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Hearing Date: January 25, 2011
Hearing Time: 11:00 a.m.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

OBJECTION OF ASHLEY HOMESTORES, LTD. AND ASHLEY FURNITURE INDUSTRIES, INC. TO CONFIRMATION OF DEBTORS' "AMENDED JOINT CHAPTER 11 PLAN OF REORGANIZATION FOR JENNIFER CONVERTIBLES, INC. AND ITS AFFILIATED DEBTORS"

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

Ashley HomeStores, Ltd. ("AHL") and Ashley Furniture Industries, Inc. ("AFI," and collectively with AHL, "Ashley") hereby respectfully submit this Objection to the Debtor's "Amended Joint Chapter 11 Plan Of Reorganization For Jennifer Convertibles, Inc. And Its Affiliated Debtors" [Docket No. 399] (the "Joint Plan")[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:

INTRODUCTION

1. One of the Debtors – Hartsdale Convertibles, Inc. ("Hartsdale") – operates six stores commonly referred to as "Ashley HomeStores" (the "Ashley Segment")[2] pursuant to six separate trademark usage agreements (collectively, the "TUAs") with AHL. Hartsdale filed a motion to assume the TUAs, and AHL objected. *See* Docket Nos. 362 and 412. At a hearing on January 11, 2011, Hartsdale's motion to assume the TUAs was continued to the confirmation hearing on the Joint Plan scheduled on January 25, 2011.[3]

2. Under applicable trademark law, Hartsdale's right to use Ashley's trademarks is personal to Hartsdale. In order to maintain the value and quality of its trademarks, Ashley has the right (and even the obligation) to carefully assess and monitor the bona fides of any potential

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1 Section references and page numbers, as well as capitalized terms used but not defined herein, refer to the first amended Joint Plan, not the Second Amended Joint Plan that the Debtors filed on the docket this afternoon. Ashley was unable to review the numerous pleadings filed by the Debtors on the docket today prior to finalizing this objection and, accordingly, reserves its right to supplement this objection therewith.

2 The Debtors' other business is its Jennifer Convertibles stores (the "Jennifer Segment").

3 After the January 11, 2011 hearing, Hartsdale took the deposition of Mr. Abada on January 19, 2011. Hereinafter the transcript of the deposition of Mr. Abada is referred to as the Abada Deposition [page:line]; excerpts of the Abada Deposition referenced herein are annexed as **Exhibit A** hereto. After the conclusion of the Abada Deposition, the Debtors served a document discovery request on AHL in the evening of January 19, 2011 which was responded to on January 21, 2011. By the oral agreement of the parties, Ashley's deadline to object to confirmation of the Amended Plan was continued to the start of the hearing on confirmation of the Amended Plan. Ashley intends to cross-examine the Debtors' witnesses at the confirmation hearing.

licensee of its trademarks. The TUAs provide Ashley with several protections to ensure that this evaluation process is ongoing and complete, including requirements for financial reporting by the licensee, confidentiality provisions, and provisions for an event of default based on any licensee action that impairs or detracts from the value of the trademarks or the goodwill associated therewith. The TUAs are not assignable, and cannot be encumbered.

3. The assumption of the TUAs and the confirmation of the Joint Plan have become linked inextricably and raise a host of issues.[4]

4. First, the Joint Plan cannot be confirmed unless the TUAs are assumed because without the Ashley Segment the Debtors' remaining business – the Jennifer Segment – operates at a loss and is not sustainable. That said, the mere desire of the Debtors to confirm the Joint Plan is not a sufficient legal or factual basis to approve the assumption of the TUAs. Hartsdale must independently satisfy its burden of proof with respect to the Section 365[5] requirements. Indeed, because the Joint Plan is dependent upon the assumption of the TUAs, safeguarding the contractual rights of AHL is of high importance. Simply put, AHL should not be saddled with the risks attendant to the Debtors' troubled Jennifer Segment.

5. Second, in addition to ensuring that AHL's legal rights are not impaired, the Court must independently determine that the requirements of confirmation of the Joint Plan are satisfied. The structure of the Joint Plan and the attendant facts are to the contrary. Thus, the Debtors have failed to sustain their burden of proof in this regard. The Joint Plan suffers from the following infirmities, among others:

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[4] Ashley reserves its rights to amend and supplement the issues discussed below in the context of the confirmation hearing.

[5] All references to "Section __" are to the applicable sections of the United States Bankruptcy Code, 11 U.S.C. §101, et. seq.

- The requirement of Section 1129(a)(2) of the Bankruptcy Code is not satisfied as the Disclosure Statement not only fails to provide adequate information regarding Hartsdale's financial condition, but is grossly misleading.

- The requirement of Section 1129(a)(3) is not satisfied as the Joint Plan is premised upon a *de facto* "substantive consolidation" that: (i) is based upon false and misleading information; (ii) is ambiguous as to the rights of creditors; (iii) conceals the Debtors' inability to satisfy the confirmation requirements as to Hartsdale; and (iv) unfairly and inequitably places the risk of the Debtors' reorganization squarely on the shoulders of the creditors of Hartsdale – including AHL.

