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A Blockbuster Failure: How an Outdated Business Model Destroyed a Giant

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A Blockbuster Failure: How an Outdated Business Model Destroyed a Giant

Todd Davis, John Higgins

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I. Introduction

The rise of the Internet in the 1990s and 2000s rapidly created new markets. Companies like Apple seized on the ability to distribute music online for a lower price than independent record stores, or even large-scale ones like Tower Records could afford, driving record stores to near-extinction.¹ A similar fate has fallen upon the video rental stores. Giants Movie Gallery and Blockbuster, driven by physical rental stores, began struggling to compete with streaming and mailing platforms. Both were driven into bankruptcy because they failed to adapt quickly enough. A series of poor choices by Blockbuster, including passing on the acquisition of Netflix for a mere \$50 million, led the company to file Chapter 11 to reduce its roughly one billion dollar debt.² This paper tells the story of Blockbuster's venture into and through bankruptcy in an attempt to reclaim its place in the video rental world.

II. Background Information

In 1985, the first Blockbuster store opened its doors in Dallas, Texas.³ The company was the brainchild of David Cook, a computer programmer.⁴ Cook's background proved crucial to Blockbuster's early success. Cook programmed Blockbuster's computers to track inventory and consumer preferences.⁵ Thus, Blockbuster thrived off its ability to provide the films that consumers wanted at individual stores.⁶ In addition to its ability to customize store selection to local neighborhoods, a large distribution center in Dallas helped Blockbuster grow quickly.⁷

¹ Cristina Guarino, *What Happened to the Record Stores?*, THE GAZETTE, (Dec. 29, 2010), http://www.qgazette.com/news/2010-12-29/Features/What_Happened_To_The_Record_Stores.html.

² Mike Spector, *Blockbuster to Remake Itself Under Creditors*, THE WALL STREET JOURNAL, (Sep. 24, 2010), <http://online.wsj.com/article/SB10001424052748703384204575509331302481448.html>.

³ *Video Venture: Taking Charge of Blockbuster*, BUSINESS WEEK, <http://www.businessweek.com/chapter/chap0009.htm>.

⁴ Stephen Gandel, *How Blockbuster Failed at Failing*, TIME, (Oct. 17, 2010), <http://www.time.com/time/magazine/article/0,9171,2022624,00.html>.

⁵ *Id.*

⁶ *Id.*

⁷ Joshua Hyatt, *He Began Blockbuster. So What? David Cook created a household name, but he refuses to become one.* CNNMONEY, (July 1, 2003) <http://www.time.com/time/magazine/article/0,9171,2022624,00.html>.

Wayne Huizenga, founder of WasteManagement, purchased a controlling interest in Blockbuster with two colleagues in 1987 for \$18 million.⁸ Huizenga believed that Blockbuster had immense potential because, like McDonalds, it was a one-product business holding national appeal.⁹ Huizenga guided the company through a period of expansive acquisition. In 1987, Blockbuster owned eight stores and franchised eleven.¹⁰ Within a year, it had become the largest video chain in the world and, by 1991, Blockbuster owned 1,654 stores in the United States alone.¹¹ Blockbuster expanded in part by buying out both video and music chain competitors like Erol, Sound Warehouse, and Music Plus.¹²

After seven years under Huizenga, Viacom purchased Blockbuster for \$8.4 billion.¹³ Without Huizenga's guidance, however, the company faltered. By 1996, Blockbuster had lost half of its value.¹⁴ A large part of this downswing was Viacom's prioritizing more than just renting movies.¹⁵ Breaking from Huizenga's singular focus, Viacom instead tried to use Blockbuster stores as outlets for Paramount and MTV merchandise, books, toys, and selected clothing.¹⁶

In 1996, Blockbuster rebranded.¹⁷ Blockbuster Entertainment Corporation was renamed Blockbuster, Inc. and retail stores changed from Blockbuster Video to simply Blockbuster.¹⁸ By

⁸ H. Wayne Huizenga, *The Billionaire Garbage Man*, ENTREPRENEUR, (Oct. 10, 2008), <http://www.entrepreneur.com/article/197648>; Gandel, *supra* note 4.

⁹ ENTREPRENEUR, *supra* note 8.

¹⁰ *Id.*

¹¹ *Id.*

¹² David Conn, *Blockbuster agrees to buy Erol's chain Curran examining antitrust concerns*, THE BALTIMORE SUN, (Nov. 20, 1990), http://articles.baltimoresun.com/1990-11-20/news/1990324060_1_blockbuster-erol-video-chain; John Lippman, *Blockbuster Buys 236 Retail Record Stores : Acquisitions: The Music Plus and Sound Warehouse chains give the video 'superstore' giant a foothold in the music business*. LOS ANGELES TIMES, (Oct. 20, 1992), http://articles.latimes.com/1992-10-20/business/fi-679_1_music-business.

