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**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF ARIZONA**

In re

**DEXTER DISTRIBUTING CORPORATION,  
et al.,**

**Debtors.**

THIS FILING APPLIES TO:

- ALL DEBTORS
- SPECIFIED DEBTORS  
DEXTER DISTRIBUTING CORPORATION  
NEW CASTLE MEGASTORE CORP.  
1113 PROGRESS DRIVE, MEDFORD, LLC  
CASTLE REALTY CORPORATION

Chapter 11

**Case No. 2-03-bk-03546-RJH**

JOINTLY ADMINISTERED WITH:

2-03-BK-03548-RJH;  
2-03-BK-04695-RJH THROUGH  
2-03-BK-04710-RJH;  
2-03-BK-05427-RJH;  
2-03-BK-11513-RJH;  
2-03-BK-11515-RJH;  
2-03-BK-04238-RJH;  
2:07-BK-01017-RJH;  
2:07-BK-01018-RJH;  
2:07-BK-01019-RJH; AND  
2:08-BK-05785-RJH

**DISCLOSURE STATEMENT  
TO ACCOMPANY JOINT PLAN OF REORGANIZATION PROPOSED BY DEBTORS,  
ANMP, OFFICIAL UNSECURED CREDITORS' COMMITTEE AND MARK A. FRANKS  
DATED AUGUST 15, 2008**

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## EXHIBITS

<b>No</b>	<b>Description</b>
<b>1</b>	Plan of Reorganization
<b>2</b>	List of Secured Claims
<b>3</b>	Balance Sheet and Results of Operations 12/31/2007
<b>4</b>	Balance Sheet and Results of Operations 6/30/2008
<b>5</b>	Projections
<b>6</b>	Liquidation Analysis

## **I. INTRODUCTION.**

Dexter Distributing Corporation (“Dexter”), New Castle Megastore Corp. (“New Castle”) 1113 Progress Drive, Medford, L.L.C. (“Medford”), and Castle Realty, Inc. (“Castle Realty”), Debtors and Debtors in Possession in the above-captioned and numbered Chapter 11 cases (Dexter, New Castle, Medford and Castle Realty are sometimes collectively referred to herein as “Debtors”); Mark A. Franks (“Franks”); the Official Unsecured Creditors’ Committee (the “Creditors’ Committee”); and American National Mortgage Partners (“ANMP”) (collectively, Debtors, Franks, the Committee and ANMP are referred to herein as the “Proponents”) have prepared this Disclosure Statement to solicit acceptances of a Joint Plan of Reorganization (the “Plan”) filed with the United States Bankruptcy Court for the District of Arizona on August 15, 2008. The Plan is attached as Exhibit 1.

### **A. PURPOSE OF DISCLOSURE STATEMENT.**

Proponents are disseminating this Disclosure Statement pursuant to § 1125 of the Bankruptcy Code to provide holders of claims against and interests in Debtors with sufficient information to permit them to cast votes to accept or reject the Plan. The Bankruptcy Court has approved this Disclosure Statement for use in this connection and has also established a deadline for casting ballots on the Plan. These dates are set forth in the Order and Notice sent with this Disclosure Statement.

### **B. VOTING ON PLAN AND ELECTION OF TREATMENT.**

The Plan provides that each Claim against, or Interest in, Debtors will be placed into one of several Classes. The Plan also specifies the treatment provided for each such Class. The Classes and their treatment are described in the Plan and below, in Section I.D.1, beginning on page 25. Only holders of Claims or Interests in Classes that are “impaired” under the Plan are entitled to vote on the Plan.

If a holder of a Claim or Interest is entitled to vote, such holder may do so by completing and delivering the accompanying ballot form in the manner and within the time specified in the accompanying notice. If you are the holder of a Claim or Interest entitled to vote, **your vote on the Plan is important.**

### **C. OVERVIEW OF THE DISCLOSURE STATEMENT.**

This Disclosure Statement is designed to afford creditors and holders of equity interests adequate information to make an informed judgment about the Plan. Creditors and Interest holders are urged to read the Plan in its entirety. In the event of a conflict between the Plan and the Disclosure Statement, the terms of the Plan and the Order of the Bankruptcy Court confirming the Plan shall control.

Section II of the Disclosure Statement (beginning on page 6) provides historical information regarding the Debtors' business, assets and liabilities, and the circumstances surrounding the filing of this bankruptcy proceeding. Section III (beginning on page 14) summarizes developments during the course of these Chapter 11 cases. Section IV (beginning on page 23) summarizes the provisions of the Plan, including the classification and treatment of Claims and Interests. Section V (beginning on page 37) contains financial information regarding Debtors and describes projections of distributions under the Plan based upon the assumptions identified in the projections. Section VI (beginning on page 37) identifies the current and intended future management of the Debtors. Section VII (beginning on page 38) discusses the legal requirements for confirmation of the Plan. Section VIII (beginning on page 41) discusses tax consequences of the Plan. Section IX (beginning on page 41) discusses certain claims bar date and Effective Date issues raised by the Plan. Section X (beginning on page 42) contains the recommendations of Debtors and the Creditors' Committee with respect to the Plan.

## **D. OVERVIEW OF THE PLAN.**

### **1. General Summary.**

The Plan provides for the liquidation of the Debtors and administration of proceeds through a Liquidating Trust. Debtors' operations and the bulk of its personal property and intangible assets will be sold to a new entity, Newco. Consideration for the sale will include assumption of certain liabilities, cash of Eight Hundred Thousand Dollars (\$800,000) on the Effective Date, and an additional One Million Seven Hundred Thousand Dollars (\$1,700,000) payable in annual installments over five years.

### **2. Structure of Newco.**

Prior to the Effective Date, Newco will be a corporation 100% owned by Franks or such other entity as may be approved by ANMP. To the extent that the ANMP Collateral Equity Value is not sufficient to satisfy the Allowed Class 3 Claim of ANMP, ANMP will receive a 50% equity interest in Newco in accordance with and subject to the terms and conditions of Paragraph 7.3 of the Plan.

### **3. Discharge of Management Board-Formation of Liquidation Trust.**

On the Effective Date, the members of the Management Board created under the 2004 Plan will be discharged and the Management Board will cease to exist. All assets and liabilities not transferred to or assumed by Newco will be transferred to the Liquidating Trust, which will be administered by a Liquidating Agent appointed pursuant to the Plan.

### **4. Treatment of Claims and Interests.**

The Plan classifies claims in accordance with the provisions of the Bankruptcy Code based upon priority, security and other factors. The Plan and the Disclosure Statement detail these classes and their treatments, which are summarized in Section IV.C below.

## **5. Other Plan Provisions.**

The Plan contains other provisions regarding such matters as discharge of claims, the procedures for allowance or disallowance of Claims, and the retention of jurisdiction by the Bankruptcy Court. A more detailed description is set forth in Section IV below and in the Plan.

### **E. DEFINITIONS.**

Most words or phrases used in this Disclosure Statement have their usual and customary meanings. Words or phrases with initial capital letters have the definitions set forth in the Plan or in the Bankruptcy Code.

### **F. MATTERS MERITING SPECIAL ATTENTION.**

Creditors and other interested parties are urged to read the entire Disclosure Statement and the Plan. The following matters are considered of special importance:

#### **DEADLINE FOR SUBMITTING BALLOTS**

**EXECUTED BALLOTS MUST BE RECEIVED NO LATER THAN 5:00 P.M., MOUNTAIN STANDARD TIME ON THE DUE DATE SET BY THE COURT. SINCE MAIL DELAYS MAY OCCUR, BALLOTS SHOULD BE MAILED OR DELIVERED WELL IN ADVANCE OF THE SPECIFIED DATE. ANY BALLOTS RECEIVED AFTER THE DUE DATE MAY NOT BE INCLUDED IN ANY CALCULATION TO DETERMINE WHETHER CREDITORS HAVE VOTED TO ACCEPT OR REJECT THE PLAN.**

#### **VOTING AND IMPAIRMENT**

**THE PLAN AND THIS DISCLOSURE STATEMENT IDENTIFY DEBTORS' JUDGMENT AS TO WHETHER EACH CLASS OF CLAIMS OR INTERESTS IS "IMPAIRED" UNDER THE BANKRUPTCY CODE, BUT THE COURT ULTIMATELY DETERMINES WHETHER A CLASS IS IMPAIRED. THE BANKRUPTCY CODE PROVIDES THAT CLAIMS OR INTERESTS IN A CLASS THAT IS NOT IMPAIRED SHALL BE CONCLUSIVELY DEEMED TO ACCEPT THE PLAN ACCORDINGLY, IF YOU DISAGREE WITH DEBTORS' JUDGMENT THAT YOUR CLASS IS NOT IMPAIRED, YOU SHOULD SUBMIT A BALLOT AND SEEK A DETERMINATION BY THE COURT OF YOUR RIGHT TO VOTE ON THE PLAN.**

#### **IMPORTANCE OF VOTE**

**YOUR VOTE IS IMPORTANT AND MAY DETERMINE WHETHER THE PLAN IS CONFIRMED. YOU ARE URGED TO STUDY THE PLAN CAREFULLY AND TO CONSULT WITH YOUR COUNSEL ABOUT ITS IMPACT UPON YOUR LEGAL RIGHTS BEFORE VOTING.**