- The requirement of Section 1129(a)(8) is not satisfied as the Joint Plan is not in the best interest of creditors of Hartsdale; such creditors would fare better in a chapter 7 liquidation.

- The requirement of Section 1129(a)(11) is not satisfied as the Joint Plan is not feasible, because the Debtors' Projections are incongruous with general economic trends in the home furnishing sector and are based upon implausible assumptions about growth, capital expenditures and profitability.

FACTUAL BACKGROUND

A. Hartsdale – Ashley Contractual Relationship

6. As of the commencement of these chapter 11 cases, AHL and debtor Hartsdale were parties to seven separate TUAs, each of which governs Hartsdale's use of certain Ashley trademarks (the "Trademarks") at a specific store location (collectively, the "Ashley HomeStores"). Except for term and location, the TUAs are substantially identical and contain specific 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).

7. All seven of the Ashley HomeStores originally operated by Hartsdale are located in New York. Hartsdale closed its Manhattan location postpetition, and the other six remain in operation.

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

9. The TUAs imposed a number of ongoing obligations upon Hartsdale, including: (i) compliance with AHL's rules, guidelines, policies, procedures, trademark usage standards and customer service requirements (TUAs, § 4); (ii) payment of sums due by Hartsdale (TUAs, § 4); (iii) operation, maintenance, and upgrades of hardware and software systems (TUAs, § 4) ; (iv) use of best efforts to promote sales of AHL's products and consultation with AHL regarding sales goals and marketing objectives (TUAs, § 5); (v) maintenance of sufficient product inventory (TUA, § 6); (vi) sales of Accessories[6] from distributors approved by AHL (TUAs § 7); (vii) the prescribed use of AHL's trademarks (TUAs, § 9); (viii) compliance with law (TUAs, § 13); (ix) servicing warranty obligations (TUAs, § 21); (x) the provision of both specified information[7] **and** "any additional reports requested by Licensor during the Term." (TUAs, § 24); and (xi) limitations on the use of confidential information (TUAs, § 37). A copy of a sample form of a TUA is annexed hereto as **Exhibit B**. As briefed more fully in AHL's "Objection Of Ashley HomeStores, Ltd. To Debtor's 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" [Docket No. 412] (the "Assumption Objection"), there are numerous monetary and non-monetary defaults under the TUAs, for which Hartsdale has failed to provide

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[6] As defined in the TUAs, "Accessories" include a variety of non-furniture items used or sold at the stores subject to the respective TUA (the "Licensed Business") such as: (i) interior decorations sold or used at the Licensed Business; (ii) mattresses and box springs; (iii) demonstration models and promotional materials; and (iv) computers and related hardware.

[7] The specified information includes: (i) quarterly financial reports, including balance sheets and income statements, in form and content required by AHL; (ii) annual income statement and balance sheet prepared in accordance with generally accepted accounting principles and prepared and reviewed by an independent certified public accountant.

cure as well as adequate assurance of future performance. The Assumption Objection is incorporated herein by this reference.

B. The Joint Plan

10. For purposes of this Objection, the following highlights certain of the salient features of the Joint Plan.

11. **Substantive Consolidation.** The Joint Plan does not separately classify claims and interests for each of the Debtors, but rather treats all holders of claims and interests as if the Debtors were substantively consolidated as one Debtor. Joint Plan, Article II, Section 2.10 (at 19); Article III (at 20). The stated justification for the "substantive consolidation" is:

> Separate Entity Plans will inevitably rest on certain assumptions; for instance, as the Debtors are not managed operationally on an individual entity basis, it may be difficult or impossible to allocate value and operational costs and benefits on a legal entity basis. In addition, the Debtors filed consolidated Schedules in these Chapter 11 Cases.

Disclosure Statement, Article V, Section 5.04(b) (at 48). Yet, as discussed below, according to the Debtors' President, COO and CFO, the Debtors can prepare separate standalone financial statements for Hartsdale, and have done so in the past. Indeed, separate standalone Schedules were filed as to Hartsdale. [Docket No. 5 filed in the Hartsdale Convertibles, Inc. case, Case No. 10-13783 (ALG).]

12. **The Elimination Of Post-Confirmation Guarantees.** The "substantive consolidation" purports to affect intercompany claims and guarantees as follows: "all Claims based upon guarantees of collection, payment, or performance made by a Debtor as to the obligation of another Debtor shall be released and of no further force and effect" and "all Claims based upon guarantees of another Debtor shall be released and of no further force and effect." Joint Plan, Article II, Section 2.01 (at 18). As discussed below, this provision of the Joint Plan

adversely affects AHL to the extent it purports to eliminate the guaranty of Jennifer Convertibles, Inc. ("JCI") of the obligations of Hartsdale under the TUAs. Moreover, as Hartsdale is owed a significant amount of money by JCI, this provision illegally and inappropriately diverts assets from Hartsdale to JCI to the material prejudice of creditors of Hartsdale.