¹³ Mary Beth Sheridan, *Viacom-Blockbuster Merges Colorful Moguls*, HERALD JOURNAL, Jan. 10, 1994, at B5

¹⁴ Gandel, *supra* note 4.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Blockbuster*, BUSINESS INSIDER, (Nov. 4, 2010) <http://www.businessinsider.com/blackboard/blockbuster>.

the end of the year, the company announced plans to relocate its headquarters from Fort Lauderdale to Dallas.¹⁹ Additionally, Jim Antioco took control as CEO in 1997.²⁰ Antioco would retain this role until 2007.²¹

Under Antioco's leadership, Blockbuster refocused on its video rental business, leading to a brief upswing in profits.²² But this success was short-lived, as Blockbuster made a series of mistakes regarding new media and new competitors.²³ These choices would haunt Blockbuster, as it began to lose business and post losses. By the time Viacom spun off Blockbuster in 2004, the company lost \$984 million despite a \$5.9 billion revenue.²⁴

Internet and subscription services emerged to challenge Blockbuster's brick-and-mortar-based dominance in the video rental business. The best-known new competitor, Netflix, started as a DVD by-mail subscription service in 1997.²⁵ Netflix employed a flat monthly fee, but did not charge late fees.²⁶ Blockbuster continued to charge late fees, even after it began charging a monthly fee.²⁷ By the time Blockbuster started a competing by-mail subscription service in

¹⁸*Id.*

¹⁹ David Altaner, 'We Are Moving To Dallas': After Weeks Of Denying Rumors, Blockbuster Tells Workers News, SUN SENTINEL, (Nov. 2, 1996), http://articles.sun-sentinel.com/1996-11-02/business/9611020304_1_blockbuster-employees-relocation-packages.

²⁰ Gandel, *supra* note 4.

²¹*Id.*

²²*Id.*

²³*Id.*

²⁴ IGN DVD, *Viacom, Blockbuster Split Up*, IGN, (Jun. 21, 2004), <http://www.ign.com/articles/2004/06/22/viacom-blockbuster-split-up>.

²⁵ John Hopkins, 'Charismatic' founder keeps Netflix adapting, USA TODAY, (Apr. 24, 2006, 4:14 AM ET), http://usatoday30.usatoday.com/money/companies/management/2006-04-23-exec-ceo-profile-netflix_x.htm.

²⁶ Gandel, *supra* note 4.

²⁷ *Id.*

2004, Netflix had already cut into its customer base.²⁸ Blockbuster finally discontinued its late fee program later that year.²⁹

Instead of focusing on video rental competitors Netflix and Redbox, Blockbuster spent the turn of the century expanding into the videogame rental market. Blockbuster purchased competitors in this market, like Gamestation,³⁰ and employed various programs to promote in-store rentals. By 2002, Blockbuster had placed video game ministores representing all the major contemporary gaming platforms in 90 percent of its stores.³¹ Blockbuster continued expanding into these fields after separating from Viacom in 2004. One expansion program, Blockbuster Gamerush, allowed for video game and DVD trading in 3,000 stores to enter into the secondary market.³²

Financier Carl Icahn, a key player throughout Blockbuster's Chapter 11, launched a proxy fight to displace John Antioco in 2007 following a failed bid to takeover failing rival Hollywood Video.³³ Icahn had gambled on the deal, owning a substantial number of shares of both Blockbuster and Hollywood Video.³⁴ After suffering large losses following the failed acquisition, Icahn sought to curtail spending on Blockbuster Online and reinstate late fees. The proxy fight occurred after Antioco resisted these measures.³⁵ Under Icahn-approved CEO Jim

²⁸ *Id.*

²⁹ *Id.*

³⁰ Paul Loughrey, *Blockbuster struggles to combat revenue loss - Gamestation up for sale?*, GAMESINDUSTRY INTERNATIONAL, (Nov. 11, 2005), <http://www.gamesindustry.biz/articles/blockbuster-struggles-to-combat-revenue-loss-gamestation-up-for-sale>.

³¹ *Company News; Blockbuster to Expand Video Game Sales*, THE NEW YORK TIMES, (May 14, 2002), <http://www.nytimes.com/2002/05/14/business/company-news-blockbuster-to-expand-video-game-sales.html>.

³² BLOCKBUSTER CORPORATE, NEWS RELEASE: BLOCKBUSTER LAUNCHES NATIONAL DVD AND GAME TRADING PROGRAM IN NEARLY 3,000 STORES AND GUARANTEES CONSUMERS BEST TRADE-IN PRICES FOR THEIR MOVIES AND GAMES, (Oct. 25, 2004), <http://blockbuster.mwnewsroom.com/manual-releases/Blockbuster-Launches-National-DVD-and-Game-Trading>.

³³ Paul Sweeting, *Following the money: What Carl Icahn sees in Netflix*, GIGAOM PRO, (Nov. 1, 2012), <http://pro.gigaom.com/blog/following-the-money-what-carl-icahn-sees-in-netflix/>.

³⁴ Paul Sweeting, *Icahn Eyes Netflix Cash Flow*, MESA, (NOV. 1, 2012), <http://mesalliance.org/blog/2012/11/01/icahn-eyes-netflix-cash-flow/>.

³⁵ *Id.*

Keyes, Blockbuster approved the cuts, temporarily boosting the value of shares.³⁶ Within a few years, Blockbuster filed bankruptcy.

a. Business Model

Blockbuster originally established its retail channels to customers through its “bricks and mortar” stores in the United States and abroad.³⁷ As of August 29, 2010, Blockbuster had 3,306 operating stores, which offered movies and games for rent and purchase in addition to other entertainment products relating to consumer electronics and accessories.³⁸ Blockbuster believed its advantage over its competitors lay with its ability to make available new releases of movies, while other competitors would not have access to new released movies for the initial 28 days of release.³⁹ In 2009, certain movie studios imposed this 28-day window on the rental of newly released titles after the initial distribution date.⁴⁰

In the early 2000s, Blockbuster expanded its operations to include new distribution channels. In early 2009, Blockbuster launched BLOCKBUSTER Express® with NCR Corporation (“NCR”).⁴¹ BLOCKBUSTER Express® branded vending kiosks to compete directly with a competitor that provides movie rentals through vending kiosks.⁴² As of September 19, 2010, NCR had approximately 6,630 kiosks operating under the BLOCKBUSTER Express® brand in the United States.⁴³

Additionally, Blockbuster made its products available through mail and digital distribution channels.⁴⁴ Blockbuster offered a by-mail subscription program through both its retail chain and its website, allowing customers rent products that were delivered directly by mail.⁴⁵ Through its BLOCKBUSTER Total Access™ program, Blockbuster customers could

³⁶ *Id.*

³⁷ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 4).