**HEARING ON CONFIRMATION OF PLAN**

**THE BANKRUPTCY COURT WILL HOLD A HEARING ON CONFIRMATION OF THE PLAN COMMENCING AT THE TIME AND PLACE STATED IN THE ACCOMPANYING ORDER AND NOTICE. THE HEARING MAY BE CONTINUED FROM TIME TO TIME THEREAFTER WITHOUT FURTHER NOTICE EXCEPT AS GIVEN IN OPEN COURT.**

**CONDITIONS TO PLAN'S EFFECTIVENESS**

**THE PLAN SHALL NOT BE EFFECTIVE UNLESS THE COURT ENTERS AN ORDER CONFIRMING THE PLAN AND UNLESS CERTAIN OTHER CONDITIONS DESCRIBED IN THE PLAN ARE SATISFIED, INCLUDING DEBTORS' OBTAINING FINANCING AND DEBTORS ENTERING INTO AN EMPLOYMENT AGREEMENT WITH MARK FRANKS.**

**NO OTHER REPRESENTATIONS AUTHORIZED**

**NO REPRESENTATIONS CONCERNING DEBTORS OR THE PLAN ARE AUTHORIZED OTHER THAN AS SET FORTH IN THIS DISCLOSURE STATEMENT. YOU SHOULD NOT RELY ON ANY ADDITIONAL REPRESENTATIONS OR INDUCEMENTS TO SECURE YOUR VOTE ON THE PLAN.**

**ABSENCE OF AUDITED FINANCIAL INFORMATION**

**THE FINANCIAL INFORMATION CONTAINED HEREIN HAS NOT BEEN SUBJECTED TO A CERTIFIED AUDIT. SUCH INFORMATION AND OTHER STATEMENTS ARE BASED UPON DEBTORS' BOOKS AND RECORDS AND THE ESTIMATES AND ASSUMPTIONS STATED. ALL INFORMATION IS ACCURATE TO THE BEST KNOWLEDGE, INFORMATION AND BELIEF OF DEBTORS, ALTHOUGH DEBTORS ARE UNABLE TO WARRANT THAT NO INACCURACIES EXIST.**

**NO OBLIGATION TO SUPPLEMENT**

**THE STATEMENTS CONTAINED IN THIS DISCLOSURE STATEMENT ARE MADE AS OF THE DATE HEREOF UNLESS ANOTHER TIME IS SPECIFIED HEREIN. NEITHER DELIVERY OF THIS DISCLOSURE STATEMENT NOR ANY EXCHANGE OF RIGHTS MADE IN CONNECTION WITH THE PLAN SHALL UNDER ANY CIRCUMSTANCES CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE INFORMATION SET FORTH HEREIN SINCE THE DATE OF THIS DISCLOSURE STATEMENT AND THE**

**MATERIAL RELIED UPON IN PREPARATION OF THIS DISCLOSURE STATEMENT WERE COMPILED. DEBTORS AND THE CREDITORS' COMMITTEE ASSUME NO DUTY TO UPDATE OR SUPPLEMENT THE DISCLOSURES CONTAINED HEREIN AND DO NOT INTEND TO UPDATE OR SUPPLEMENT THE DISCLOSURES.**

**NO INDEPENDENT VERIFICATION BY COURT**

**THE COURT HAS NOT VERIFIED THE ACCURACY OF THE INFORMATION, AND THE COURT'S APPROVAL OF THIS DISCLOSURE STATEMENT MEANS ONLY THAT, IF THE INFORMATION IS ACCURATE, IT IS SUFFICIENT TO PROVIDE AN ADEQUATE BASIS FOR CREDITORS AND INTEREST HOLDERS TO MAKE INFORMED DECISIONS WHETHER TO ACCEPT OR REJECT THE PLAN.**

**NO SEC APPROVAL**

**THIS DISCLOSURE STATEMENT HAS NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION, NOR HAS THE COMMISSION PASSED ON THE ACCURACY OR ADEQUACY OF THE STATEMENTS IN IT.**

**II. HISTORY OF DEBTORS AND THEIR OPERATIONS.**

**A. FORMATION, OWNERSHIP, AND ASSETS.**

Debtors, with affiliated entities, own and operate an adult products retail business at locations in Arizona, Washington, New Mexico, Oregon and Alaska.

Dexter, the Debtor in Case No. 03-0246-PHX-RJH and 2:07-bk-01017-RJH, was formed as an Arizona corporation in January 1988. Taylor Coleman is the sole shareholder, subject to the voting trust. Prior to the 2004 Plan, Dexter acquired and stored the inventory of products sold at retail locations. After the effective date of the 2004 Plan, existing inventory was transferred to New Castle, which thereafter acquired all new inventory. As a result, Dexter is an inactive company that remains a co-debtor under the 2004 Plan.

New Castle, the Debtor in Case No. 2:07-bk-01018-RJH, was formed as an Arizona corporation on October 9, 1997, under the name "Castle Superstore Corporation." Pursuant to the Plan, stipulations filed in the 2003 Case and the orders of this Court, the Articles of

Castle Superstore Corporation were amended and restated on July 16, 2004, changing the name of the corporation to “New Castle Megastore Corp.”

Mr. Coleman is the owner of eighty percent (80%) of the stock in New Castle, and Mark Franks owns the remaining stock, subject to the voting trust. Under the 2004 Plan, the non-real estate operating assets of the reorganized debtors under the 2004 Plan were vested in New Castle, which has since been the main operating entity for Debtors and the operator of Debtors’ stores. New Castle is managed by the New Castle Management Board.

New Castle operates seventeen (17) locations. Eleven of these locations are owned by, and leased from, affiliated entities pursuant to month-to-month leases approved by order of the Bankruptcy Court. Under these leases, New Castle is responsible for paying expenses of the property, including taxes, insurance, maintenance and mortgage payments. The store number, location, record owner, and holders of mortgages for these locations are as follows:

#	Store Name	Location	Original Affiliate Owner	Lienholders
1	Washington	5501 E. Washington Blvd., Phoenix, AZ	Castle Realty Corp. f/k/a Real Estate Holding Corporation	Wachovia (1 <sup>st</sup> ); Stillman Trust (2d); ANMP (3 <sup>rd</sup> )
2	Camelback	300 .E. Camelback Ave., Phoenix, AZ	Castle Realty Corp. f/b/o 300 E. Camelback, L.L.C.	Mortgages, Ltd. (1 <sup>st</sup> ) Mortgages Ltd. (2d); ANMP (3 <sup>rd</sup> )
3	Dunlap	8802 N. Black Canyon Hwy., Phoenix, AZ	Castle Realty Corp. f/b/o 117-Dunlap, L.L.C.	Wachovia (1 <sup>st</sup> ); Stillman Trust (2d) ANMP (3 <sup>rd</sup> )
4	Apache Trail	8315 E. Apache Trail, Mesa, AZ	Castle Realty Corp. f/b/o 8315 East Apache Trail, L.L.C.	Wachovia (1 <sup>st</sup> ); Stillman Trust (2d) ANMP (3 <sup>rd</sup> )
6	Tacoma	6015 Tacoma Mall Blvd., WA	[ANMP entity f/b/o Castle Realty Corp. f/b/o] 6015 Tacoma Mall Blvd., L.L.C	Olympic Coast (1 <sup>st</sup> ) ANMP (2d)
7	Silverdale	2789 N. Randall Way, Silverdale, WA	[ANMP entity f/b/o Castle Realty Corp. f/b/o] Silverdale Building, L.L.C.	Wachovia (1 <sup>st</sup> ); AEA Bank (2d); ANMP (3 <sup>rd</sup> )
8	Spokane	11324 E. Sprague Ave., Spokane, WA	Castle Realty Corp. f/b/o East Sprague Avenue, L.L.C.	Olympic Coast (1 <sup>st</sup> ) ANMP (2d)
10	Kennewick	522 N. Columbia Center Blvd., Kennewick, Benton County, WA	[ANMP entity f/b/o Castle Realty Corp. f/b/o] 522 N. Columbia Blvd., L.L.C.	Wachovia (1 <sup>st</sup> ); M&M&M (2d); ANMP (3 <sup>rd</sup> )
11	Portland	9815 SW Capitol Hwy, Portland, OR	Castle Realty Corp. f/b/o 9815 S.W. Capitol Highway, L.L.C.	Olympic Coast (1 <sup>st</sup> ) Helm Resources (2d) ANMP (3 <sup>rd</sup> )

#	Store Name	Location	Original Affiliate Owner	Lienholders
14	Deer Valley	21815 N. 26 <sup>th</sup> Ave., Phoenix, AZ	Castle Realty Corp f/b/o Deer Valley/26 <sup>th</sup> Avenue, L.L.C	Friends Investor (1 <sup>st</sup> ) ANMP (2d)
16	Anchorage	1851 E. Fifth Ave., Anchorage, AK	Castle Realty Corp. f/b/o 1851 E. Fifth Ave., ,L.L.C.	Cactus Commerce (1 <sup>st</sup> ) ANMP (2d)

New Castle operates six (6) locations leased from unaffiliated third parties, consisting of the following:

#	Store Name	Location
5	Albuquerque	5110 Central Ave., Albuquerque, NM
9	Medford	1601 N. Riverside Ave., Medford, OR
12	Springfield	3270 Gateway Blvd., Springfield, OR
15	Van Buren	222 N. 44 <sup>th</sup> St., Phoenix, AZ
17	Seattle	206 Broadway, East Seattle WA
18	Tukwila	405 Evans Black Dr., Tukwila, WA

Medford, the Debtor in Cases No. 03-04702-PHX-RJH and 2:07-bk-01019-RJH, was formed as an Arizona limited liability company in August 1998. Mr. Coleman and Real Estate Holding Corporation II are the members and their interests are subject to the voting trust. Medford was previously the owner of Store Number 9, in Medford, Oregon (the "Medford Property"). Pursuant to the 2004 Plan, the Medford Property, (and other store locations owned by debtors in the 2003 Case), were transferred to Castle Realty. Subsequently, the property in Medford, Oregon was foreclosed upon and Store #9 was relocated.