13. **Assumption Of Executory Contracts And Payment Of Cure Amounts.** The Joint Plan purports to "assume" executory contracts as of the Effective Date of the Joint Plan, which contracts "shall revest in and be fully enforceable by the applicable Reorganized Debtor in accordance with its terms, except as modified by the provisions of the Plan, or any order of the Bankruptcy Court authorizing and providing for its assumption or applicable federal law." Joint Plan, Article XI, Section 11.01 (at 42-43). Any amounts to be paid to cure monetary defaults are to be paid "in Cash on the later of thirty (30) days after (i) the Effective Date or (ii) the date on which the Cure Amount has been resolved (either consensually or through judicial decision)." Id. To the extent of any Cure Dispute, the payment of the Cure Amount is to be paid "following the entry of a Final Order resolving such Cure Dispute." Id. To the extent that a Cure Dispute relates solely to the Cure Amount, the assumption of an executory contract is conditioned upon the establishment of a cash reserve "in an amount sufficient to pay the full amount asserted as cure payment by the non-Debtor party to such contract or lease." Id. Given the pending dispute between AHL and Hartsdale as to the payment required to cure the defaults under the TUAs, the Debtors must establish a segregated cash reserve account to fund the payment as **ultimately** determined by the Court.

14. **Obligations And Risks Saddling Hartsdale On The Effective Date.** Under the Joint Plan, various notes are to be issued. Joint Plan, Article IV, Section 4.02 (at 23-24); Article

VI, Section 6.02 (at 27). The proposed Exit LC Facility and the proposed Exit Funding Facility are post-confirmation obligations to Mengnu, the Plan Sponsor and a competitor of AFI, for which Hartsdale will be liable. Id.; see also Plan Supplement Documents, Form of Secured Exit Credit Agreement and Tranche E Note [Docket No. 442; 456; 457]. These obligations imposed upon Hartsdale are to be secured by a lien on all of the assets of Hartsdale. Id. The TUAs, in the aggregate, obligate Hartsdale to Mengnu in an amount in excess of $10 million dollars. The lion's share of Hartsdale's obligation to Mengnu arose, or will arise, in connection with the Debtors' Jennifer Segment and not Hartsdale's Ashley Segment. Id.; see also Amended Disclosure Statement With Respect To Joint Chapter 11 Plan Of Reorganization For Jennifer Convertibles, Inc. And Its Affiliated Debtors ("Disclosure Statement") [Docket No. 398] at Exhibit C. Moreover, the operative agreements imposing the obligations owing to Mengnu call for payments of excess consolidated cash flow. Thus, Hartsdale's cash reserves will be siphoned for the benefit of the Plan Sponsor and others, at the expense and, to the detriment, of the existing and future creditors of Hartsdale. See Plan Supplement Documents, Form of Secured Exit Credit Agreement and Tranche E Note [Docket No. 442; 456; 457].

15. **The Ashley Segment Underwriting Of The Jennifer Segment.** The Ashley Segment is currently profitable, even after a full allocation of corporate overhead. The Jennifer Segment is not profitable. Accordingly, the Ashley Segment is the *only* business of the Debtors that is currently profitable. See Abada Dep. at 95:4-24. As of the Petition Date, Hartsdale had a receivable owing from Jennifer Convertibles, LLC. See Abada Dep. at 100:12-18. Although the existence of such a receivable is consistent with the financial statement prepared for Hartsdale pre-filing (see **Exhibit C** annexed hereto), the receivable has not been disclosed as part of the filings in these cases. See Hartsdale Convertibles, Inc. Schedule Of Assets And Liabilities

[Docket No. 5 filed in the Hartsdale Convertibles, Inc. case, Case No. 10-13783 (ALG)]. Under the Debtors' cash management system, cash continues to flow from Hartsdale to Jennifer Convertibles, LLC. See Corporate Monthly Operating Report [Docket No. 269]. It is not clear when, if ever, the Ashley Segment will be relieved from subsidizing the losses of the Jennifer Segment.

16. **The Debtors' Economic Projections Are Fundamentally Inconsistent With General Economic Trends in the Home Furnishing Sector**. The Debtors' Projections accompanying their Disclosure Statement present a hockey stick view of the future and lack credibility as they are based upon assumptions of perpetual growth and profitability. See Disclosure Statement, Exhibit B. According to the Debtors' Projections, in 2011 same store sales for the Ashley Segment are projected to grow at 8% and same store sales for the Jennifer Segment are projected to grow at 5%; thereafter, same store sales are projected to grow a 4% per year notwithstanding that the growth in the Jennifer Segment has not experienced such results in the recent past. Id. Though the Debtors' growth projections are bullish, they estimate costs to increase only modestly. Id. The improbable projected growth in net sales from $88 million in 2011 to $103 million in 2015 (a 17% increase) is coupled with a similarly improbable stasis of expenses and capital expenditures at $300,000 a year. Id. And yet, even with such sanguine predictions, by the end of 2018 – 9 years from the start of the period covered by the Projections – the Jennifer Segment will account for a mere $815,441 in EBITDA, of a total projected EBITDA in 2018 of $6,859,250 – or less than 12% of the total profitability of the Debtors. Id. See Disclosure Statement, Exhibit C. Suffice it to say, the Debtors' past, present and future economic well-being rests squarely on the shoulders of the Ashley Segment.

I. Argument

A. The Debtors Have Failed to Satisfy the Requirements Of Section 365(c) of the Bankruptcy Code for Assumption of the TUAs Without the Consent of AHL.