³⁸ *Id.* at 3.

³⁹ *Id.* at 5.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 4.

augment their subscriptions with the ability to exchange up to five online movie rentals for in-store movies at its retail locations.⁴⁶ Blockbuster tried to promote its by-mail channel by launching a marketing partnership with Comcast Cable Corporation (“Comcast”). The marketing partnership offered Comcast customers Blockbuster’s by-mail services through a co-branded website, www.DVDsbymail.com, as an additional service within Comcast packages.⁴⁷ In return, Blockbuster installed Comcast-dedicated kiosks in select stores that allowed customers to learn about and sign up for Comcast services.⁴⁸

To help establish its digital channel, Blockbuster purchased Movielink from a consortium of movie studios in 2007.⁴⁹ Consequently, Blockbuster’s website allowed customers to download and watch movies on their personal computers.⁵⁰ Blockbuster also formed partnerships with third-party consumer electronics device developers to digitally deliver media entertainment to customers through devices like Internet-connected televisions.⁵¹ To expand in mobile markets, Blockbuster partnered with device makers, such as Motorola and HTC, to include Blockbuster’s digital applications in their new models for Verizon and T-Mobile.⁵²

Domestically, in 2010, Blockbuster employed 25,500 employees, of whom approximately 7,500 were full-time and approximately 18,000 were part-time.⁵³ Blockbuster paid a substantial portion of its employees, about 88%, on an hourly basis.⁵⁴ In dealing with retail and by-mail channels, Blockbuster managed its inventory out of the 850,000 square foot distribution center in McKinney, Texas.⁵⁵ Blockbuster used a network of third-party delivery

⁴⁵*Id.* at 5-6.

⁴⁶*Id.* at 6.

⁴⁷*Id.*

⁴⁸*Id.*

⁴⁹*Id.* at 7.

⁵⁰*Id.*

⁵¹*Id.*

⁵²*Id.* at 7-8.

⁵³*Id.* at 11.

⁵⁴*Id.*

⁵⁵*Id.*

agents for distributing merchandise from this distribution center to domestic stores.⁵⁶ Along with the McKinney distribution center, Blockbuster operated 39 additional distribution centers across the United States to support its by-mail subscription program.⁵⁷

Blockbuster also operated stores internationally, including owned retail operations in Canada, the United Kingdom, Denmark, Italy, Mexico, Argentina, and Uruguay.⁵⁸ Additionally, Blockbuster franchised retail operations in Australia, Brazil, Chile, Columbia, Guatemala, Israel, Italy, Mexico, New Zealand, Panama, Portugal, and Taiwan.⁵⁹ As of August 29, 2010, Blockbuster owned 2,333 stores in 16 markets outside of the United States.⁶⁰

Blockbuster was aware that brick and mortar stores could not compete in the twenty-first century. Despite Blockbuster's efforts to expand into new retail channels, Blockbuster continued to struggle against its competitors. In the end, Blockbuster had to file for bankruptcy protection.

b. Key Events Leading to Chapter 11

A changing market paved the way into bankruptcy for Blockbuster. Jeffery Stegenga, Chief Restructuring Officer of Blockbuster, attributed Blockbuster's declining revenue to five main events: (i) increased competition in the media entertainment industry; (ii) technological advances that changed the landscape of the industry; (iii) changing consumer preferences; (iv) the rapid growth of disruptive new competitors; and (v) the general economic environment.⁶¹ Along with these changes and difficult operating environment, Blockbuster was hindered by the high level of debt that the business had incurred during earlier periods of significantly lower competition and higher operating performance.⁶²

In particular, the greatest challenge for Blockbuster was the rapid rise of new competitors utilizing alternative distribution methods to meet customer demand.⁶³ These competitors

⁵⁶*Id.*

⁵⁷*Id.*

⁵⁸*Id.* at 12.

⁵⁹*Id.*

⁶⁰*Id.*

⁶¹*Id.* at 16.

⁶²*Id.*

⁶³*Id.*

acquired substantial market shares and eroded the size of Blockbuster's traditional store-based customer market.⁶⁴ Even though Blockbuster initiated other channels of distribution to customers, the revenues and profits from these other channels have not compensated for the declining revenue from the reduced traffic within its traditional store-based channel.⁶⁵ Furthermore, Blockbuster faced an overall lapse in the market for the rental and sale of physical disks.⁶⁶ Instead, the increasing number of competitors providing direct delivery media entertainment replaced the demand for rental and sale of physical disks.⁶⁷

The rise of competitors arguably could not have happened at a worse time, as the economic recession from 2009 to 2010 exacerbated the hard times felt by Blockbuster.⁶⁸ During this economic recession, domestic unemployment remained high, keeping consumer spending consistently low.⁶⁹ Therefore, customers became more sensitive to pricing and convenience, negatively impacting the performance of most retailers, including Blockbuster.⁷⁰

