

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

In re:

JENNIFER CONVERTIBLES, INC.,<sup>1</sup>  
  
Debtors.

Chapter 11

Case No. 10-13779 (ALG)

(Jointly Administered)

**MOTION OF THE FORMER DIRECTORS AND OFFICERS  
FOR ENTRY OF AN ORDER AUTHORIZING AND  
APPROVING PAYMENT OF DEFENSE COSTS AND  
EXPENSES UNDER THE DIRECTORS AND OFFICERS POLICY**

Rami Abada, Harley Greenfield, Ed Bohn, Mark Berman and Kevin Coyle, (collectively, the “Insured” or the “Directors and Officers”), potential defendants in litigation arising from their prepetition roles with Jennifer Convertibles, Inc. (“Jennifer”), by and through their respective counsel, out of an abundance of caution, hereby move this Court (the “Motion”) for entry of an order pursuant to sections 105(a), 362 and 363 of title 11 of the United States Code (the “Bankruptcy Code”), attached hereto as Exhibit “A”, authorizing Illinois National Insurance Company (“Illinois National”) to pay defense costs and expenses incurred by the Directors and Officers (collectively, the “Defense Costs”) in accordance with and subject to the terms and conditions of Illinois National’s Executive and Organization Liability Insurance Policy, Policy No. 01-420-58-47 issued to Jennifer (“D&O Policy”).

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<sup>1</sup> 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).

## Status of the Bankruptcy Case

1. Jennifer Convertibles, Inc. 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, with stores located throughout the Eastern seaboard, Midwest, West Coast and Southwest, 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.

2. On July 18, 2010 (“the Petition”), each of the Debtors commenced with the Bankruptcy Court a voluntary case pursuant to chapter 11 of titles of the United States Code (the Bankruptcy Code”). The Debtors continue to operate their business and manage their properties as debtors in possession pursuant to their business and manage their properties as debtor in possession pursuant to sections 11707(a) and 1108 of the Bankruptcy Code. An official Committee of Unsecured Creditors was appointed in these chapter 11 cases (the “Committee”).

3. As of the Petition Date, the Debtors employed 497 people. There are 336 employees in the Jennifer segment, 114 employees in the Ashley segment and 47 corporate employees. None of the employees are represented by a collective bargaining unit.

4. Negotiations ensued between and among the Debtors, the Official Committee of Unsecured Creditors, and Haining Mengnu Group Co. Ltd. As a result of the same, on December 22, 2010, the Debtors filed their Amended Disclosure Statement with Respect to the Chapter 11 Plan of Reorganization of Jennifer Convertibles, Inc. and Its Affiliated Debtors (the “Amended Disclosure Statement”) and their Amended Joint Chapter 11 Plan of Reorganization of Jennifer Convertibles, Inc. and Its Affiliated Debtors (the “Amended Plan”). Thereafter, on February 9, 2011, the Bankruptcy Court entered the Order Confirming the Amended Plan (the “Confirmation Order”).

5. Pursuant to, *inter alia*, Section 7.01 of the Amended Plan and the Confirmation Order, certain cause of actions were retained, reserved and assigned to KDW Restructuring Company as Litigation Trustee (the “Litigation Trustee”).

6. The Amended Plan became Effective on February 22, 2011.

### **Jurisdiction**

7. This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

8. The statutory predicates for the relief requested herein are Bankruptcy Code sections 105(a) and 363(b).

### **Relief Requested**

9. By this Motion, the Insured request entry of an order, allowing and authorizing Illinois National to advance and or reimburse the Directors and Officers for the Defense Costs incurred in connection with a potential Director and Officer Litigation now being asserted by the Litigation Trustee (the “Potential D&O Litigation”). As an accommodation to Illinois National, the Insured are seeking this Court’s authorization for the relief requested herein to reimburse and advance their Defense Costs in accordance with the D&O Policy, applicable non-bankruptcy law, the Certificate, and the Employment Agreements (as such terms are defined below). While the Insured contend that the advancement and/or reimbursement of their Defense Costs in connection with the Potential D&O Litigation is a transaction within the ordinary course of business, they nonetheless seek this Court’s approval out of an abundance of caution since the D&O Policy itself is a so-called wasting policy.

### **The Insured and the Potential Litigation**

10. The Insured are the former Directors and Officers of the Debtors.

11. On or about December 2, 2010, the Committee, through its Counsel, gave notice by letter to the Debtors of its demand for suit against the Insured and stated its intention that if the Debtors did not pursue potential claims arising from the errors and omissions of the former Directors and Officers, it would deem the Debtors “to have refused to comply with the demand made . . . and the Committee will seek authority from the Bankruptcy Court to institute a lawsuit to recover damages on behalf of the Debtors’ bankruptcy estates.” See letter attached as Exhibit “B.” That notice was followed by repeated demands for Informal Discovery and ultimately resulted in an order being entered permitting certain discovery and documents being furnished.