17. AHL has previously set forth its opposition to the assumption of the TUAs in its Assumption Objection and hereby incorporates that opposition by reference herein.

18. In sum, the Debtors cannot satisfy the requirements of section 365 of the Bankruptcy Code for a few reasons.

a. First, the structure of the Joint Plan nullifies Hartsdale's corporate independence and existence and effects an impermissible assignment of the TUAs[8] by: (i) saddling Hartsdale with over $10 million of secured obligations to the Plan Sponsor[9]; (ii) encumbering the TUAs in violation of the TUAs[10]; (iii) siphoning Hartsdale's surplus cash to JCI[11]; (iv) eliminating intercompany payables due to Hartsdale[12]; and (v) vesting the use, operation, and maintenance of AHL's marks, reputation and goodwill in the hands of a competitor.[13]

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[8] Section 365(c) and the terms of the TUAs prohibit such an actual assignment without the consent of AHL. TUAs § 30.

[9] The newly minted Plan Supplement documents continue to impose upon Hartsdale the approximately $10 million of obligations owing to the Plan Sponsor, Ashley's competitor, and to secure those obligations with a lien on Hartsdale's assets, including the TUAs in direct violation of paragraph 30 of the TUAs. See Plan Supplement Documents, Form of Secured Exit Credit Agreement, Tranche E Note and related Security Agreement [Docket No 456]. Mr. Abada conveniently ignores these documents in his declaration in support of confirmation of the Joint Plan wherein he only refers to the Tranche A, B, C and D Notes. See Decl. of Rami Abada [In Support of Confirmation]. [Docket No. 458, at ¶ 52]. Implicitly, Mr. Abada acknowledged that Hartsdale's assets will be encumbered by at least the Tranche E Note (although he ignores the Exit LC Facility, when he stated, "The Tranche E Note is a working capital facility, a material portion of which is being used to fund the Ashley cure payment and HCI's future purchases from Ashley." See Decl. of Rami Abada [In Support of Confirmation]. [Docket No. 458, at ¶ 53]. The fact that Mengnu is providing the capital source of payment for obligations owing to AHL, of course, does not justify a violation of the TUAs.

[10] See supra at n.9.

[11] Recognizing that draining Hartsdale of cash is inappropriate, the Debtors apparently are now agreeable to maintaining a $100,000 cash balance in Hartsdale's accounts. See Decl. of Rami Abada [In Support of Confirmation]. [Docket No. 458, at ¶ 51]. This concession is cold comfort, as the millions of dollars that are generated by Hartsdale will be transferred to JCI and encumbered in favor of the Plan Sponsor. In any event, the proposed confirmation order does not reflect this concession. See Proposed Confirmation Order [Docket No. 454].

[12] See Joint Plan, Article II, Section 2.01.

[13] See Joint Plan, Article IV, Section 4.02 (issuing 90.1% of the New Common stock with the Plan Sponsor).

b. Second, by failing to pay the required monetary defaults under the TUAs as required by Section 4 of the TUAs on the Effective Date of the Joint Plan, or depositing the amount asserted by AHL to be paid in an interest bearing segregated account,[14] Hartsdale has not tendered a cure under Section 365.

c. Third, the Debtors have not provided adequate assurance of future performance in accordance with section 365(b)(1)(C). In fact, the Debtors have virtually guaranteed that Hartsdale will *not* be able to perform in the future under the TUAs by draining Hartsdale of cash and encumbering its assets. In addition, having failed to comply with its reporting requirements in the past, and now failing to commit to the full range of reporting requirements imposed under the TUAs, Hartsdale has not demonstrated that it will, or can, fulfill its ongoing reporting obligations.[15] Naked promises are not sufficient. Further, Hartsdale has refused

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[14] The recently filed Notice Of Filing Of Cure Schedule… [Docket No. 436] indicates $0.0 as the cure amount for Ashley. That said, Mr. Abada in his recent declaration states that the cure amount is $980,366.96. See Decl. of Rami Abada [In Support of Confirmation]. [Docket No. 458, at ¶ 51]. This amount is not reconciled with Ashley as it does not include continued legal fees incurred, or amounts due to AFI. Moreover, the Joint Plan suggests a "reserve" will be established for disputed cure amounts, but it is not clear if a reserve is intended to be an "accounting" entry, or the deposit of cash in a segregated account. Given that the Debtors' assets will be encumbered, a mere accounting entry is no assurance that AHL will be paid. Moreover, Bankruptcy Rule 3012 requires that payments due on the Effective Date that are not paid, be deposited in a segregated account. In addition, as the Joint Plan contemplates a delay in payment of disputed cure amounts – which delay may be substantial as the Joint Plan provides for payment when the dispute is resolved by Final Order – if interest is not paid on the amount due from and after the Effective Date until the date of payment, then the amount paid will, by virtue of the time value of money, be less than the amount due on the Effective Date. Moreover, the Debtors' proposed confirmation order fails to provide for the reserve. See Proposed Confirmation Order [Docket No. 454].