From 2009 to 2010, Blockbuster responded to these continued economic challenges and changing media industry with a number of proactive steps.⁷¹ Specifically, Blockbuster (i) reduced general and administrative expenses, resulting in a \$333 million decrease of administrative expenses in 2009; (ii) closed unprofitable and underperforming domestic stores; (iii) evaluated the divestiture of certain of its international assets; (iv) completed two refinancing transactions in 2009 to extend debt maturities and amortizations schedules; (v) negotiated the release of significant restricted cash associated with letters of credit relating to historical lease guarantees; and (vi) granted certain studios a security interest in the assets of its Canadian operation in exchange for enhanced credit terms.⁷² Consequently, from 2009 to 2010, Blockbuster closed 1,061 domestic company-operated stores.⁷³

⁶⁴*Id.*

⁶⁵*Id.*

⁶⁶*Id.* at 16-17.

⁶⁷*Id.* at 17.

⁶⁸*Id.* at 18.

⁶⁹*Id.*

⁷⁰*Id.*

⁷¹*Id.* at 17.

⁷²*Id.*

⁷³*Id.*

In February 2009, Blockbuster sought Rothschild, Inc. (“Rothschild”) to serve as investment banker and financial advisor, specifically to help evaluate its capital structure and financing alternatives.⁷⁴ Worried about the imminent maturity of its revolving credit facility and its lack of access to new capital, Blockbuster replaced its maturing revolver with a steeply amortizing term loan.⁷⁵ This amortizing term loan carried high rates of interest and fees; moreover, the amortization schedule significantly reduced available liquidity and constrained operations.⁷⁶ Then, in October 2009, Blockbuster successfully completed the issuance of the Senior Secured Notes to refinance the existing credit facility term loans ahead of scheduled amortization payments that were to take place in 2010 and 2011.⁷⁷ The issuance of the Senior Secured Notes gave Blockbuster an extension of maturities and additional liquidity.⁷⁸ Blockbuster invested heavily in its inventory levels to gear up for the key 2009 holiday season.⁷⁹

Although the issuance of the Senior Secured Notes allowed Blockbuster to prepare for the 2009 holiday season, the fourth quarter of 2009 proved extremely difficult for Blockbuster.⁸⁰ During this quarter, Blockbuster faced the ever-present rapid expansion from key competitors like Netflix.⁸¹ Blockbuster suffered from deeply discounted sales of new-release titles by big-box retailers.⁸² It further failed to secure the anticipated 28-day window advantage on key titles ahead of the holidays.⁸³ Consequently, the operating results and period-ending liquidity for the final quarter of 2009 fell significantly short of projections.⁸⁴ This disappointing quarter capped

⁷⁴ *Id.* at 18.

⁷⁵ *Id.* at 18-19.

⁷⁶ *Id.* at 19.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

off a terrible year for Blockbuster, in which it reported a loss of \$558.2 million and a 15.6% decline in its domestic segment.⁸⁵

Shortly thereafter in the beginning of 2010, Blockbuster, Rothschild, and attorneys for the Debtors, Weil, Gotshal & Manges LLP (“Weil”) engaged in negotiations with financial and legal advisors, respectively, to select holders of the Senior Secured Notes (the “Senior Secured Noteholders”).⁸⁶ Additionally, Blockbuster, Rothschild, and Weil started discussions with financial and legal advisors to group of holders of the Senior Subordinated Notes (the “Senior Subordinated Noteholders”).⁸⁷ These negotiations between the respective parties centered upon an infusion of capital by the Senior Secured Noteholders and a recapitalization of Blockbuster pursuant to reorganization under Chapter 11 of the Bankruptcy code.⁸⁸

As 2010 progressed, and Blockbuster’s business continued to decline, the New York Stock Exchange sent Blockbuster notice that it was no longer in compliance with the Exchange’s continued listing standard.⁸⁹ In order to boost liquidity for a \$43 million payment on the Senior Secured Notes due on April 1, 2010, Blockbuster pledged the collateral of Blockbuster’s non-Debtor Canadian operations to certain studios to receive an additional 30 days of credit terms (the “Canadian Lien”).⁹⁰ After entering this pledge agreement, Blockbuster further failed to raise new capital with an unsuccessful offer to exchange the Senior Secured Notes for equity.⁹¹

As a result, in late April 2010, Blockbuster retained Alvarez & Marsal North America LLC (“A&M”) to serve as restructuring advisors.⁹² Then, in early July 2010, A&M appointed Jeffery Stegenga as Chief Restructuring Officer of the Blockbuster project.⁹³ Blockbuster’s liquidity further deteriorated due to its lagging performance, the tightening of credit by non-

⁸⁵ *Id.* at 20.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* at 20-21.