Castle Realty, the Debtor in Case No. 03-04698-PHX-RJH and 2:08-bk-05785-RJH, was formed in 1988 under the name "Real Estate Holding Corporation," and acquired the Washington Street store location in February 1989. To effectuate the 2004 Plan, the name of the corporation was changed to Castle Realty Corporation. Mr. Coleman is the shareholder of Castle Realty, subject to the voting trust. Under the 2004 Plan, Castle Realty is managed by the Management Board of New Castle.

Under the 2004 Plan, the twelve (12) store locations owned by other debtors in the 2003 Cases, including the Medford Property, were to be transferred to Castle Realty. In July and August 2004, nine (9) of these properties were transferred by ANMP-related entities to Castle Realty by quitclaim deeds indicating that the transfers were for the benefit of the original affiliated entity.

**B. NON-DEBTOR AFFILIATED ENTITIES.**

Debtors are affiliated with a number of entities, including limited liability companies, directly or indirectly owned by Taylor Coleman, that own store locations leased by New Castle. The affiliated entities that were subjects in the 2003 Cases are identified in Schedule 1 to the Plan. Under the 2004 Plan, the store locations owned by these entities were to be transferred to Castle Realty Corporation. Mr. Coleman's interests in these entities are subject to the voting trust.

Under the 2004 Plan, New Castle is currently liable with these entities for approximately \$12 million in debt (exclusive of the ANMP Claim) secured by the real property and New Castle leases such property on terms that require New Castle to pay the actual cash expenses of these properties, including debt service.

**C. MANAGEMENT.**

Debtors are managed pursuant to the terms of the 2004 Plan. A Management Board was appointed on the effective date of the 2004 Plan consisting of a Manager, Vern Schweigert; two members selected by holders of "General Claims"; and two members selected by James Sell, as receiver of ANMP and affiliated entities. In March 2008, Vern Schweigert resigned as Manager and was replaced by James Spear. The affairs of New Castle are exclusively managed by the Management Board, subject to certain limitations and

restrictions imposed by the 2004 Plan. The Management Board also manages Castle Realty, Medford, and the various real-estate-owning entities, pursuant to the terms of the 2004 Plan.

Equity interests in Debtors and the affiliated entities are held in a voting trust pursuant to an amended voting trust and the terms of the 2004 Plan. Vern Schweigert was initially appointed the voting trustee. Mr. Schweigert has tendered his resignation as voting trustee and Mr. James Spear has succeeded to the position as voting trustee of the voting trust.

#### **D. OPERATIONS.**

##### **1. General Background.**

Debtors own and operate retail outlets for adult products, including sexually explicit magazines and videos, lingerie and other clothing, greeting and humor cards, sexual aids, and adult toys. Debtors operate seventeen (17) retail locations in five states - six (6) in Arizona, six (6) in Washington, three (3) in Oregon, one (1) in New Mexico, and one (1) in Alaska. Eleven (11) of the locations are owned by Debtors or affiliated entities and six (6) are leased by New Castle. Each location features Debtors' well-established "Castle" trade name and is identified locally as a "Castle Megastore" or "Castle Superstore." Individual stores range in size from 6,000 to 33,300 square feet, averaging approximately 15,300 square feet. Some locations are open 24 hours per day.

Debtors' headquarters are located in leased premises in Tempe, Arizona, and include central purchasing, accounting, executive and human resource services, and warehouse facilities. Debtors' non-store staff members are located primarily in the Tempe office.

##### **2. Industry Factors.**

The adult product industry is highly competitive and many of Debtors' competitors have significant advantages because of their size and access to capital. The industry is heavily regulated both by anti-obscenity laws and zoning laws that impose serious restrictions

on store locations, operating hours, control of access by minors, and on-site advertising. The industry is subject to special legal and financial risks because many people regard Debtors' primary business as unwholesome and as purveying in pornography. The nature of Debtors' business has tainted its ability to acquire store locations and obtain products and services. Additionally, investors, lenders, and others in the investment community have shown reluctance in participating in Debtors' financing or other activities due to the nature of the Debtors' business.

Debtors have sought to establish a niche in the adult product market by avoiding the most unwholesome features of competitors. Debtors do not operate jointly with nightclubs, bars or exotic dance facilities. Debtors do not operate video arcades or provide private viewing rooms. Debtors rigidly enforce restrictions on minors' access to the premises, and employ regular, random drug testing of employees. Debtors believe that these policies have, to some extent, permitted Debtors to "mainstream" their operations. However, Debtors continue to encounter significant legal and political opposition to their facilities.

### **3. Background to Prior Filings.**

Debtors and their affiliated entities embarked on a rapid expansion program in 2000 through 2002, acquiring store locations with seller carry-back or third party mortgage loans, and obtaining additional financing through high-interest loans provided primarily by ANMP and its affiliates. By early 2003, Debtors were in default on substantially all of their secured financing and were facing foreclosures on a number of their locations. To avoid a disastrous liquidation, Debtors commenced Chapter 11 filings for the operating companies and the real estate owning entities. Taylor Coleman, who had guaranteed essentially all of the financings, also faced a ruinous liquidation and personal bankruptcy proceedings were commenced in March 2003. Because of widespread creditor dissatisfaction with Mr. Coleman's

management, Vern Schweigert was appointed as Chief Restructuring Officer for the companies and he guided the companies through the Chapter 11 process and operational restructuring.

In February 2004, the Bankruptcy Court confirmed a plan of reorganization for the companies, which emerged from the process as reorganized debtors.

#### **4. The 2004 Plan.**

Under the 2004 Plan, the reorganized debtors continued the existing business operations under the direction of the Management Board and Mark Franks, who was appointed as Chief Operating Officer. Shareholder management rights were significantly curtailed until all creditors under the 2004 Plan were paid.

The plan provided for immediate payment of non-tax priority claims. The plan also provided for the restructuring of third party loans, primarily based on a ten year amortization schedule, with the balance payable five years after the effective date of the plan. The plan also provided for the payment in full of unsecured, non-priority claims ("2004 General Claims"), in quarterly installments based upon available cash flow, with interest at eight percent (8%) per annum commencing on the effective date of the plan (March 31, 2004).

By stipulation, the numerous claims of ANMP entities were consolidated into one claim, eventually reduced to \$12 million to be secured by a subordinate lien on the real estate of all Castle companies, and to bear interest at eight percent (8%) per annum commencing on the third anniversary of the effective date.

Payments on account of the ANMP Claim and the 2004 General Claims varied depending upon available cash flow. Each quarterly payment was required to be at least \$500,000 and was required to be greater based upon sixty percent (60%) of Available Cash, as defined in the 2004 Plan. Until the 2004 General Claims were paid in full, with interest, the

quarterly payments were distributable fifty-five percent (55%) to holders of 2004 General Claims and forty-five percent (45%) to ANMP. Until General Claims were paid in full, the 2004 Plan required that two members of the Management Board to be selected by holders of such claims. After payment of the 2004 General Claims, the 2004 Plan provided that the Management Board would continue with the Manager and two ANMP representatives, until payment in full of the ANMP Claim.

#### **5. Coleman Chapter 13 Plan.**

The 2004 Plan did not resolve all claims against Mr. Coleman, who remained subject to the Chapter 13 proceedings. After months of negotiations, ANMP agreed to reduce its various claims against Coleman to an additional \$2,000,000, which the parties stipulated would be payable by the Castle companies, as an addition to the existing \$12,000,000 claim. The parties also agreed that various claims against Coleman would be payable through the Castle companies, which were effectively added to the claims of 2004 General Claims. In addition, the parties agreed that certain claims secured by real estate owned by Mr. Coleman would be payable by the Castle companies on stipulated terms. With these various agreements, a Chapter 13 plan for Mr. Coleman was approved by the Bankruptcy Court in February 2007. On or about August 13, 2008, ANMP and the Unsecured Creditors' Committee jointly filed a Motion to Convert Mr. Coleman's Chapter 13 case to a proceeding under Chapter 7 of the Bankruptcy Code.

#### **E. REASONS FOR FILING CHAPTER 11.**

Debtors initiated these Chapter 11 proceedings because they faced likely defaults in their obligations to creditors, including the creditors under the 2004 Plan. These likely defaults include short-term defaults, to the holder of a lien against the Medford property and the holder of the first lien on Debtors' inventory. The likely defaults also include mid-term

defaults on the \$15 million in obligations to non-ANMP creditors secured by Debtors' store locations, the majority of which mature in April of 2009. The likely defaults also include current and long-term defaults on 2004 General Claims and the ANMP Claim because Debtors' financial condition does not permit Debtors to continue their sales growth by expanding to other locations.