### **The Policy**

12. In 2009, Illinois National issued the D&O Policy for Jennifer covering claims made during the policy period of December 13, 2009 to December 13, 2010 (the “Policy Period”). A copy of the policy is attached hereto as Exhibit “C”. Pursuant to the “run off” endorsement, an additional 90 day “Discovery Period” was established pursuant to which the Insured could provide notice of a claim made relating to acts occurring prior to August 1, 2008. The Policy, sets forth its coverages:<sup>2</sup>

With respect to Coverage A, B and C, solely with respect to Claims first made against an **Insured** during the **Policy Period** or the Discovery Period (if applicable) . . . and reported to the **Insurer** . . . this policy affords the following coverage:

#### **COVERAGE A: EXECUTIVE LIABILITY INSURANCE**

This policy shall pay the **Loss** of any **Insured Person** arising from a **Claim** made against such **Insured Person** for any **Wrongful Act** of such **Insured Person**, except when and to the extent that an **Organization** has Indemnified such Insured Person . . .

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<sup>2</sup> Per page 1 of the D&O Policy’s Declarations, terms in bold are elsewhere defined in the Policy.

## **COVERAGE B: ORGANIZATION INSURANCE**

(i) **Organization Liability:** This policy shall pay the **Loss** of any **Organization** arising from a **Securities Claim** made against the **Organization** for any **Wrongful Act** of such **Organization**.

(ii) *Indemnification of an Insured Person:* This policy shall pay the **Loss** of an **Organization** arising from a **Claim** made against an **Insured Person** (including an **Outside Entity Executive**) for any **Wrongful Act** of such **Insured Person**, but only to the extent that such **Organization**, has **Indemnified** such **Insured Person**.

13. The D&O Policy defines an “Insured Person” to include the former Directors and Officers of Jennifer; a “Loss” to include defense costs arising out of “Claim”; and a “Claim” to include written demand for monetary, non-monetary or injunctive relief. The overall D&O Policy limit (the D&O Policy’s “Limit of Liability”) for all coverages is \$5 million. The Policy is thus a “wasting” policy under which each payment reduces what is left under the Limit of Liability for further Losses of any kind.

14. The D&O Policy specifically and unequivocally gives payment to an Insured under Coverage A priority over all other payments under the D&O Policy.

### **The Debtors Have A Duty to Pay Defense Costs**

15. The Debtors have a duty to indemnify the Directors and Officers for costs and expenses incurred in connection with the Potential D&O Litigation. However, the D&O Policy itself provides for the Defense Costs to be advanced and or reimbursed to the Directors and Officers at this time. In addition to the D&O Policy, pursuant to (i) the Certificate of Incorporation of Jennifer Convertibles (the “Certificate”), (ii) applicable provisions of state and federal law, and, (iii) the employment agreements with the Directors and Officers (the “Employment Agreements”), claims for indemnification could be made.

a. The Certificate and Employment Agreements

16. In accordance with applicable Delaware or New York law, the Certificate and the Employment Agreements,<sup>3</sup> the Debtors are obligated to indemnify the Directors and Officers under certain circumstances, as well as directly pay and/or advance defense costs and expenses incurred by such Directors and Officers.

17. The Debtors' Certificate provides in relevant part as follows:

Any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or proceeding ... by reason of the fact that he is or was a director, officer ... or is or was serving at the request of the Corporation as a director, officer ... shall be entitled to be indemnified by the Corporation to the full extent then permitted by law against expenses (including attorneys' fees), judgments ... and amounts paid in settlement incurred by him in connection with such action, suit, or proceeding.

18. In addition, Jennifer Convertibles is party to the Employment Agreements with the Directors and Officers. The Employment Agreements are identical, and provide as follows:

**INDEMNIFICATION.** To the fullest extent permitted by law, the Company shall indemnify the Executive (including the advancement of expenses) for any judgment, fines, amounts paid in settlement and reasonable expenses, including attorneys' fees, incurred by the Executive in connection with the defense of any lawsuit or other claim to which he is made a party by reason of being an officer, director or employee of the Company or any of its subsidiaries. During the Employment Period and for at least two (2) years thereafter, the Company shall make every reasonable effort to maintain customary director and officer liability insurance covering the Executive for acts and omissions prior to and during the Employment Period.

Thus, by executing the Employment Agreements, the Directors and Officers have already completed all of the prerequisites necessary to be entitled to advancement.