⁹⁰ *Id.* at 21.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

studio vendors, and loss of trade credit at the international operations that normally carried material cash flow to Blockbuster.⁹⁴

Realizing that recapitalization would require even more capital, Blockbuster and its advisors negotiated a transaction that would exchange a portion of the debt under the Senior Secured Notes for equity under a reorganized Blockbuster.⁹⁵ This exchange would be achieved through a debtor-in-possession financing agreement once Chapter 11 was commenced.⁹⁶ Besides focusing on how to capitalize the reorganized Blockbuster, the Debtors also sought proposals of acquisitions from other financial partners.⁹⁷ Meanwhile, Blockbuster continued to suffer significant shortfalls with both its operating performance and liquidity.⁹⁸ On July 7, the New York Stock Exchange suspended trading of Blockbuster's common stock.⁹⁹

In response, Blockbuster entered into a Forbearance Agreement with Senior Secured Noteholders to defer a \$42.4 million payment of interest and principal which was due on July 1, 2010.¹⁰⁰ Blockbuster publicized the (for clarity, what exactly is the news) disappointing news on August 13, 2010.¹⁰¹ Consequently, Blockbuster experienced a material decline in the trading prices of all its securities and received adverse media attention.¹⁰²

During this time, Blockbuster's management along with the Senior Secured Noteholders negotiated heavily with certain key studios regarding new trade agreements.¹⁰³ Blockbuster understood that the reorganization of the business depended on preserving relationships with its trade creditors, especially the studios.¹⁰⁴ Therefore, in order to prevent the expiration of trade

⁹⁴ *Id.* at 22.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.* at 22-23.

⁹⁸ *Id.* at 23.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 23-24.

¹⁰² *Id.* at 24.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

agreements with the studios, the parties agreed to extend the terms of the Forbearance Agreement to September 30, 2010.¹⁰⁵

Finally, on September 1, 2010, Blockbuster missed a \$13.5 million payment on the Senior Secured Notes.¹⁰⁶ Aware of the approaching deadlines for the forbearance and payment grace periods, Blockbuster believed the best way to protect the interests of its stakeholder while maximizing the value of the business was to seek protection under Chapter 11 of the Bankruptcy Code.¹⁰⁷

III. Chapter 11

a. “The Plan”

As discussed above, Blockbuster and its advisors had worked closely with a large number of interested parties to smooth its transition into a new organization, including the Sponsoring Noteholders and their advisors.¹⁰⁸ As a result of these negotiations, Blockbuster entered into an agreement with these parties regarding the terms of Chapter 11.¹⁰⁹

The goal of the plan was to “substantially delever” Blockbuster so it could carry on as a new organization.¹¹⁰ To accomplish this goal, the plan provided that all of the Senior Secured Notes would convert into equity in the new Blockbuster.¹¹¹ This move, believed the involved parties, would provide the financial flexibility necessary for the company to compete in the market going forward.¹¹² Blockbuster estimated that it could reduce its debt from over \$1 billion

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 24.

¹⁰⁹ The “Plan Support Agreement” involved approximately 80% of the principal amount of the Senior Secured Notes. *Id.* at 25.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

to an estimated \$100 million or less.¹¹³ Under the plan, holders of Blockbuster's outstanding subordinated debt, preferred stock, and common stock would not recover.¹¹⁴

Blockbuster attempted to pursue a long-term strategy of standing out as the only market player providing access across multiple delivery channels while providing convenience and value to customers.¹¹⁵ In pursuing new opportunities in the digital market, the new Blockbuster aimed to capitalize on its brand, library of titles, and relationships with major studios.¹¹⁶ Encouraging the company in its reorganization was the success of other traditionally strong brands, like Apple, who thrived with a new business model.¹¹⁷

Blockbuster planned to evaluate the overall profitability of its 3,000 American stores during bankruptcy.¹¹⁸ At the time of filing, none of these stores had yet been closed.¹¹⁹ This part of the plan demonstrates Blockbuster's self-belief in competing with a hybrid of brick-and-mortar stores, delivery services, and streaming media.

Essentially, Blockbuster viewed Chapter 11 as an opportunity to temporarily hold off creditors and restructure into a better version of what it already was, using financing to expand its pursuits into newer forms of media. It believed that it needed only increased liquidity to effectuate these changes.

¹¹³ BLOCKBUSTER CORPORATE, NEWS RELEASE: BLOCKBUSTER RECEIVES FINAL COURT APPROVAL OF 'DIP' FINANCING, (Oct. 27, 2010) <http://phx.corporate-ir.net/phoenix.zhtml?c=99383&p=irol-newsArticle&id=1487994>.

¹¹⁴ BLOCKBUSTER CORPORATE, NEWS RELEASE: TO IMPLEMENT RECAPITALIZATION, COMPANY INITIATES "PRE-ARRANGED" CHAPTER 11 PROCEEDINGS BLOCKBUSTER STORES AND OPERATIONS CONDUCTING BUSINESS IN THE ORDINARY COURSE SECURES \$125 MILLION DIP FINANCING COMMITMENT, (Sep. 23, 2010) <http://investor.blockbuster.com/phoenix.zhtml?c=99383&p=irol-newsArticle&id=1474126>.

¹¹⁵ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4).

¹¹⁶ *Id.*

¹¹⁷ Austin Carr, *Blockbuster CEO Jim Keyes on Bankruptcy, Netflix, and Becoming the Next Apple*, FAST COMPANY, (Jun. 21, 2010), <http://www.fastcompany.com/1661556/blockbuster-ceo-jim-keyes-bankruptcy-netflix-and-becoming-next-apple>.

¹¹⁸ News Release, *supra* note 113.