[15] The failure to provide the financial reporting required under the TUAs (which includes reporting in accordance with generally accepted accounting principles) is not attributable to a lack of ability, but a lack of will. According to Mr. Abada:

> Q: How do you know the Ashley segment is highly profitable to your company?
>
> A: We have very, very good reports, as I mentioned before, that are able to show the flow of money where – to and from, and we have very, very good reporting, four-wall, which represents significant costs in the entity, and that would be payroll, rent, advertising, so we have the ability to see what is going on.
>
> The one area of difficulty which we touched on before is in the allocation of corporate overhead, and even that, we discussed was it impossible. You know, it's impossible to nail it down to the penny or to the dollar, but we are able to make certain assumptions and be fairly accurate.
>
> Q: So I want to be clear. So you have made certain assumptions and have allocated corporate overhead to HCI [Hartsdale Convertibles, Inc.]?
>
> A: No, I'm saying we are capable of.
>
> Q: But you haven't done that?
>
> A: Up to this point, no.

> to confirm that AFI's confidential information will be protected from disclosure and use by the Plan Sponsor – AFI's competitor.[16]

B. The Joint Plan Does Not Satisfy The Disclosure Requirements of Section 1129(a)(2) of the Bankruptcy Code.

19. Section 1129(a)(2) requires the proponent of the plan to comply with all applicable provisions of the Bankruptcy Code. 11 U.S.C. § 1129(a)(2). One such provision is Section 1125, which provides that:

> An acceptance or rejection of a plan may not be solicited . . . from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.

11 U.S.C. § 1125(b) (emphasis added). Pursuant to Section 1125(a)(1), adequate information means:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan.

11 U.S.C. § 1125(a)(1).

20. The Debtors' disclosure obligations are not limited solely to the preparation and dissemination of a disclosure statement. See In re Momentum Mfg. Corp., 25 F.3d 1132, 1136

Abada Dep. at 93:25 – 94:22. Mr. Abada's declaration in support of confirmation of the Joint Plan provides no additional clarity on this issue. See Decl. of Rami Abada [In Support of Confirmation] [Docket No. 458, at ¶ 49].

[16] See Abada Dep. at 135:12-22. Mr. Abada's declaration in support of confirmation of the Joint Plan provides no additional clarity on this issue. See Decl. of Rami Abada [In Support of Confirmation] [Docket No. 458, at ¶ 50].

(2d Cir. 1994) ("The Code obliges a Debtor to engage in full and fair disclosure, providing to creditors information of a kind and in sufficient detail, as far as is reasonably practicable . . . that would enable a hypothetical reasonable investor typical of claims of interests of the relevant class to make an informed judgment about the plan. . . . [The disclosure requirements of 11 U.S.C. § 1125(a)(1) do] not attach only to the preparation of disclosure statements. . . . it begins on day one, with the filing of the Chapter 11 petition.") (citation and internal quotes omitted). "Only those plans which have been proposed in good faith and patently comply with the applicable provisions of the Bankruptcy Code will pass muster for disclosure purposes." In re Filex, Inc., 116 B.R. 37, 41 (Bankr. S.D.N.Y. 1990). Here, the Debtors have failed to meet their statutory and fiduciary duties of full and candid disclosure with respect to Hartsdale.

21. Hartsdale's assets included cash as of the Petition Date and a substantial accounts receivable from JCI. See Corporate Monthly Operating Report [Docket No. 269]; Exhibit C; Abada Dep. at 100:12-18. Yet, the filed Schedules of Assets and Liabilities for Hartsdale fail to disclose these critical facts. See, e.g., Hartsdale Schedule of Assets and Liabilities [Case No. 10-13783 (ALG); Docket No. 5] (Hartsdale shown to have zero cash and no accounts receivable). The obfuscation of Hartsdale's financial condition is not remedied by the Disclosure Statement, which includes only consolidated information. No separate liquidation analysis is provided for Hartsdale. Disclosure Statement, Exhibit D. The failure to provide full disclosure of Hartsdale's independent financial information is inexplicable given that Hartsdale has approximately $800,000 of independent creditors other than AFI. See Corporate Monthly Operating Report [Docket No. 269]. This failure to provide a full and complete picture of Hartsdale's information is compounded by the Debtors' inaccurate and misleading statement in the Disclosure Statement that such standalone, separate entity basis, financial information cannot be provided. See

Disclosure Statement, Article V, Section 5.04(b) (at 48). In fact, Mr. Abada now admits that such standalone accounting can in fact be provided. See supra at n.15 (quoting Mr. Abada's deposition testimony).

C. The Joint Plan Does Not Satisfy The Good Faith Requirements Of Section 1129(a)(3) of the Bankruptcy Code.

22. Many courts have recognized that a plan is only proposed in "good faith" when it is consistent with policy goals grounding the Bankruptcy Code and not by any means forbidden by law. See, e.g., McCormick v. Banc One F Leasing Corp. (In re McCormick), 49 F.3d 1524, 1526 (11th Cir. 1995) ("While the Bankruptcy Code does not define the term, courts have interpreted 'good faith' as requiring that there is a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code."); In re Koelbl, 751 F.2d 137, 139 (2d Cir. 1984) (defining the good faith standard as "requiring a showing that the plan was proposed with honesty and good intentions and with a basis for expecting that a reorganization can be effected." (internal quotations omitted), aff'd, 84 F.3d 1415 (9th Cir. 1996); In re Enron Corp., 2004 Bankr. LEXIS 2549, at *218 (Bankr. S.D.N.Y. 2004) ("Section 1129(a)(3) of the Bankruptcy Code requires a plan to be proposed in good faith and not by any means forbidden by law.") (citation omitted).