### **III. POST PETITION OPERATIONS AND DEVELOPMENTS.**

#### **A. DEVELOPMENTS IN THE CHAPTER 11 CASE.**

##### **1. Continued Operations.**

On March 9, 2007, Debtors Dexter, New Castle, and Medford filed new voluntary chapter 11 bankruptcy petitions. On May 19, 2008, Debtor Castle Realty filed its Chapter 11 bankruptcy petition. Debtors have continued to operate in the ordinary course under existing management.

##### **2. Joint Administration.**

On March 9, 2007, Debtors Dexter, New Castle and Medford applied for joint administration of these Chapter 11 cases with the Chapter 11 cases filed in 2003 and the Taylor Coleman Chapter 13 case (Docket # 1148). The application was granted on March 13 (Docket # 1153). On May 20, 2008, Debtor Castle Realty applied for joint administration of its Chapter 11 case with the aforementioned cases (Docket # 2093). This application was granted on May 28, 2008 (Docket # 2101).

##### **3. First Day Operating Orders.**

On March 12 and 14, Debtors Dexter, New Castle and Medford filed applications to pay pre-petition wage claims, to pay claims of certain critical vendors in the ordinary course, to pay utilities in the ordinary course and to maintain certain cash management and banking arrangements (Docket # 1149, 1155, 1158, 1159). These applications were granted (Docket

# 1170, 1180, 1182, 1183). Based on these orders, Debtor New Castle has paid wage claims, utility claims and certain vendor claims in the ordinary course on existing terms. As a result, Debtor New Castle has experienced little post-petition employee turnover and most of Debtor New Castle's trade creditors have continued existing trade credit terms.

#### 4. Employment of Professionals.

Upon commencing these proceedings, Debtors Dexter, New Castle and Medford applied for approval to employ **Stinson Morrison Hecker LLP**, of Phoenix, Arizona, as bankruptcy counsel for Debtors (Docket # 1156). Taylor Coleman objected to the application (Docket # 1157), but consented to approval on an interim basis (Docket # 1179), The Bankruptcy Court granted the application on March 19 (Docket # 1181). On May 29, 2008, Castle Realty applied for approval to employ **Stinson Morrison Hecker LLP** as counsel for Castle Realty (Docket # 2103). The Bankruptcy Court granted the application on June 4, 2008 (Docket # 2129).

On April 18, Debtors Dexter, New Castle and Medford applied for approval to employ **Weston Garrou, DeWitt & Walters**, as special counsel for various non-bankruptcy matters (Docket #1246). The application was granted on April 19 (Docket # 1259). On April 18, Debtors Dexter, New Castle and Medford also requested authority to employ various professionals, including **Fennemore Craig, Barry & Moore**, and **Osborn Maledon**, in the ordinary course for various non-bankruptcy matters (Docket # 1245). The request was granted by Order dated May 23, 2007 (Docket #1359). On July 25, 2007, the Court approved the employment of **Morris-Anderson & Associates, Ltd.**, as a valuation expert (Docket #1426). On August 15, 2007, the Court approved the employment of **Ben Goren** as a financing expert (Docket #1574). On September 5, 2007, the Court approved the employment of **Integra Realty Resources, Winius Realty Analysts** as a real property

appraiser (Docket #1705). On September 10, 2007, the Court approved the employment of **Professor Jonathan Lipson** as a rebuttal expert witness (Docket #1725).

#### **5. Creditors' Meeting and Creditors' Committee.**

The United States Trustee presided over an initial creditors' meeting under §341 of the Bankruptcy Code on April 24, 2007. An Official Unsecured Creditors' Committee was appointed on May 18, 2007 (Docket #1343). Employment of the Committee's counsel, **Tiffany & Bosco**, was approved on May 21, 2007 (Docket #1353), and employment of the Committee's financial and business valuation advisor, **Sierra Consulting Group**, was approved on July 16, 2007 (Docket #1481).

#### **6. Stay Litigation on Medford Property, Foreclosure and Substitute Premises.**

On April 11, 2007, Professional Portfolio Service, L.L.C. ("PPS") filed a motion for relief from the automatic stay with respect to its lien on the Medford Property (Docket # 1237). Debtors Dexter, New Castle and Medford responded in opposition to the motion on April 27, 2007 (Docket # 1281). On November 28, 2007, the Court granted stay relief on the ground that no feasible plan of reorganization was reasonably in prospect.

Castle Realty has also claimed an interest in the Medford Property and, upon the filing of its bankruptcy petition, invoked the automatic stay relative to such property. On June 6, 2008, PPS filed an emergency motion for stay relief in the Castle Realty case with respect to its lien on the Medford Property (Docket # 2109). After a contested hearing, on June 24, 2008, the Court granted stay relief (Docket # 2177).

On July 30, 2008, PPS completed its foreclosure sale of its lien interest in the Medford Property. On or about August 1, 2008, New Castle leased new premises in Medford, Oregon. The new lease is for approximately 6,000 square feet (compared to @18,000 square feet in the previous premises) at a rental rate of \$6,700 per month (compared to

@\$17,000 per month at the previous premises). On August 4, 2008, the Court approved the new lease.

#### **7. 2007 Stipulation with ANMP and Plan.**

On March 14, Debtors Dexter, New Castle and Medford applied for approval of a stipulation between these Debtors and ANMP providing, *inter alia*, for (i) ANMP to release its secured claim under the 2004 Plan in exchange for the issuance of preferred stock in New Castle in the context of a new plan of reorganization, (ii) all other creditors to be unimpaired under such plan, and (iii) modifications of Debtors' management structure. In June 2007, Debtors Dexter, New Castle and Medford filed a plan of reorganization based on the stipulation. In September, 2007, ANMP withdrew from the stipulation and Debtors Dexter, New Castle and Medford withdrew their plan of reorganization.

#### **8. Motion for Appointment of Trustee or Examiner.**

On March 19, Taylor Coleman moved for the appointment of a trustee or examiner. On April 10, the Court granted the motion (Docket # 1235) and, on April 26 (Docket # 1280), Anthony Schnelling was appointed as examiner. On May 2, Mr. Schnelling applied for approval to employ local bankruptcy counsel, general bankruptcy counsel and a financial advisor (Docket # 1291, 1293, 1295). These applications were granted on May 3 (Docket # 1298, 1299, 1300).

The Examiner issued his report on August 15, 2007, and the report is available to parties in interest. The Examiner opined, *inter alia*, that the Board of Directors (i) authorized the funding of store improvements and other capital improvements between 2004 and 2006 that reduced the funds available to make payments to creditors under the 2004 Plan, (ii) failed to give adequate consideration to refinancing approaches other than the refinancing approach reflected in the 2007 Stipulation, (iii) terminated Mr. Coleman's

employment and delayed payments to certain creditors of Mr. Coleman as a means to persuade Mr. Coleman to accept the substantive terms of the 2007 Stipulation.

Debtors vigorously dispute these, and other, opinions expressed in the Examiner's Report. Debtors believe store improvements undertaken by Debtors were necessary, in many instances to comply with employee and public health concerns, and in other instances to maintain and enhance the stores' customer appeal. Other capital improvements were necessary to establish adequate inventory control and discourage theft and other inventory shrinkage.

Debtors believe that management and the board gave adequate consideration to other available refinancing options and that no refinancing alternative was available or superior to the approach reflected in the 2007 Stipulation. Debtors believe that the Examiner Report's specific references to other financial alternatives were substantially incorrect, as shown by the sworn statements of the alleged sources of these alternatives.

Debtors believe that the board appropriately exercised its authority under the 2004 Plan to terminate Mr. Coleman's employment because Mr. Coleman was not performing any services for Debtors.

On August 24, 2007, after the filing of the Examiner's report, Coleman renewed his emergency motion for the appointment of a Chapter 11 Trustee (Docket #1638), relying in large part on the Examiner's report. Debtors vigorously dispute the allegations in the motion, just as they dispute the allegations in the Examiner's report. Debtors believe that, especially in light of the extensive discovery conducted during the summer of 2007, the facts will demonstrate that there are no grounds for appointing a Chapter 11 Trustee. A hearing on this motion was set for March 4, 2008 but the hearing was vacated following the resignation of Mr. Schweigert as discussed below.

On May 16, 2008, Coleman again renewed his emergency motion for the appointment of a Chapter 11 Trustee (Docket # 2076). On May 20, 2008, the Court denied Coleman's motion without prejudice (See Minute Entry at Docket # 2095).

**9. Exclusivity.**

On April 25, 2007, Taylor Coleman filed a motion to terminate the exclusive right of Debtors Dexter, New Castle and Medford to propose a plan of reorganization under § 1121 of the Bankruptcy Code (Docket # 1273). Debtors Dexter, New Castle and Medford agreed to allow only Coleman to file a competing plan, and otherwise retain exclusivity as to all other persons. See Order Modifying Debtors' Exclusive Period for Filing Plan dated May 22, 2007 (Docket #1358). Debtors Dexter, New Castle and Medford filed their prior plan within the 120-day period provided to preserve their exclusive right as specified in § 1121(b). Exclusivity remains with respect to Debtor Castle Realty but has terminated with respect to all other Debtors.