¹¹⁹ *Id.*

b. Filing

Blockbuster filed a Voluntary Petition (the “Petition”) for bankruptcy protection on September 23, 2010 in the Southern District of New York.¹²⁰ Blockbuster is from Dallas, TX, and its principle place of business is Dallas County.¹²¹ As mentioned earlier, Blockbuster retained Weil Gotshal, an international law firm based out of Houston, TX, to file its petition.¹²² Stephen Karotkin served as lead counsel.¹²³ Blockbuster’s Vice President, General Counsel, and Secretary, signed the petition on behalf of the company.¹²⁴

Blockbuster filed as a retail corporation.¹²⁵ The Petition estimated that Blockbuster had over 100,000 creditors, greater than one billion dollars in assets, and greater than one billion dollars in liabilities.¹²⁶ The debts are denoted as primarily business debts.¹²⁷ At the time of filing, Blockbuster estimated that funds would be available for distribution to unsecured creditors.¹²⁸

Exhibit A of the Petition provided more specific information regarding the financial situation current to August 1, 2010.¹²⁹ According to Exhibit A, Blockbuster had \$1,017,035,832 in total assets and \$1,464,939,759 in total debt.¹³⁰ As of September 2, 2010, Blockbuster had 32,610 shares of preferred stock and 223,801,559 shares of common stock outstanding.¹³¹ More than 500 holders held approximately \$930,000,000 worth of debt securities.¹³²

¹²⁰ DEBTOR’S VOLUNTARY PETITION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 1).

¹²¹ *Id.*

¹²² *Id.*; *see also* WEIL, GOTSHAL & MANGES, <http://www.weil.com/>.

¹²³ DEBTOR’S VOLUNTARY PETITION, *In re* Blockbuster, Inc. at 1.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.* at Exhibit A.

¹³⁰ *Id.*

¹³¹ *Id.*

Rider 2 of the Petition includes a list of the thirteen affiliated entities that would request a consolidated hearing for procedural purposes.¹³³ The Petition also includes a list of the various names Blockbuster used over the eight years prior to filing for Chapter 11 protection.¹³⁴

The Petition included a list of the 50 largest unsecured claims against the various Blockbuster affiliates.¹³⁵ However, the Petition does not include the list of creditors, whom Blockbuster listed later in its Schedules.¹³⁶ Blockbuster instead filed a motion requesting a waiver of this requirement pursuant to sections 105(a), 342(a), and 521(a)(1) of title 11 of the United States Code, Rules 1007(a)(1) and 2002(a), (f), and (l) of the Federal Rules of Bankruptcy Procedure, as well as some local rules.¹³⁷

c. Petition Schedules: Liabilities, Creditors, and Assets

Blockbuster filed Petition Schedules (“Schedules”) for its thirteen affiliates on October 22, 2010.¹³⁸ There are ten different types of Schedules. Debtors are supposed to include real property assets in a Schedule A, personal property assets in a Schedule B, and exempted property in a Schedule C. Creditors holding secured claims are to be listed in a Schedule D, creditors holding unsecured priority claims should be listed in a Schedule E, while creditors holding unsecured non-priority claims need to be listed in a Schedule F. Schedules G and H reflect

¹³² Approximately 41 institutional holders out of possibly more than 500 total holders held \$630,000,000 in 11.75% Senior Secured Notes due 2014. Approximately 11 institutional holders out of possibly more than 500 total holders held \$300,000,000 in 9% Senior Subordinated Notes due 2012. *Id.*

¹³³ *Id.* at Rider 2.

¹³⁴ *Id.* at Rider 1.

¹³⁵ *Id.* at 1.

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ DEBTORS’ SCHEDULES (Blockbuster Inc., Blockbuster Digital, Trading Zone, Movielink, B2, Blockbuster Video Italy, Blockbuster Canada, Blockbuster Distribution, Inc., Blockbuster Gift Card, Blockbuster Global Services, Blockbuster International Spain, Blockbuster Procurement), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). Pursuant to an order granted on October 23, 2010, Blockbuster received an additional 15 days to file its Schedules on top of the 14 day period under § 1007(c). ORDER PURSUANT TO 11 U.S.C. § 521 AND FED. R. BANKR. P. 1007(C) EXTENDING TIME TO FILE SCHEDULES OF ASSETS AND LIABILITIES, SCHEDULES OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES, AND STATEMENTS OF FINANCIAL AFFAIRS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010).

executory contracts and unexpired leases and codebtors, respectively. Debtors list current income in Schedule I and current expenditures in Schedule J.

i. Blockbuster, Inc.

The Schedules filed for Blockbuster, Inc. contained the bulk of the total assets and liabilities for the affiliates. Schedule A listed an estimated \$10,240,132 in real property assets,¹³⁹ while Schedule B listed an estimated \$607,426,522 in personal property assets.¹⁴⁰ Real property assets largely included stores owned by the Debtor.¹⁴¹ Personal property assets included cash-on-hand in store registers, checking and savings accounts, lease deposits, movie memorabilia, accounts receivable, machinery, office equipment, and inventory.¹⁴² The largest personal property asset, at \$275,672,540, was Blockbuster's rental inventory.¹⁴³

Blockbuster, Inc. listed \$665,831,108 in secured claim liabilities,¹⁴⁴ \$486,105,509.97 in unsecured non-priority liabilities,¹⁴⁵ and no unsecured priority liabilities.¹⁴⁶ The secured claim amount listed on Blockbuster, Inc.'s Schedule D wholly stemmed from the principle and interest due on the Senior Secured Notes.¹⁴⁷ The unsecured priority claims include a large number of undetermined payroll, income, and property tax liabilities.¹⁴⁸ The unsecured non-priority claims

¹³⁹ DEBTOR'S SCHEDULE A (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010). (No. 420)

¹⁴⁰ DEBTOR'S SCHEDULE B (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010). (No. 420).

¹⁴¹ DEBTOR'S SCHEDULE A (Blockbuster Inc.), *In re* Blockbuster, Inc. (No. 420).