19. The advancement and indemnification rights discussed herein have been fully disclosed to the Debtors' stockholders and the general public, by way of the Debtors' filings with the Securities and Exchange Commission and the general availability of the Certificate.

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<sup>3</sup> Copies of the Certificate and Employment Agreements are available upon request.

b. Applicable State Law

20. Jennifer Convertibles, employer of all of the Directors and Officers, is incorporated in Delaware. Delaware law specifically authorizes the indemnification provisions described above. See 8 Del.C § 145(a) (“A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding ... by reason of the fact that the person is or was a director [or] officer ... if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation”).

21. Furthermore, Jennifer Convertibles’ headquarters, where its Directors and Officers are also headquartered, is in New York, which also has an indemnification statute that authorizes a corporation to indemnify “any person made, or threatened to be made, a party to an action or proceeding . . . by reason of the fact that he . . . was a director or officer of the corporation . . . if such director or officer acted, in good faith, for a purpose which he reasonable believed to be in . . the best interests of the corporation.” See N.Y.B.C.L. § 722(a).

22. Accordingly, the Debtors could seek authority to advance to the Directors and Officers for, and indemnify them from, any actual defense costs incurred in connection with the Potential D&O Litigation and advance such Defense Costs as required by the Certificate and Employment Agreements. Fortunately, the D&O Policy is in place to satisfy these expenses.

**Basis for Relief Requested**

23. As discussed herein, at the request of Illinois National, the Insured have filed this Motion and are seeking, out of an abundance of caution, this Court’s authorization to permit Illinois National to advance or reimburse the Defense Costs of the Directors and Officers. To the extent that the Court finds that the transactions contemplated are outside of the ordinary course of business, sections 362 and 363(b) of the bankruptcy Code permits a debtor in possession to

use property of the estate other than in the ordinary course of business after notice and a hearing. The Insured respectfully contend that the proceeds are not estate property. Even if the estate has some sort of interest in the proceeds because the use of the proceeds will diminish the aggregate value of what is available under the policy, that interest is expressly subordinate to the Directors and Officers interest in being able to pay for the Defense Costs associated with the Litigation Trustee's Proposed D&O Litigation. Accordingly, the Directors and Officers seek authorization from the Bankruptcy Court to allow Illinois National to pay the Defense Costs of the Directors and Officers in accordance with and subject to the terms and conditions of the filing.

24. Additionally, Bankruptcy Code section 105(a) empowers a court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]." The purpose of section 105(a) is to ensure a bankruptcy court's power to take whatever action "is appropriate or necessary in aid of the exercise of [its] jurisdiction." In re Casse, 198 F.3d 327, 336 (2d Cir. 1999); see In re The 1031 Tax Group, LLC, 397 B.R. 670, 684 (Bankr. S.D.N.Y. 2008).

25. By offering indemnification rights to its Directors and Officers when they joined the Debtors, Jennifer Convertibles created an expectation that the individual would be protected, by way of prompt advancement of any defense fees and costs, for any matters relating to their service. Indeed, the Debtors have an existing contractual obligation to advance defense costs to the Directors and Officers and to indemnify them for costs associated with the Potential D&O Litigation. The Potential D&O Litigation clearly constitutes a "lawsuit or other claim" for which the Directors and Officers are entitled to advancement of Defense Costs and indemnification from the Debtors under the Employment Agreements. Regardless, the D&O Policy is available and in place to satisfy the Defense Costs.

26. The Directors and Officers reasonably relied upon the D&O Policy and the Employment Agreements and the aforementioned advancement and indemnity protections contained in the Certificate at the time they joined the Debtors and throughout the performance of their duties. Any failure to comply with the terms would not be in the best interest of the Debtors or their estates.

27. Additionally, the obligations under Delaware and New York statutes could not be more clear.

28. Obligations to comply with their contractual and statutory obligations do not terminate merely because the Debtors filed for bankruptcy. As Courts within this district and courts applying Delaware law have held, provisions in a Debtors' charter and bylaws have continued viability after the filing of the bankruptcy petition. See In re Sahlen & Associates, Inc., 113 B.R. 152, 153 (Bankr. S.D.N.Y. 1989) (holding a debtor had to indemnify its current officers and directors to the full extent provided by its bylaws and the laws of the state of incorporation); Continuing Creditors' Comm. of Star Telecomm., Inc. v. Edgecomb, 385 F.Supp.2d 449 (D. Del. 2004) (granting motion to dismiss claims of the creditors' committee that former directors of debtor had breached fiduciary duties on the basis of exculpation provision in the debtor's charter).