**10. Adversary Proceeding Filed by Taylor Coleman.**

Shortly after the commencement of these proceedings, Taylor Coleman filed a complaint against Debtors' officers and directors, affiliated companies, and ANMP in the Superior Court of Maricopa County, Arizona. The action was removed to the Bankruptcy Court and remains pending as *Coleman v. Schweigert et al.* In May 2008, Mr. Coleman filed a third amended complaint. It remains pending.

**11. Examination Motions Filed by Taylor Coleman.**

Taylor Coleman has, on several occasions, filed motions under Bankruptcy Rule 2004 seeking the production of documents and the examination of various persons, including Debtors' directors. Currently, Debtors have provided tens of thousands of pages of documents at Taylor Coleman's request and examinations have been taken of several of

Debtors' directors. Discovery under these proceedings are subject to various confidentiality agreements on terms approved by the Bankruptcy Court.

**12. Plan and Disclosure Statement Filed by Taylor Coleman.**

On June 12, 2007, Taylor Coleman filed a proposed Joint Plan of Reorganization (Docket #1408) and proposed Disclosure Statement (Docket #1409). In September 2007, Mr. Coleman withdrew his plan.

**13. Proof of Claim Filed by Taylor Coleman.**

On July 26, 2007, Taylor Coleman filed a proof of claim in an unspecified amount against Debtors Dexter, New Castle and Medford based upon (i) such Debtors' alleged failure to comply with obligations under the 2004 Plan, (ii) wages allegedly unpaid by such Debtors, and (iii) unreimbursed expenses allegedly incurred by Coleman on such Debtors' behalf.

**14. Mediation and Terminated Term Sheet.**

In October, 2007, various parties to the case participated in mediation presided over by an agreed-upon bankruptcy judge. The mediation sessions continued until February 2008, when ANMP and Mr. Coleman announced a settlement between them on a "term sheet" read into the record specifying various deadlines for obtaining financing, filing a plan, and other matters. In April, ANMP terminated its participation in the term sheet based upon Mr. Coleman's failure to perform.

**15. Bar Date for Administrative Claims.**

In January 2008, the Court established a bar date for the filing of professional administrative claims incurred in the case through January. Various professionals filed claims, including professionals retained by the Debtors and the Committee's professionals. In addition, ANMP and Mr. Coleman filed claims for "substantial contributions" to these proceedings. Including over \$2 million in substantial contribution claims, claims filed by the

deadline exceeded \$6.4 million. Concurrently with the filing of this Disclosure Statement, Debtors have objected to the substantial contribution claims of Mr. Coleman and his professionals.

**16. Resignation of Vern Schweigert.**

In March 2008, ANMP demanded that Vern Schweigert resign as Manager and filed a motion for the appointment of a trustee. The motion was resolved by agreement when Mr. Schweigert resigned as Manager. Subsequently, Debtors Dexter, New Castle and Medford, Mr. Coleman and ANMP agreed to Vern Schweigert's designation of James Spear as a replacement.

**17. Sale of I-17/Dunlap Property.**

On January 31, 2008, the Court entered a stipulated order approving a sale of excess property located at 8802 North Black Canyon Highway in Phoenix, Arizona consisting of approximately 1.765 acres for the purchase price of \$849,952.35 (together with extension fees of \$45,000 for a total consideration of \$894,952.35). The sale transaction closed on or about February 19, 2008. Approximately \$132,798.26 of the sale proceeds were retained in escrow pending resolution of a dispute over the interest rate on delinquent real estate taxes. Additionally, approximately \$205,075.21 of the sale proceeds remain in escrow pending a dispute with Coleman over the party properly entitled to such proceeds.

**18. Tax Claim Rate.**

On April 22, 2008, Debtors filed a motion to determine the interest rate to accrue on delinquent real estate taxes. Debtors contended that a rate of 5% was appropriate. Maricopa County, Arizona and LPT Co., the holder of a real estate tax certificate for delinquent real estate taxes, filed objections contending that the rate as to properties in Maricopa County should be the statutory rate of 16% per annum. There were no other

objections. The Debtors, Maricopa County, Arizona and LPT Co. have resolved their dispute and have stipulated to an interest rate of 8.5% to accrue on the delinquent real estate taxes. A rate of 5% will apply to all delinquent real estate taxes on properties located outside of Maricopa County, Arizona. The foregoing interest rates were approved by the Court at a hearing held on August 4, 2008 subject to notice to be given to all appropriate parties.

**19. Real Property Transfers.**

On May 19, 2008, Debtors filed a motion to authorize the transfer of all of the Castle real properties to Castle Realty as contemplated by and in accordance with the 2004 Plan. At a hearing on May 23, 2008, the Court granted the transfer motion to the limited extent that the transfers are necessary to implement, or are contemplated by, a plan of reorganization to be confirmed by the Court (See Minute Entry at Docket # 2177).

**20. Valuation.**

On July 11, 2008, ANMP filed its motion to determine the value of its collateral consisting of all of the Castle real properties (Docket # 2190). The Court has scheduled an evidentiary hearing on this motion for September 23, 2008.

**21. Business Operations.**

During the course of these proceedings, Debtors have continued to operate in all existing locations. Debtors' revenues declined by approximately 2% in 2007 compared to 2006, with newer store locations (particularly Anchorage) partially offsetting declines in existing stores. Since October 2007, sales have declined from 6% to 10% over prior-year sales. Debtors believe that these declines are consistent with industry and overall retail revenue trends throughout the markets in which Debtors operate and that, in fact, Debtors are suffering more moderate declines than the industry generally.

Revenue losses have been partially offset by achievements in reducing cost of goods and other operational efficiencies. However, Debtors anticipate a decline in gross revenue and net income for 2008, in part because of the continued high cost of litigation and other professional fees.

#### **IV. DESCRIPTION OF THE PLAN.**

The following section of the Disclosure Statement contains a description of the more important terms of the Plan of Reorganization. The Plan itself is attached hereto as Exhibit 1. Creditors and other parties in interest are encouraged to read the Plan in its entirety, including the exhibits thereto. In case of a conflict between the description in this summary and the terms of the Plan, the terms of the Plan shall control.

##### **A. GENERAL SUMMARY.**

The Plan provides for the liquidation of the Debtors and administration of proceeds through a Liquidating Trust. Debtors' operations and the bulk of its personal property and intangible assets will be sold to a new entity, Newco. Consideration for the sale will include Newco's assumption of the liabilities identified on Schedule 6 to the Plan, cash of Eight Hundred Thousand Dollars (\$800,000) to the Liquidating Trust on the Effective Date, and an additional One Million Seven Hundred Thousand Dollars (\$1,700,000) payable in annual installments over five years. Pursuant to the Plan, ANMP's secured claim against Debtors will be exchanged for fee title to Debtors' eleven real properties, subject to existing liens. The loans secured by these existing liens will be restructured, to the extent necessary, prior to the transfer so that monthly payments will continue through the longer of the current maturity date or for an additional five years from April 1, 2009, after which these liens will be paid in full. Other unsecured claims not assumed by Newco will be paid in accordance with the terms of the Liquidating Trust.

On the Effective Date, the members of the Management Board created under the 2004 Plan will be discharged and the Management Board will cease to exist. All assets and liabilities not transferred to or assumed by Newco will be transferred to the Liquidating Trust, which will be administered by a Liquidating Agent appointed pursuant to the Plan.

The Plan provides for the classification of claims against and interests in Debtors into various classes, based upon the priority of the claims within the Bankruptcy Code's priority structure and certain other factors as follows:

#	Class	Description	Impair	Payment
None	Administrative	Expenses arising after Petition Date	*	Unless assumed by Newco, on ED** or due date
1	Priority Non-Tax	Priority non-tax claims for wages, employee benefits, and deposits	Yes	In full over time pursuant to Liquidating Trust
2	Priority Tax	Tax claims entitled to priority under §507(a)(8) and (c)	Yes	In full over time pursuant to Liquidating Trust
3,	ANMP	ANMP under 2004 Plan	Yes	Transfer of real property; equity in Newco
4.	Various Secured	Non-ANMP liens on store locations	Yes	In full, monthly payments amortized over 5 years
5	Miscellaneous Secured	Other secured claims and secured tax claims	Yes	Value of interest in collateral upon liquidation
6.	Assumed Unsecured Claim	Franks Claim	Yes	Assumed and paid by Newco
7	Unassumed Unsecured Claims	All other unsecured, non-priority claims	Yes	Pursuant to Liquidating Trust
8	Equity Interests	Canceled	Yes	None

\* Not subject to classification under § 1123(a)(1)

\*\* Effective Date of this Plan

The Plan contains provisions governing the filing of claims, objections to such claims, and the allowance and disallowance of claims. The Plan provides that no distributions will be made on account of claims until such claims are Allowed or Estimated in accordance with the terms of the Plan and the Bankruptcy Code. The Plan also provides for the retention of the Bankruptcy Court's jurisdiction over Debtors to interpret and enforce the Plan.

## **B. LIQUIDATING TRUST**

The form of the Liquidating Trust is attached to the Plan as Schedule 10. It provides for the liquidation of Debtors' assets and distribution of the proceeds thereof among the holders of Allowed Claims in those Classes where Newco does not assume liability for the Claims.