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ DEBTOR'S SCHEDULE D (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 420). In addition, Blockbuster Inc. listed several claims, including UCC lien claims, of an undetermined value. *Id.*

¹⁴⁵ DEBTOR'S SCHEDULE F (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010). (No. 420).

¹⁴⁶ DEBTOR'S SCHEDULE E (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 420)

¹⁴⁷ DEBTOR'S SCHEDULE D (Blockbuster Inc.), *In re* Blockbuster, Inc. (No. 420).

¹⁴⁸ DEBTOR'S SCHEDULE E (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 420).

include large amounts of trade payable, including over a million dollars to Coca Cola and its subsidiaries, for example.¹⁴⁹ Others falling in this category are claims for leases, unclaimed property claims, litigation liabilities, workers' compensation, and stock options, amongst others.¹⁵⁰

Blockbuster, Inc. claimed no property exemptions; as a corporation, it was not entitled to any.¹⁵¹ The codebtors mainly included the Blockbuster affiliates and CBS affiliates formerly associated with Blockbuster through Viacom.¹⁵² Blockbuster Inc.'s Schedule G, listing its executory contracts, contains 775 pages of various marketing agreements, property leases, public relations agreements, and franchise agreements.¹⁵³

Likely due to the massive scope of its operations, Blockbuster, Inc. did not attempt to estimate its current income or expenditures.¹⁵⁴ The information in the Schedules roughly corresponds to the estimates include in the Voluntary Petition.

ii. Blockbuster Digital

Blockbuster Digital's filings were substantially shorter than those of Blockbuster, Inc. Only Blockbuster Digital's Schedules B and F listed any determined asset or liability.¹⁵⁵ However, Schedules D and E allowed for the possibility of undetermined amounts owed to creditors.¹⁵⁶

¹⁴⁹ DEBTOR'S SCHEDULE F (Blockbuster Inc.), *In re* Blockbuster, Inc. (No. 420).

¹⁵⁰ *Id.*

¹⁵¹ DEBTOR'S SCHEDULE C (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010) (No. 420).

¹⁵² DEBTOR'S SCHEDULE H (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010) (No. 420).

¹⁵³ DEBTOR'S SCHEDULE G (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010) (No. 420).

¹⁵⁴ DEBTOR'S SCHEDULES (Blockbuster Inc.), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010) (Schedules I, J not filed).

¹⁵⁵ *See* DEBTOR'S SCHEDULES (Blockbuster Digital), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 418).

¹⁵⁶ *See* DEBTOR'S SCHEDULES D AND F (Blockbuster Digital), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 418).

At the time of filing, Blockbuster Digital held an estimated \$110,493.00 in assets and \$4,335,368.83 in liabilities.¹⁵⁷

iii. Blockbuster Procurement

Blockbuster Procurement listed personal property assets include accounts receivable and cash in corporate accounts.¹⁵⁸ In total, Blockbuster Procurement held \$1,278,103.95 in determined assets.¹⁵⁹

The filings for Blockbuster Procurement listed roughly \$900,000.00 in determined unsecured non-priority liabilities.¹⁶⁰

iv. Blockbuster Canada, Blockbuster Distribution, Inc., Blockbuster Gift Card, Blockbuster Global Services, Blockbuster International Spain, Blockbuster Investments LLC, Blockbuster Video Italy, Movielink, Blockbuster Trading Zone, and B2

In even simpler filings, a majority of the Blockbuster subsidiaries only included one determined asset, a personal property asset described as “intercompany receivable.” All of these subsidiaries faced undetermined amounts of liabilities, mainly tax and insurance liabilities.¹⁶¹

The largest intercompany receivable belonged to Blockbuster Distribution, Inc. Blockbuster Distribution listed \$502,560.00 in intercompany receivable.¹⁶² Listing \$1,000 in

¹⁵⁷ See DEBTOR’S SCHEDULES D AND F (Blockbuster Digital), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 418).

¹⁵⁸ DEBTOR’S SCHEDULE B (Blockbuster Procurement), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 435).

¹⁵⁹ *Id.*

¹⁶⁰ DEBTOR’S SCHEDULE F (Blockbuster Procurement), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 435).

¹⁶¹ See DEBTORS’ SCHEDULES (Blockbuster Inc., Blockbuster Digital, Trading Zone, Movielink, B2, Blockbuster Video Italy, Blockbuster Canada, Blockbuster Distribution, Inc., Blockbuster Gift Card, Blockbuster Global Services, Blockbuster International Spain, Blockbuster Procurement), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 418).

¹⁶² DEBTOR’S SCHEDULE B (Blockbuster Liquidating), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 425).

intercompany receivables were Blockbuster Canada,¹⁶³ Blockbuster Gift Card,¹⁶⁴ Blockbuster International Spain,¹⁶⁵ Blockbuster Investments,¹⁶⁶ Blockbuster Video Italy,¹⁶⁷ Movielink,¹⁶⁸ Blockbuster Trading Zone,¹⁶⁹ and B2.¹⁷⁰ Schedule B of Blockbuster Global Services listed \$200.00 of the same generic asset.¹⁷¹

d. First Day Motions

Blockbuster's first day motions reflect the goals of the company's bankruptcy plan. Blockbuster planned to emerge from Chapter 11 as an invigorated, optimal version of what it had been previously. Blockbuster's first-day motions can be separated into two groups, those that were primarily administrative motions and those that were largely substantive motions.

Administrative Motions

For the sake of procedural convenience, Blockbuster filed a motion requesting joint administration for the thirteen companies falling under the greater Blockbuster umbrella.¹⁷² The

¹⁶³See DEBTOR'S SCHEDULES (Blockbuster Canada), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 423).