23. Chapter 11 cases are guided by three general directives: (i) that disclosure should be full and complete, (ii) that similarly situated creditors should be treated equally,[17] and (iii) that the burdens and risks of a reorganization not be shifted to a particular class of creditors.[18] The Debtors have flouted each of these directives.

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[17] See In re Journal Register Co., 407 B.R. 520, 532 (Bankr. S.D.N.Y. 2009) ("[Section] 1123(a)(4) of the Bankruptcy Code . . . advances the policy of equality of distribution of estate property in bankruptcy law.").

[18] See In re Kennedy, 158 B.R. 589, 601 (Bankr. D.N.J. 1993) (refusing to confirm a chapter 11 debtor's plan where "the risk of debtor's default under the Chapter 11 plan [were placed] entirely on upon the secured creditor."); In re EFH Grove Tower Assoc., 105 B.R. 310, 313 (Bankr. E.D.N.C. 1989) (refusing to confirm

24. The "de facto" substantive consolidation to be implemented pursuant to the Joint Plan is a smoke screen to avoid the exacting standards for confirmation for each debtor – standards which Congress enacted to protect creditors – not debtors.[19] As discussed below, the Debtors cannot meet the confirmation requirements for Hartsdale. The justification for the substantive consolidation is illusory: the Debtors actually can provide standalone entity by entity financial statements and have done so in the past. Put simply, the Debtors are attempting to hoodwink Hartsdale's creditors by shrouding its financial condition under the veil of substantive consolidation. Such conduct is a breach of the fiduciary duties imposed upon the Debtors as debtors in possession and dispels any pretense of good faith by the Debtors.

D. The Joint Plan Does Not Satisfy The Best Interests Test Of Section 1129(a)(8) of the Bankruptcy Code.

25. Section 1129(a)(7), often referred to as the "best interests of creditors test," provides that:

> With respect to each impaired class of claims or interests—
>
> (A) each holder of a claim or interest of such class--
>
> (i) has accepted the plan; or
>
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of [the Bankruptcy Code] on such date; or
>
> (B) if section 1111(b)(2) of [the Bankruptcy Code] applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan an account of such claim property of a value, as of the effective date of the plan, that

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debtor's plan and lifting the automatic stay where the plan was "one-sided" and where the debtor's primary creditor gained little but shouldered all of the risk).

[19] See Union Sav. Bank v. Augie/Restivo Baking Co. Ltd. (In re Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir.1988) (noting the primary purpose of substantive consolidation is to "insure the equitable treatment of all creditors"); In re Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005) ("While substantive consolidation may be used defensively to remedy the identifiable harms caused by entangled affairs, it may not be used offensively (for example, having a primary purpose to disadvantage tactically a group of creditors in the plan process or to alter creditor rights).").

> is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

11 U.S.C. § 1129(a)(7). Thus, under Section 1129(a)(7), a plan cannot be confirmed if a creditor in an impaired class votes against the plan and does not "receive or retain under the plan . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7." See 11 U.S.C. § 1129(a)(7)(A). As noted by a leading treatise, "Section 1129(a)(7) is one of the cornerstones of chapter 11 practice. It is an individual guaranty to each creditor . . . that it will receive at least as much in reorganization as it would in liquidation." 7 Collier on Bankruptcy ¶1129.03[7] (16th ed. rev. 2009). Thus, this inquiry is largely factual and requires the Debtor to put forward a liquidation analysis. See In re Valley Park Group, Inc., 96 B.R. 16, 21 (Bankr. S.D.N.Y. 1989) (denying confirmation of a plan where, among other defects, no liquidation analysis was provided).

26. In these cases, the Debtors have proffered a consolidated liquidation analysis. See Disclosure Statement, Exhibit D. A consolidated liquidation analysis does not establish that the creditors of each of the Debtors are receiving a least what they would receive in a hypothetical liquidation under chapter 7. In the case of Hartsdale, the incontrovertible facts demonstrate that the creditors of Hartsdale are not receiving what they would receive in a liquidation under chapter 7.

27. The Debtors own documents indicate that at the Petition Date Hartsdale had approximately $800,000 in cash, approximately $1,900,000 in inventory, approximately $1.0 million in miscellaneous equipment, and an unspecified amount due from Jennifer Convertible (but which amount as of August, 29, 2009 was approximately $1 million). *See* Corporate Monthly Operating Report [Docket No. 269] (showing cash on hand in the Ashley Concentration

Account on July 18, 2010 of $782,319, Schedules of Assets and Liabilities filed in the Hartsdale chapter 11 case [Docket No.5] (showing assets of Hartsdale as of the Petition Date], Exhibit C (Hartsdale Balance Sheet as of August 29, 2009 showing "Due from Company" of approximately $1.0 million), supra at n.15 (quoting Abada deposition testimony acknowledging that Hartsdale has a receivable due and owing from JCI.). Based upon the assumptions contained in the Debtors' consolidated liquidation analysis, these assets have the following liquidation values:

Asset	**Book Value**	**Liquidation Value Based Upon Debtors' Assumptions**
Cash	$782, 319	$ 782,319
Accounts Receivable	$1.0 million	$ 200,000
Inventory	$1.9 million	$1,235,000[20]
Other Equipment	$1.0 million	$ 50,000
Total Liquidation Value		**$2,267,319**

28. Per the Hartsdale Schedules, the total debt of Hartsdale at the Petition Date was $1.6 million. Even if all of the Hartsdale leases were rejected, the lease rejection cap claims[21] plus the $1.6 million of scheduled liabilities would result in a dividend to Hartsdale's creditors in excess of the estimated projected 22.7% recovery for Class 3 General Unsecured Claims under

[20] The Debtors' liquidation analysis assumes a recovery rate of 65% to 75% for showroom inventory, and 85% to 100% for warehouse inventory. For these purposes, the lower rate of 65% is applied to Hartsdale's entire inventory.

[21] The Debtors' liquidation analysis does not break out the estimated lease rejection claims for the Ashley Segment.

the Joint Plan. See Disclosure Statement, Article I, Summary Of Treatment Of Claims And Equity Interests And Estimated Recoveries.[22]

E. The Joint Plan Is Not Feasible.

29. Section 1129(a)(11), known as the "feasibility" requirement, provides that a court shall confirm a plan only if:

> Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor under the plan, unless such liquidation or reorganization is proposed under the plan.

11 U.S.C. § 1129(a)(11). In short, Section 1129(a)(11) requires the Debtors to demonstrate that the Joint Plan has a reasonable probability of success. See In re Kane v. Johns-Manville Corp., 843 F.2d 636, 649 (2d Cir. 1988) ("[T]he feasibility standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed.") (citation omitted); In re WorldCom, Inc., 2003 Bankr. LEXIS 1401, *168 (Bankr. S.D.N.Y. 2003) ("The feasibility test set forth in section 1129(a)(11) requires the Court to determine whether the Plan is workable and has a reasonable likelihood of success"). Thus, if a chapter 11 plan of reorganization is not found to have a reasonable chance of success, it cannot be confirmed.

30. It is the Debtors' burden to persuade this Court that the Joint Plan is feasible. See In re Young Broadcasting, 430 B.R. 99, 128 (Bankr. S.D.N.Y. 2010) ("The proponent of a proposed plan bears the burden of proving essential elements of confirmation by a preponderance of the evidence.") (citation omitted). In fact, Section 1129(a)(11) requires the plan proponent to show concrete evidence of a plan's feasibility, and "projections must not be speculative, conjectural, or unrealistic." Id. Evidence presented supporting the plan's feasibility must:

[22] Indeed, the Disclosure Statement suggests that the liquidation dividend would be a mere 8% for Class 3 General Unsecured Creditors, further highlighting the misleading disclosure to creditors.

> (a) [be] reasonable, persuasive, credible and accurate as of the dates such analysis or evidence was prepared, presented or proffered; (b) utilize reasonable and appropriate methodologies and assumptions; (c) have not been controverted by other evidence; (d) establish that the Plan is feasible and Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization . . . and (e) establish that the Reorganized Debtors will have sufficient funds available to meet their obligations under the Plan.

In re Am. Media, Inc., 2010 Bankr. LEXIS 4942, *39-40 (Bankr. S.D.N.Y. 2010); see also In re Calpine Corp., 2007 Bankr. LEXIS 4390, *35 (Bankr. S.D.N.Y. 2007) (citing four of the same factors).

31. In analyzing the feasibility of a plan of reorganization, courts have found the following factors to be probative:

> 1. the adequacy of the capital structure; 2. the earning power of the business; 3. economic conditions; 4. the ability of management; 5. the probability of the continuation of the same management; and 6. any other related matters which will determine the prospects of a sufficiently successful operation to enable performance of the provisions of the plan.

In re Young Broadcasting, 430 B.R. at 129 (citations to other cases noting these factors omitted). However, the above-recited factors are not exclusive or exhaustive; feasibility is analyzed on a case-by-case basis. Id.

32. To meet their burden of proof that the Joint Plan is feasible the Debtors rely upon their Projections. See Disclosure Statement, Exhibit C. The Projections are accompanied by a cursory statement of the underlying assumptions, providing no supporting documentation or detail to justify the basis for the magical change from failure to success by the mere stroke of a pen on a confirmation order.

33. Critical to the Projections are the growth assumptions. It is not surprising that an increasing top line, with a flat or modest expense line, will automatically grow the bottom line. The existence of an excel spreadsheet does not presuppose that the input is reasonable.

34. At the outset of these cases, the President, CFO, and COO of the Debtors, Mr. Rami Abada said unequivocally as of July 19, 2010:

> If current economic and credit conditions prevail they could have a material adverse effect on demand for the Debtors' products and financial condition and operating results.