The Liquidating Trust is intended to qualify as a "grantor trust" for federal income tax purposes and the Liquidating Agent shall operate and maintain the Liquidating Trust in compliance with the guidelines for liquidating trusts as set forth in Internal Revenue Service Revenue Procedure 94-45, 1994-2 C.B. 684, and Treasury Regulation Section 1.671-4(a) and all subsequent guidelines regarding liquidating trusts issued by the Internal Revenue Service.

For United States federal and applicable state income tax purposes, the transfer of the assets to the Liquidating Trust pursuant to and in accordance with the Plan shall be reported as a disposition of the assets directly to and for the benefit of the beneficiaries immediately followed by a contribution of the assets by the beneficiaries to the Liquidating Trust for the benefit of the beneficiaries. The beneficiaries will be treated as the grantors and deemed owners of the Liquidating Trust.

To the full extent permitted by law, all rights under (i) Section 363(h) of the Bankruptcy Code and (ii) Section 365 of the Bankruptcy Code (including without limitation Section 365(f) thereof) are preserved for the benefit of the Estates and their creditors, and may be exercised by the Liquidating Agent with the approval of the Bankruptcy Court.

As soon as practicable after the Effective Date, the Liquidating Agent may, if reasonably deemed necessary by the Liquidating Agent, make a good faith valuation of the trust assets. Such valuation shall be made available from time to time to the extent relevant

as reasonably determined by the Liquidating Agent and shall be used consistently by all parties (including the Debtors, the Liquidating Agent and the beneficiaries) for all purposes, including federal and applicable state income tax purposes. Notwithstanding the foregoing, any such valuation shall not be binding upon the Liquidating Agent with respect to liquidation of assets or any other action taken pursuant to the Plan.

Holders of Allowed Claims, if any, entitled to distributions from the Liquidating Trust will receive payment in the following priority: First, Allowed Administrative Claims; second, Allowed Class 1 Claims; third, Allowed Class 2 Claims; fourth, Allowed Class 7 Claims. This treatment is incorporated into the following description of the treatment of all Claims against and Interests in the Debtors.

### **C. TREATMENT OF CLAIMS AND INTERESTS.**

The Plan classifies, and specifies the treatment of, all claims against, and interests in, Debtors, whether such claims are liquidated or unliquidated, fixed or contingent, disputed or acknowledged, and whether such claims or interests are the subject of proofs of claim or interest. The following sections describe the classes and specify their respective treatments.

#### **1. Priority Claims.**

Section 507 of the Bankruptcy Code identifies certain types of Claims entitled to payment with priority over all other claims. Certain of the priority claims must be paid in full on the Effective Date of the Plan, pursuant to Section 1129(a)(9)(A) and (B) of the Bankruptcy Code, in order for a plan to be confirmed. The Plan classifies Priority Claims and provides for payment in full of such claims as follows:

##### **a) Administrative Claims (Unclassified)**

The Plan does not classify administrative claims and expenses allowable under § 503(b) and entitled to priority under § 507(a)(2) because under the Bankruptcy Code such

claims do not vote on a plan of reorganization. Administrative claims, as defined in § 503 of the Code and in the Plan, consist of the actual, necessary costs and expenses of preserving the Estate, including taxes incurred, salaries or commissions for services rendered after the commencement of the case, fees of professionals employed by Debtor, and fees and charges assessed against the Estate under Chapter 123 of Title 28 of the United States Code. Notwithstanding the foregoing, in accordance with the requirements of the Bankruptcy Code, professional fees shall be paid only pursuant to Court authorization.

Under § 1129(a)(9)(A), administrative claims must be paid in full on the Effective Date in order for a plan to be confirmed. The Plan complies with this requirement by providing that administrative claims will be paid in full on the Effective Date of the Plan, or upon allowance, whichever occurs first, except to the extent a holder of an administrative claim otherwise agrees. Amounts due to holders of administrative claims will be treated in one of two ways: (a) the administrative claim of Debtors' Professionals and the administrative claims of post-petition lessors and vendors to Debtors will be assumed by Newco and paid either when due or in accordance with an agreement between the claimant and Newco; and (b) all other administrative claims will be paid from the assets of the Liquidating Trust.

Debtors anticipate that the following administrative expenses will accrue during these proceedings and will be payable on the Effective Date of the Plan, or later if (i) the administrative claimant agrees to terms more favorable to Debtors, or (ii) the Debtors' agreement with the administrative claimant provides for deferred payment or otherwise more favorable terms.

Ordinary Course Inventory Purchases, Leasing Costs, and Operating Expenses. In the ordinary course of business, Debtors incur substantial expenses for wages and salaries, inventory purchases and services, utilities, insurance and similar

operating expenses. New Castle also incurs real and personal property rental expenses, including rent obligations to third parties and obligations to affiliated entities, measured by mortgage, tax and insurance debt service, maintenance, and operating costs associated with Debtors' stores. Debtors anticipate that these administrative expenses will be paid on ordinary course terms during the course of the case and that, on the Effective Date, Debtors will be liable for approximately one month's operating expenses and two month's inventory purchases. This liability as of the Effective Date will be assumed and paid by Newco.

Debtors' Professional Fees. The Bankruptcy Code requires that fees and expenses of attorneys and other professionals are subject to Court approval under §330 of the Bankruptcy Code. Accordingly, the Plan provides that the fees of such professionals shall not be paid until Final Orders of the Bankruptcy Court have been entered approving and authorizing payment of such fees. Debtors anticipate that these fees will include the fees of Debtors' counsel, Debtors' accountants, special counsel, and ordinary course counsel and other professionals. Liability for the fees of Debtors' Professionals, as that term is defined in the Plan, will be assumed and paid by Newco, while the Liquidating Trust will be responsible for all other professional fees.

Committee Fees and Expenses. As discussed above, the Court has appointed an official Unsecured Creditors' Committee and has authorized the employment of counsel and a financial and valuation consultant for the Committee. The Liquidating Trust will be required to pay the fees only upon approval of the Bankruptcy Court.

Examiner Fees, Expenses, and Professionals. As discussed above, the Court has appointed an Examiner and authorized the employment of counsel and other

professionals for the Examiner. Debtors will be required to pay such fees only upon approval of the Bankruptcy Court. The Court has approved payment of certain fees and expenses of the Examiner and his professionals on a monthly schedule. The Debtors are current in payments under that schedule and anticipate that these fees will be paid in full before the Effective Date of the Plan. Any unpaid approved amount due the Examiner on the Effective Date will become the liability of the Liquidating Trust.

Fees and Expenses Allowable Under § 503(b)(3). Section 503(b) provides for administrative expense treatment of reasonable costs and expenses incurred by certain creditors or other parties, including parties that make a substantial contribution in these Chapter 11 cases. Such claims have been filed on behalf of ANMP and Mr. Coleman. ANMP has agreed to waive its substantial contribution claim upon confirmation of the Plan. Debtors have objected to the substantial contribution claims of Coleman and his professionals. The Liquidating Trust will be required to pay substantial contribution claims only upon approval of the Bankruptcy Court.

Indemnification Obligations. Under applicable law and Debtors' by-laws and articles of incorporation, Debtors are obligated to reimburse officers and directors for fees, costs, expenses and liabilities incurred by them in connection with their services in such capacity. Debtors anticipate that the officers and directors will seek indemnification and reimbursement for such costs and liabilities incurred by them in the course of these proceedings, including costs and liabilities incurred as a result of the adversary proceeding commenced by Taylor Coleman referred to in Section III.A.10 at page 19 hereof, to the extent these costs and liabilities are not reimbursed by existing D & O insurance maintained by Debtors.

Debtors anticipate that the aggregate of the Unassumed Administrative Claims, will exceed \$400,000 plus any substantial contribution claims.

Because the Plan provides for payment in full of Administrative Claims as of the Effective Date, they are not impaired.

**b) Class 1 Priority Non-Tax Claims**

The Plan classifies claims entitled to priority under § 507(a)(4), (a)(5) and (a)(7) as Class 1 Claims. Such claims include claims under §507(a)(4) for wages, salaries, and commissions, including severance, sick pay and vacation leave, to the extent the claims were incurred within the 90-day period immediately prior to the bankruptcy filing. The amount of each such claim entitled to priority is limited to \$10,000 per claimant. Claims for wages outside the 90-day period or in excess of the dollar amount limitation are classified as unsecured non-priority claims. Debtors anticipate that all priority wage claims have been or will be paid in full prior to the Effective Date pursuant to the Bankruptcy Court's Order authorizing payment of such claims (Docket #1170).

Class 1 also includes claims for contributions to employee benefit plans entitled to priority under § 507(a)(5). Such claims include claims for amounts due pursuant to Debtors' insurance benefit plans to the extent incurred for services rendered within the 180-day period immediately prior to the bankruptcy filings. The amount of claims entitled to priority is limited to \$10,000 per each employee less any priority wage claims for such employee. Claims for employee benefit plan contributions outside the 180-day period or in excess of the dollar limitation are classified in the Plan as unsecured non-priority claims. Debtors anticipate that all priority employee benefit claims have been or will be paid in full prior to the Effective Date pursuant to the Bankruptcy Court's Order authorizing payment of such claims (Docket #1170).

