as amended, the "Plan"); (ii) Disclosure Statement with Respect to the Plan; and (iii) Debtors Motion to Approve the Disclosure Statement.[6] On December 22, 2010, the Court entered an Order Approving the Disclosure Statement.[7] The confirmation hearing is scheduled for January 25, 2011.

8. As set forth in the Objection, Ashley and Hartsdale entered into the TUAs to govern Hartsdale's use of certain trademarks at the Ashley Stores. The TUA's were entered into at different times, commencing on October 27, 2006 through April 9, 2010.[8]

9. Until July 2009, the Debtors, including Hartsdale, and Caye Upholstery LLC ("Caye"), the Debtors' previous primary supplier, were parties to a $10 million credit agreement (the "Caye Credit Agreement") and security agreement (the "Security Agreement"), each dated as of July 11, 2005.[9] Pursuant to the Caye Credit Agreement, the Debtors could draw down as much as $10 million to be used to purchase inventory from Caye for the Debtors'

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5 Docket Entry No. 77.

6 Docket Entry Nos. 338-340 and 398-399.

7 Docket Entry No. 397.

8 Objection at ¶4. The actual dates of the seven TUAs are October 27, 2006, February 1, 2008, September 5, 2009, September 25, 2009, November 9, 2009 and March 15, 2010 (2 agreements).

9 *See* Declaration of Rami Abada Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York in Support of First-Day Motions at ¶37. Docket Entry No. 3. Copies of the Caye Credit Agreement and the Security Agreement are attached as Exhibits 10.1 and 10.2 to the Form 10-Q of Jennifer Convertibles, Inc. for the quarterly period ended May 28, 2005.

"Jennifer" stores.[10] Pursuant to the Security Agreement, the Caye Credit Agreement was collateralized by a security interest in all property and assets of the Debtors, including Hartsdale.[11] The borrowers under the Caye Credit Agreement were Jennifer Convertibles, Inc. and its subsidiaries and the Caye Credit Agreement and the Security Agreement were executed by each borrower, including Hartsdale. Pursuant to section 14.1 of the Caye Credit Agreement, each borrower jointly guaranteed the full and prompt payment when due of all obligations under the Caye Credit Agreement.[12]

ARGUMENT

10. Notwithstanding Ashley's arguments to the contrary, the Assumption Motion should be granted because the TUAs are assumable under section 365(a) of the Bankruptcy Code and applicable case law. As set forth in the Assumption Motion, the Debtors intend to cure any outstanding monetary defaults and have provided, or will provide, adequate assurance of future performance.[13] Accordingly, the relief requested in the Assumption Motion is appropriate and should be granted.

11. The assumption of the TUAs is a critical component of the Plan which will almost certainly unravel if the Assumption Motion is not granted. Although only six stores, the Ashley Stores generate substantial revenue for the Debtors. As set forth in the Debtors' most recent annual report, of the $76.3 million in revenue generated by the Debtors for the fiscal year ended August 28, 2010, the Ashley stores accounted for $19.4 million, or roughly 25% of the

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10 *See* Caye Credit Agreement at §6.22.

11 *See* Security Agreement at §2.

12 Caye Credit Agreement at §14.1.

13 Assumption Motion at ¶¶ 16, 34-38.

revenue of the Debtors.[14] The Ashley Stores, which cannot be operated without the TUAs, are unquestionably a substantial part of the Debtors' overall business.

12. The Plan is the culmination of extensive negotiations among the Debtors, the Committee and the Debtors' current primary supplier, Haining Mengnu Group Co. Ltd. ("Mengnu"). Mengnu is the Debtors' DIP lender, the sponsor of the Plan and has agreed in the Plan: (i) to provide substantial exit financing to the Reorganized Debtors, without which the Debtors could not emerge from bankruptcy; and (ii) to convert millions of dollars of debt to equity. However, if Hartsdale is unable to assume the TUAs, there is little doubt that Mengnu will withdraw as the Plan sponsor. Without Mengnu, the Debtors' Plan can not go forward and the Debtors will likely be forced to liquidate. The Assumption Motion, therefore, is a critical step in ensuring that the Debtors' business will continue, the Debtors' employees will continue to have jobs and the general unsecured creditors of the Debtors will receive some distributions.

13. As set forth in the Assumption Motion, the proper standard to apply in determining whether the TUA's can be assumed is the standard set forth in *In re Footstar, Inc.*, 323 B.R. 566 (Bankr. S.D.N.Y. 2005). The court in *Footstar* explicitly stated that section 365(c)(1) of the Bankruptcy Code is not applicable to a debtor in possession which seeks to assume, but not assign, a non-assignable contract. *Id.* at 569. In reaching this decision, the court analyzed, and expressly rejected, the "hypothetical test" upon which Ashley now seeks to rely. *Id.* at 569-72. The rejection of the "hypothetical test" was subsequently confirmed in *In re Adelphia Communications Corp.*, 359 B.R. 65 (Bankr. S.D.N.Y. 2007). As the court in *Adelphia* stated, "the law in this district, and by far the better view, is that where the assumption is to be effected by a debtor in possession (as contrasted to a trustee), the right to object to *assignment*

[14] *See* Form 10-K of Jennifer Convertibles, Inc. for the fiscal year ended August 28, 2010 at pg. F.23.

does not by itself affect the right to *assume*." *Id.* at 72 (emphasis in original). In rejecting the rulings of other circuits that had adopted the "hypothetical test," the court stated "[c]ases to the contrary, including some Circuit Court decisions that apply a species of 'plain meaning' analysis to section 365(c)(1), are in this Court's view incorrectly decided." *Id.*

14. Therefore, notwithstanding Ashley's contentions otherwise, the "actual test," and not the "hypothetical test," is the proper standard in the Southern District of New York. Applying the "actual test" set forth in *Footstar* and confirmed in *Adelphia*, Hartsdale, a debtor in these chapter 11 cases, can unquestionably assume the TUAs as an exercise of its business judgment under section 365(a) of the Bankruptcy Code.