29. Pursuant to the D&O Policy, it is clear that there is an obligation to make advancements to and indemnify the Directors and Officers for the Defense Costs and expenses incurred by the Directors and Officers in connection with the Potential D&O Litigation. Currently, the Insured are at risk of being subjected to alleged causes of action resulting from their actions as Directors and Officers of the former Debtors. Their ability to defend themselves far outweighs any interest in preventing any erosion to the policy limits. The Directors and

Officers have an immediate need for funds to pay their legal expenses since the Directors and Officers have already been compelled to provide documents and retain separate counsel. Accordingly, this comfort Order Authorizing the Payment of Defense Costs to the Directors and Officers at this time is appropriate under the specific circumstances of these cases.

**Reservation of Rights**

30. Nothing herein shall be construed as an admission of any liability or waiver of any rights of Illinois National or any of the Directors and Officers.

**Notice**

31. No trustee or examiner has been appointed in these chapter 11 cases. Notice of this Motion has been provided to: (i) Office of the United States Trustee for the Southern District of New York; (ii) counsel to the Litigation Trustee; (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**

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

WHEREFORE the Debtors respectfully request entry of the Proposed Order granting the relief requested herein and such other and further relief as the Court may deem just and appropriate.

Dated: New York, New York  
March 28, 2011

OLSHAN GRUNDMAN FROME  
ROSENZWEIG & WOLOSKY LLP  
*Counsel For Rami Abada*

By: /s/ Michael S. Fox  
Michael S. Fox  
Allen Wolff  
Park Avenue Tower  
65 East 55<sup>th</sup> Street  
New York, New York 10022  
(212) 451-2300

-and-

CLARICK GUERON REISBAUM LLP  
*Counsel For Harley Greenfield*

By: /s/ Nicole Gueron  
Nicole Gueron  
40 West 25<sup>th</sup> Street, 12<sup>th</sup> Floor  
New York, New York 10010  
(212) 633-4310  
-and-

YANKWITT & MCGUIRE LLP  
*Counsel For Ed Bohn, Mark Berman and  
Kevin Coyle*

By: /s/ Russell Yankwitt  
Russell Yankwitt  
140 Grand Street  
White Plains, New York 10611

**EXHIBIT A**

**Proposed Order**

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

In re:

JENNIFER CONVERTIBLES, INC.,<sup>1</sup>  
Debtors.

Chapter 11

Case No. 10-13779 (ALG)

(Jointly Administered)

**ORDER AUTHORIZING AND APPROVING PAYMENT OF DEFENSE  
COSTS AND EXPENSES TO CERTAIN DIRECTORS AND  
OFFICERS UNDER DIRECTORS AND OFFICERS LIABILITY POLICY**

Upon consideration of the Motion, (the “Motion”)<sup>2</sup> of the Former Directors and Officers of Jennifer Convertibles, Inc. and its affiliated debtors, as debtors in possession (collectively, the “Debtors”), for entry of an order pursuant to sections 105(a), 362, and 363(b) of title 11 of the United States Code (the “Bankruptcy Code”), authorizing payment of defense costs and expenses to those offices and directors of the Debtors serving as of the petition date (collectively, the “Directors and Officers”) and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157 and 1334 and the Standing Order M-61 Referring to Bankruptcy Judges for the Southern District of New York Any and All Proceedings Under Title 11, dated July 10, 1984; and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the parties listed therein, and it appearing that no other or further notice need be provided; and a hearing

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<sup>1</sup> 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).

<sup>2</sup> All capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Motion.

having been held to consider the relief requested in the Motion (the “Hearing”); and the appearances of all interested parties having been noted in the record of the Hearing; and the Court having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and it appearing that the relief requested in the Motion is in the best interests of the Debtors, their estates, creditors, and parties in interest; and upon all of the proceedings had before the Court and after due deliberation and sufficient cause appearing therefor,

**IT IS HEREBY:**

1. Ordered the Motion is granted: and it is further
2. Ordered that the automatic stay does not bar the use of the insurance proceeds of the D&O Policy issued by Illinois National to pay the reasonable defense costs, including all actual and necessary costs and expenses incurred by the Directors and Officers (the “Defense Costs”), to defend and otherwise respond to the Potential D&O Litigation; and it is further
3. Ordered that Illinois National is authorized to pay all Defense Costs incurred by the Directors and Officers from the D&O Policy; and it is further
4. Ordered that the Litigation Trustee shall not review any legal bills associated with the Defense Costs in connection with the Potential D&O Litigation; and it is further
5. Ordered that this Court shall retain jurisdiction to interpret and enforce this Order.

Dated: \_\_\_\_\_, 2011  
New York, New York

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Honorable Alan Gropper  
UNITED STATES BANKRUPTCY JUDGE