Class 1 also includes claims for consumer deposits entitled to priority under §507(a)(7). Under this provision of the Bankruptcy Code, a claim is entitled to priority treatment if it arises from the deposit of money by the claimant with a debtor in connection with the purchase of property or services for the personal, family or household use of the claimant. The amount entitled to priority is limited to \$2,225 per claim. Claims for customer deposits outside the Code definition or in excess of the dollar limitation are classified in the Plan as non-priority unsecured claims. Debtors believe that there are no claims for deposits.

Under § 1129(a)(9)(B) of the Bankruptcy Code, claims for wages, employee benefits and consumer deposits entitled to priority must be paid in full as a condition to confirmation. The Plan complies with this requirement by providing that such claims will be paid in full by the Liquidating Agent pursuant to the Liquidating Trust.

The Class 1 Claims, if any, are impaired.

**c) Class 2. Priority Tax Claims**

The Plan classifies claims for taxes entitled to priority under § 507(a)(8) and (c) as Class 2 Claims. Under Section 1129(a)(9)(C), claims for taxes entitled to priority must be paid in full within five years from the petition date in order to confirm a plan. The Plan complies with this requirement by providing that such claims will be paid by the Liquidating Agent pursuant to the Liquidating Trust. Debtors estimate that priority tax claims will be approximately \$300,667.

Class 2 claims are impaired.

**2. Secured Claims.**

Secured claims, as defined in §§ 506 and 1111 of the Bankruptcy Code, consist of claims secured by liens or other security interests in property of the Estates. Under § 506(a) of the Bankruptcy Code, a secured claim is ordinarily limited to the lesser of (i) the amount of

the claim secured, together with interest and costs, or (ii) the value of the collateral, as determined by the Court. If the value of the collateral is less than the amount of the claim, the balance of the claim is treated as an unsecured claim.

The Plan identifies and separately classifies classes of Secured Claims, as follows:

a) **Class 3. ANMP Claim.**

The Plan classifies the claim of ANMP as the Class 3 Claim. The Plan provides that the holder of an Allowed Class 3 Claim shall receive, on or before the Effective Date, a transfer of the ANMP Collateral subject to (i) ANMP Permitted Liens, and (ii) the ANMP Leases in favor of Newco an amount equal to the ANMP Collateral Equity Value. To the extent that the ANMP Collateral Equity Value is not sufficient to fully satisfy the ANMP Claim, ANMP shall receive a 50% equity interest in Newco and retain all of its rights to proceed against Taylor Coleman under the guarantee provisions of Paragraph 3 of the Order Confirming Mr. Coleman's Chapter 13 Plan dated January 18, 2007 (Docket #1134). In consideration for this exchange, Newco will be obligated to repurchase 1/60 of ANMP's original 50% equity position in Newco, monthly, commencing on the first day of the month following the Effective Date, for a monthly payment equal to the difference between the debt service on the ANMP Collateral and the lease payments on the ANMP Collateral as set forth in Paragraph 5.4 of the Plan. Except as set forth herein, Newco, the Liquidating Agent and the Liquidating Trust shall not have any liability for ANMP's Claim.

The Plan Proponents have agreed that for purposes of the Plan the Allowed ANMP Claim will be \$13,866,024.00. Debtors believe that the ANMP Collateral Equity Value will be less than the amount of the ANMP Claim.

The ANMP Claim is impaired.

**b) Class 4. Permitted Lien Claims.**

The Plan classifies the claims of holders of liens on the ANMP Collateral identified on Schedule 11 to the Plan as Class 4 Claims. Each holder of an Allowed Class 4 Claim will retain its lien on the ANMP Collateral and will be paid according to the terms of the Modified Loan Documents as defined in the Plan. The terms of the Modified Loan Documents, including the interest rates stated therein, shall remain in full force and effect, and except as follows will not be modified or otherwise amended by the Plan. The Loan Documents shall be amended to (1) authorize and allow the substitution of the performance of ANMP for that of the Debtors and (ii) the maturity date under the Modified Loan Documents shall be the longer of the current maturity date or for an additional five (5) years from April 1, 2009. From and after the transfer of the ANMP Collateral to ANMP, ANMP will be solely responsible for payment of the Allowed Class 4 Claims.

Debtors believe that the Class 4 Claims will aggregate approximately \$11,961,685 on the Effective Date.

The Class 4 Claims are impaired.

**c) Class 5. Miscellaneous Secured Claims.**

The Plan classifies all Secured Claims and Secured Tax Claims not otherwise classified herein as Class 5 claims. Each holder of a Secured Claim in Class 5 is considered to be in its own separate subclass within Class 5, and each subclass is deemed to be a separate Class for purposes of the Plan.

Each holder of an Allowed Class 5 Claim will retain its lien on the collateral securing the Class 5 Claim, and will be paid in cash following the liquidation of the collateral securing such Claim the lesser of (1) the proceeds resulting from the liquidation of the collateral securing such Claim, or (2) the amount of the holder's Allowed Class 5 Claim. Alternatively,

the Debtors may elect, at any time on or before the Confirmation Date, to satisfy a Class 5 Claim by abandoning the collateral securing such Claim to the holder of such Claim.

The Class 5 Claims are impaired.

### **3. Unsecured Claims.**

The remaining claims against Debtors consist of unsecured claims not entitled to priority under the Bankruptcy Code. The Plan identifies two classes of such claims, as follows:

#### **a) Class 6. Assumed Unsecured Claim.**

The Plan classifies the Franks Claim as the Class 6 Claims. The Allowed Class 6 Claim will be assumed by Newco on the Effective Date, and will receive no payment from the Debtors or their bankruptcy estates.

Class 6 Claims are impaired.

#### **b) Class 7. Other Claims.**

The Plan classifies all other claims not otherwise classified in the Plan, and which are not assumed by Newco, as Class 7 Claims. The Plan provides that such claims will be paid pursuant to the terms of the Liquidating Trust.

Class 7 Claims are impaired.

### **4. Equity Interests.**

#### **a) Class 8. Interests in Debtors.**

The Plan classifies all equity interests in Debtors (held by Taylor Coleman and Mark Franks) as Class 4.A. The Plan provides that all Equity Interests shall be cancelled and terminated as of the Effective Date. The holders of Allowed Class 8 interests shall not receive or retain any property under the Plan on account of their interests.

Class 8 Interests are impaired and, because the holders of Class 8 Interests receive nothing on account of their interests, they are deemed to have rejected the Plan.

**D. MANAGEMENT OF DEBTORS, THE VOTING TRUST AND THE LIQUIDATING TRUST.**

The Plan provides for the cessation of Debtors' operations, the termination of the existing Management Board, the termination of the Voting Trust, and the appointment of a Liquidating Agent as of the Effective Date.

**E. ASSUMPTION OF LEASES AND EXECUTORY CONTRACTS.**

The Plan provides that, on the Effective Date, Debtors will assume and assign to Newco the Unexpired Real Property Leases identified on Schedule 7 to the Plan, and Debtors will reject those Unexpired Real Property Leases identified on Schedule 12 to the Plan. The Plan also provides that, on the Effective Date, Debtors will assume and assign to Newco the Executory Contracts identified on Schedule 5 to the Plan, and Debtors will reject the Rejected Executory Contracts as defined in the Plan.

Newco will be responsible for any cure amounts associated with any assumed lease or executory contract, and the Bankruptcy Court will retain jurisdiction to determine such cure amounts; provided, however, that if the Bankruptcy Court orders the payment of a cure amount that Newco finds unacceptable, Newco shall have ten (10) days from the date of the Final Order making such determination within which to file a motion for rejection with the Bankruptcy Court, and such Assumed Unexpired Real Property Lease or Assumed Executory Contract shall be deemed to never have been assumed.

Claims for rejection damages for leases or executory contracts not assumed and assigned to Newco must be filed with the Bankruptcy Court on or before the first business day at least twenty (20) days after the Confirmation Date. To the extent such rejection damages claims are allowed, they will be classified as and treated with Class 7 claims.

**F. OWNERSHIP OF AVOIDANCE ACTIONS AND LITIGATION CLAIMS.**

The Plan provides that Newco will acquire all statutory causes of action under sections 506, 510, 542, 543, 544, 547, 548, 549, 550, and 1123(b) of the Bankruptcy Code that the Debtors and their Estates may have against Franks, Brett Frederick, Dave Hopkins, Stan Chernoff, James Spear, Lyman Davis, Jim Sell, ANMP and/or Debtors' professionals. The Plan also provides that Newco will acquire all rights, claims, torts, liens, liabilities, obligations, actions, causes of action, avoiding powers, proceedings, debts, contracts, judgments, offsets, damages and demands whatsoever in law or in equity, whether known or unknown, contingent or otherwise, including, without limitation, any legal malpractice claims or breach of fiduciary duty claims, that the Debtors and their Estates may have against Franks, Brett Fredrick, Dave Hopkins, Stan Chernoff, James Spear, Lyman Davis Jim Sell, ANMP and/or Debtors' professionals.

Except for the avoidance actions and litigation claims described above, all of the avoidance actions and claims which might be asserted by the Debtors or their Estates will be transferred to the Liquidating Trust on the Effective Date.