15. Ashley further argues that assumption should be denied in light of the facts of the present case because if assumption is permitted, Hartsdale's assets would be encumbered by a security interest in favor of Mengnu to secure repayment of the Trache B and E Notes, subjecting Hartsdale to liability for over $10.5 million in debt.[15] This argument is completely without merit. In the first instance, Ashley fails to point to a single provision in the TUAs that would restrict Hartsdale, or any of the Debtors, from incurring indebtedness or liens upon their assets. No such restrictions exist.

16. Further, Ashley's argument is contradicted by historic realities. As set forth above, in July 2005, the Debtors, including Hartsdale, entered into the Caye Credit Agreement, providing for $10 million in debt to finance the purchase of product from Caye for the Debtors' "Jennifer" stores. The Security Agreement granted Caye a lien on all of the assets of the Debtors, including Hartsdale. These agreements were in effect when Ashley and

[15] Objection at ¶14.

Harstdale entered into the first two TUAs. It is therefore disingenuous for Ashley to now argue that the proposed financing and the liens to be granted to Mengnu present a problem.

17. Ultimately, Ashley cannot point to any applicable case law or any restrictions in the TUAs that would prevent Hartsdale from assuming the TUAs. The Objection omits the fact that the TUAs do not contain (i) any provisions restricting indebtedness or the incurring of liens; (ii) any provisions regarding change in the ownership structure of Hartsdale or Jennifer Convertibles; (iii) any cross-default provisions; or (iv) any other provisions that could form the basis of an objection to assumption of the TUAs. Ashley states that it "did not license its Trademarks to an entity who assets are encumbered by a blanket lien to secure $6.5 million in debt to its controlling indirect parent, which is also the exclusive vendor for sixty other stores in the enterprise's other business segment."[16] However, as is clear from the evidence contained in the Debtors' public filings, when Ashley entered into the first TUAs, it did license its Trademarks to an entity who assets were encumbered by a blank lien to secure $10 million in debt to Caye, which at the time was the Debtors' primary supplier to Jennifer's other business segment. Ashley fails to articulate a single coherent reason why the substitution of Mengnu for Caye in the equation constitutes a distinction critical enough to deny the Assumption Motion. No such reason exists.

18. Finally, Ashley's argument that assumption should be denied because of certain alleged non-monetary defaults should be rejected. Ashley's first alleged non-monetary default, the closing of the "Manhattan Homestore" is clearly not a default under any of the TUAs that Hartsdale seeks to assume. As indicated above and not denied by Ashley, the TUAs do not contain any cross-default provisions. Therefore, the closing of the "Manhattan Homestore"

[16] Objection at ¶17.

cannot be a default under any of the other TUA's. Ashley's attempt to link such closure to the provisions of the TUAs that provide for an event of default if Hartsdale commits an act that "impairs or detracts" from the Trademarks is nothing more than grasping at straws.

19. The only substantive provision that Ashley points to is Hartsdale's alleged failure to provide certain financial reporting. Even if Hartsdale has failed to do so, this does not constitute a non-monetary default which justifies denial of the Assumption Motion. In analyzing historic non-monetary defaults in the context of assumption, courts employ a "material or economically significant" standard. *In re New Breed Realty Enter., Inc.*, 278 B.R. 314, 321 (Bankr. E.D.N.Y. 2002) (*citing In re Josua Slocum Ltd.*, 922 F.2d 1081, 1092 (3d Cir. 1990)); *In re Chapin Revenue Cycle Mgmt., LLC*, 343 B.R. 728, 731 (Bankr. M.D. Fla. 2006); *In re Fleming Co.*, 499 F.3d 300, 305-06 (3d Cir. 2007). The focus of this inquiry is placed on the importance of the term within the overall bargained-for exchange; that is, whether the term is integral to the bargain struck between the parties (its materiality) and whether performance of that term gives a party the full benefit of his bargain (its economic significance). *In re Fleming*, 499 F.3d at 306.

20. Here, the financial reporting requirements are neither material nor economically significant. Any historic failure by Hartsdale to provide the specific reporting that Ashley claims it requested did not impact the economics of the bargained for exchange between the parties. Ashley cannot point to a single harm that is has suffered as a result of any alleged failure to provide reports. Accordingly, there is no legitimate basis for Ashley to argue that any missed reporting was economically significant to Ashley and therefore, to the extent any such "default" did occur, it would not justify the denial of the Assumption Motion.

21. Ultimately, if the Debtors cure all monetary defaults under the TUAs, which the Debtors indicate it will, and provide adequate assurance of future performance, the business judgment rule dictates that Hartsdale be allowed to assume the TUAs. Nothing in the Objection requires a different result.

CONCLUSION

WHEREFORE, the Committee respectfully request that the Court (i) grant the Debtors' Assumption Motion; and (ii) grant such other and further relief as the Court deems just and proper.

Dated: New York, New York
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