Decl. of Rami Abada Pursuant to Rule 1007-2 of the Local Bankr. R. for the S.D.N.Y. in Support of First-Day Mots. at ¶53 [Docket No. 3]. The economic and credit conditions referred to were described by Mr. Abada as follows:

> The slowdown in the U.S. economy and other national, regional or global economic conditions affecting disposable consumer income, such as the depressed housing market, employment levels, inflation, business conditions, fuel and energy costs, consumer debt levels, lack of available consumer or commercial credit, uncertainty in future economic prospects, interest rates, and tax rates, may adversely affect the Debtors' business by reducing overall consumer spending or by causing customers to shift their spending to products other than those sold by the Debtors or to products sold by the Debtors that are less profitable than other product choices.

Id.

35. In the six short months since Mr. Abada offered this analysis, the U.S. economy remains stagnant, international economic volatility remains, the housing market has not recovered, employment has not recovered, credit remains a trickle, and uncertainty prevails. Mr. Abada does not disagree. See Abada Dep. at 136:14-22.

36. Ever optimistic, and with blinders to reality, the Projections are premised upon compounded growth and modest expense increases. No analysis is provided to support these Projections and the basis for their attainability given the current and projected economic climate. In his deposition, Mr. Abada's explanation was long on optimism and short on detailed facts to support the increase from 2010 to 2011, relying on large measure on what is set forth in the Disclosure Statement. Abada Dep. at 139:7-9 ("There are a variety of factors all described in our disclosure statement…"). The Disclosure Statement discussion is limited to the bare bones

assumptions set forth in Exhibit C: (i) 8.6% increase in 2011 same store stales for the Jennifer stores; (ii) 56.9% increase in 2011 same store sales for the Ashley HomeStore sales; (iii) 4% increase thereafter in same store sales for both segments; (iv) modest increases in expenses/ Id. Other than stating these assumptions, no supporting back-up or detail is provided. In addition to the stated growth and expense assumptions, the Projections call attention to: (i) the ability of management to focus on operations following confirmation; (ii) the provision of a stable inventory supply; (iii) continued advertising; (iv) re-newed customer confidence; and (v) the launch of a new private label card. Id. However beneficial these soft factors may be to the Debtors in 2011, they hardly account for continued sustained 4% year of year same store sales growth. Indeed, when asked about what sustained the Debtors' continued growth after 2011, all that Mr. Abada could offer was:

> We really believe that we are going to continue to build. When you first emerge from bankruptcy, it takes some time to hit your stride again, and by the time we get into 2012, we will have had a significant amount of time to implement a lot of what I described.

Abada Dep. at 142:18-23. With respect to the growth from 2012 to 2013, and 2014 to 2015, the best that Mr. Abada could add to being able to hit your stride, was to fall back on "inflation". Id. at 143:14 – 144:8.

37. With respect to the risks associated with the Projections, Mr. Abada implied that there was no risk, stating: "it would be foolish to say that there is absolutely no chance in the world that projections can be off at all." Abada Dep. at 145:14-16. Such a cavalier answer evidences the complete lack of attention and critical analysis underlying the Projections, and highlights their lack of credibility. The business risks delineated in the Disclosure Statement are no more exacting. See Disclosure Statement, Article XIX, Sections 19.02 and 19.04 (pp. 100-104).

38. The Debtors' failure to evidence detailed, and reasoned, support for the Projections precludes confirmation of the Joint Plan. Pan Am Corp. v. Delta Air Lines, 175 B.R. 438, 508 (S.D.N.Y. 1994) ("Pan Am was unable to provide the required evidence at confirmation that there would be sufficient cash flow to fund and maintain operations").

CONCLUSION

WHEREFORE, Ashley respectfully requests that the Court: (i) deny the assumption of the TUAs; (ii) deny confirmation of the Joint Plan; and (iii) grant such other and further relief as the Court deems to be just and proper. To the extent the Court rules otherwise, Ashley respectfully requests that the Court: (i) with respect to the TUAs, (a) require Hartsdale to deposit in a segregated interest bearing account the funds required to cure all monetary defaults under Section 4 of the TUAs; and (b) in addition to requiring Hartsdale to comply with all of the obligations of the TUAs, specifically require that Hartsdale: (x) comply with the reporting requirements of the TUAs (including providing historical, current and ongoing annual and quarterly income statements, balance sheets, and cash flow statements for Hartsdale in accordance with generally accepted accounting principles (including the accounting of intercompany transactions and allocations) and including the provision of historical, current and ongoing annual and quarterly store level "4–wall" income statements, balance sheets, and cash flow statements, (y) comply with the confidentiality provisions of the TUAs by restricting the Plan Sponsor from the receipt of any confidential information, and (z) segregate in an interest bearing account all Hartsdale customer deposits; and (ii) with respect to the Joint Plan, (a) require that the JCI remain liable on its intercompany obligations to Hartsdale, (b) require that JCI affirm its guaranty of the TUAs, (c) strike any imposition of liability on Hartsdale of any of the obligations owing under the Joint Plan on account of the Tranche A, B, C, D, or E Notes, the

Exit LC Facility or the Exit Funding Facility, (d) strike any imposition of a security interest, lien or other encumbrance on the assets of Hartsdale to secure any of the Tranche A, B, C, D, or E Notes, the Exit LC Facility or the Exit Funding Facility, and (e) grant such other and further relief as the Court deems to be just and proper.

Dated: January 24, 2011
Santa Monica, California

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