**G. RETENTION OF JURISDICTION.**

The Plan provides for the retention of jurisdiction in the Bankruptcy Court to interpret and enforce the Plan, to resolve disputed claims and to enforce the obligations under the Plan.

**THE FOREGOING IS ONLY A SUMMARY OF THE PLAN. CREDITORS ARE URGED TO READ THE PLAN IN FULL AND TO CONSULT WITH THEIR COUNSEL AND/OR FINANCIAL ADVISERS REGARDING THE PLAN'S TERMS AND LEGAL EFFECT. CREDITORS ARE ADVISED THAT, SHOULD THE PLAN BE CONFIRMED, THE PLAN AND THE ORDER CONFIRMING THE PLAN SHALL BE BINDING ON CREDITORS, DEBTORS, AND THE REORGANIZED DEBTOR.**

## **V. FINANCIAL INFORMATION AND PROJECTIONS.**

### **A. DEBTORS' CURRENT FINANCIAL CONDITION.**

Debtors have prepared a consolidated balance sheet and a summary of the results of operations for New Castle for the period ending on December 31, 2007, which is attached as Exhibit 3. Debtors have attached the comparative balance sheet and a summary of the results of operations for New Castle for the period ending on June 30, 2008 as Exhibit 4.

### **B. PROJECTIONS.**

Debtors have prepared projections which are attached as Exhibit 5. A full discussion of the economic assumptions underlying the Plan's financial projections is included in the Notes to Exhibit 5

### **C. RISK FACTORS.**

As explained in the Notes to Projections attached to Exhibit 5, the projected results of operation are based on the assumptions stated, which represent Debtors' best estimates. The projections contain forward-looking statements that are inherently subject to risk and uncertainty and actual results may vary materially from the results assumed in the projections. When determining whether to accept the Plan, holders of claims and interests should consider these inherent risks.

## **VI. CURRENT MANAGEMENT.**

### **A. MANAGEMENT PERSONNEL.**

Debtors' management includes the following individuals:

**Mark A. Franks, President, Chief Executive Officer.** Mr. Franks was appointed Chief Operating Officer of Debtors in June, 2003, pursuant to an application filed June 24 and approved by the Bankruptcy Court on August 12. Mr. Franks has been employed in the adult retail store industry for the past eighteen (18) years. He has owned and operated numerous

companies, including the largest adult retail store industry in Australia. His expertise includes: (i) executive negotiations; (ii) vendor relations; (iii) inventory control/purchasing; and (iv) financial operations and account management. Mr. Franks has been employed since the Effective Date of the 2004 Plan under the terms of an Employment Agreement, which provided Mr. Franks with a twenty percent (20%) interest in New Castle, subject to partial defeasance upon early termination.

#### **B. MANAGEMENT BOARD MEMBERS.**

The current members of the Management Board are as follows: Stanley Chernoff and David Hopkins, members designated by the Creditors' Committee in the 2003 Cases; James Sell and Lyman Davis, members designated by ANMP.

#### **C. LIQUIDATING TRUST**

As of the Effective Date, Debtors will have no employees or management. The Liquidating Trust will be managed by the Liquidating Agent, who will be approved by the Court.

### **VII. LEGAL REQUIREMENTS FOR CONFIRMATION.**

This Section of the Disclosure Statement discusses the legal requirements for Confirmation of the Plan as established by § 1129 and other provisions of the Bankruptcy Code.

#### **A. VOTING ON PLAN.**

The Bankruptcy Code contains detailed provisions regarding which creditors and interest holders are entitled to vote on a plan or reorganization. In general, the creditors and interest holders in classes that are not impaired under the Plan are not entitled to vote and are conclusively presumed to accept a plan. Creditors and interest holders in classes that receive nothing under the plan need not vote and are conclusively presumed to reject a plan.

Creditors and interest holders whose claims or interests are “impaired” under the plan are entitled to vote on the plan.

If a party in interest believes that it holds a claim or interest in another class that is impaired under §1124 of the Bankruptcy Code, such party may request the Bankruptcy Court to determine its right to vote on the plan.

**B. ACCEPTANCE OF PLAN BY CREDITORS.**

A Class of Claims impaired under the Plan “accepts” the Plan only if (a) more than one-half of the holders who submit ballots for Claims in that Class vote to accept, and (b) the holders of Claims accepting the Plan hold at least two-thirds, by dollar amount, of the voted Claims within that Class. A Class of Interests impaired under the Plan “accepts” the Plan only if two-thirds of the voted Interests in such Class have voted to accept the Plan. If the requisite acceptances of each Class of Claims or Interests are obtained and the Plan is confirmed, the Plan will be binding with respect to all holders of Claims and Interests of each Class, including members who did not vote or who voted to reject the Plan.

**C. BEST INTERESTS OF CREDITORS.**

Section 1129(a)(7) provides that, as a condition to confirmation, a Plan must provide that any creditor or interest holder not voting to accept the Plan must receive, under the Plan, distributions of a value at least equal to that which such creditor would receive if Debtor were liquidated under Chapter 7 of the Bankruptcy Code. This provision is generally referred to as the “best interest test.”

Debtors believe that the best interests test is satisfied by the Plan. Under the Plan, ANMP will receive its collateral, subject to existing liens, in satisfaction of its claim. All other creditors will receive payments, in cash or in installments, to the extent of available cash, in accordance with the priority scheme of the Bankruptcy Code.

For the purpose of applying the “best interest” test, Debtors have prepared an estimate of the results of a liquidation under Chapter 7, which is attached as Exhibit 6 to this Disclosure Statement. This estimate indicates that Debtors’ liquidation under Chapter 7 would likely result in a substantially smaller recovery than anticipated under the Plan.

**D. CONFIRMATION POSSIBLE WITHOUT ACCEPTANCE BY CREDITORS.**

Debtors intend to request the Bankruptcy Court to confirm the Plan even if a Class of Claims or Interests does not accept the Plan. To do so, the Bankruptcy Court must find that the Plan is fair and equitable with respect to each Class of Claims or Interests that is impaired and has not accepted the Plan. Debtors believe that the Plan will satisfy the fair and equitable requirements of the Bankruptcy Code to the extent such requirements are applicable based upon the vote of Creditors on the Plan.

**1. Fair and Equitable Treatment of Secured Claims.**

With respect to a Class of Secured Claims that does not accept the Plan, the Bankruptcy Code’s “fair and equitable” standard includes a requirement that the holders of the Claims either (i) retain their liens on the collateral and receive cash payments, on the Effective Date or in installments, of a value equal to the amount of the Secured Claim, or (ii) receive the realization of the indubitable equivalent of the Secured Claim. Debtors believe that this standard is satisfied by the Plan, which provides that each holder of a Secured Claim will receive payment of the full amount of its Claim, with interest at a rate to be determined by the Bankruptcy Court, and will retain the holders’ lien on the collateral to secure payment of the amounts specified by the Plan.

**2. Fair and Equitable Treatment of Unsecured Claims.**

With respect to an unsecured, non-accepting Class of Claims, the Bankruptcy Code’s “fair and equitable” standard includes a requirement that either (i) the holders of the Claims

receive cash payments, on the Effective Date or in installments, of a value equal to the amount of the Claim, or (ii) no Class of junior Claims or Interests receives anything on account of such junior Claim or Interest. Debtors believe that this standard is satisfied by the Plan, because no junior claim or interest will be paid anything until such senior claim is satisfied.

#### **VIII. TAX CONSEQUENCES OF PLAN.**

The filing of these Chapter 11 proceedings and/or the consummation of the Plan may have federal and state tax consequences on Debtors, its equity holders, and creditors. In general, creditors receiving cash under the Plan may recognize an ordinary or capital loss based upon the difference between the amount of their claim and the value of the assets received by them under the Plan. In addition, the creation of and distributions from the Liquidating Trust may have tax consequences.

**IN NO EVENT WILL DEBTORS OR ANY AFFILIATE OF PROFESSIONAL ADVISORS ENGAGED BY ANY OF THEM BE LIABLE IF, FOR ANY REASON, THE FEDERAL TAX CONSEQUENCES OF THE PLAN ARE OTHER THAN AS ANTICIPATED. CREDITORS MUST LOOK SOLELY TO AND RELY SOLELY UPON THEIR OWN ADVISORS AS TO THE FEDERAL TAX CONSEQUENCES OF THIS PLAN.**

#### **IX. CLAIMS BAR DATES AND EFFECTIVE DATE.**

##### **A. BAR DATES.**

The deadline for filing proofs of claim in all cases other than Castle Realty was July 16, 2007 (Docket #1376). The Castle Realty bar date will be set by the Court.

##### **B. PLAN EFFECTIVE DATE.**

“Effective Date” means the date upon which all conditions to the effectiveness of the Plan have been satisfied and the Reorganized Debtors take steps necessary to substantially consummate the Plan. The Effective Date shall occur on the earlier of the sixtieth (60) day after the Confirmation Order has become a Final order or December 31, 2008, provided that

all of the conditions set forth in Section 13.1 of the Plan have been satisfied, provided that the Bankruptcy Court may, for cause shown, extend the time for the occurrence of the Effective Date.

**X. RECOMMENDATIONS OF PLAN PROPONENTS.**

Debtors, ANMP, Mark Franks, and the Creditors' Committee recommend that the Plan of Reorganization be approved.

DATED this 15<sup>th</sup> day of August 2008.

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