¹⁶⁴See DEBTOR'S SCHEDULES (Blockbuster Liquidating), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 427).

¹⁶⁵DEBTOR'S SCHEDULE B (Blockbuster Intl. Spain), *In* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 431).

¹⁶⁶DEBTOR'S SCHEDULE B (Blockbuster Investments), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 433).

¹⁶⁷DEBTOR'S SCHEDULE B (Blockbuster Video Italy), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 437).

¹⁶⁸DEBTOR'S SCHEDULE B (Movielink), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010). (No. 439).

¹⁶⁹DEBTOR'S SCHEDULE B (Trading Zone), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 S. (Bankr. D.N.Y. 2010). (No. 441).

¹⁷⁰DEBTOR'S SCHEDULE B (B2), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 443).

¹⁷¹DEBTOR'S SCHEDULE B (Blockbuster Global Services), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 429).

¹⁷² AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4); MOTION FOR JOINT ADMINISTRATION / DEBTORS' MOTION PURSUANT TO FED. R. BANKR. P. 1015(B) REQUESTING JOINT

court granted this motion on September 23, 2010.¹⁷³ The motion sought to reduce administrative costs and reduce the burden on the court, creditors, and the debtors.

The size of the case could have potentially caused problems had Blockbuster attempted to comply explicitly with all the default requirements of the Bankruptcy Code. Blockbuster asked the court to waive the requirement to file a list of creditors and equity security holders under section 521(a)(1) of the Bankruptcy Code, amongst other rules.¹⁷⁴ In the same motion, to comply with notice requirements in a more efficient manner, Blockbuster requested that it be able to hire Kurtzman Carson Consultants.¹⁷⁵ Amongst other things, Kurtzman Carson maintained a website listing important dates and parties.¹⁷⁶ While Kurtzman Carson used a list of creditors and equity holders to furnish notice, Blockbuster also published its notice of commencement in the Wall Street Journal, the New York Times, the Dallas Morning news, as well as on the Blockbuster and Kurtzman Carson websites.¹⁷⁷

Blockbuster also requested an extension of the period in which to file its schedules of assets and liabilities, schedules of executory contracts and unexpired leases, and statements of financial affairs.¹⁷⁸ The Bankruptcy Code, under Rule 1007(c), normally provides a fourteen-

ADMINISTRATION OF CHAPTER 11 CASES, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010) at 1. (No. 3).

¹⁷³ ORDER SIGNED ON 9/23/2010 GRANTING MOTION DIRECTING THE PROCEDURAL CONSOLIDATION AND JOINT ADMINISTRATION OF THE CHAPTER 11 CASES, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 39).

¹⁷⁴ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 342(A), AND 521(A)(1), FED. R. BANKR. P. 1007(A) AND 2002(A), (D), (F), AND (L), AND LOCAL BANKRUPTCY RULE 1007-1 REQUESTING (I) A WAIVER OF THE REQUIREMENT THAT DEBTORS FILE LISTS OF CREDITORS AND EQUITY SECURITY HOLDERS AND (II) APPROVAL OF THE FORM AND MANNER OF NOTIFYING CREDITORS OF COMMENCEMENT OF DEBTORS CHAPTER 11 CASES AND FIRST MEETING OF CREDITORS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 6).

¹⁷⁵ *Id.*

¹⁷⁶ Listed parties include Counsel to the Debtors, Counsel to the Official Committee of Unsecured Creditors, and the United States Trustee. Contact information for all is provided. KURTZMAN CARSON CONSULTANTS, *BB Liquidating Inc., et al. (f/k/a Blockbuster Inc., et al.)*, <http://www.kccllc.net/blockbuster>.

¹⁷⁷ APPLICATION TO EMPLOY KURTZMAN CARSON CONSULTANTS LLC AS NOTICE AND CLAIMS AGENT, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 24).

¹⁷⁸ MOTION TO EXTEND TIME / DEBTORS' MOTION PURSUANT 11 U.S.C. § 521 AND FED. R. BANKR. P. 1007(c), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 7).

day period to file these documents.¹⁷⁹ Blockbuster sought an additional forty-five days to file, giving it fifty-nine days total after commencing the Chapter 11 case.¹⁸⁰

The Bankruptcy Court granted both these motions in their entirety.¹⁸¹ These sorts of arrangements are both necessary and common in large Chapter 11 cases as, without them, the administrative expense of literal compliance with the Code and Rules would only increase what are already typically stunningly high fees for case administration in Chapter 11.

Substantive Motions

The rest of Blockbuster's first-day motions dealt with continuing various aspects of its business. With continuity as an overriding goal, Blockbuster filed a motion on September 24, 2010 to allow for the employment and retention of employees in the ordinary course of business.¹⁸² Otherwise, it would have been forced to submit separate employment applications and retention orders for court approval for each individual professional.¹⁸³ A company of Blockbuster's magnitude could not possibly conform to this sort of regulation in a cost-effective manner—it employed attorneys, accountants, real estate brokers, and other professionals all over the country. This motion was granted by the court on October 21, 2010.¹⁸⁴

Blockbuster utilized a complex cash management system in the ordinary course of its business.¹⁸⁵ Various bank accounts funneled into a centralized system to collect, transfer, and

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ ORDER SIGNED ON 9/23/2010 EXTENDING TIME TO FILE SCHEDULES OF ASSETS AND LIABILITIES, SCHEDULES OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES, AND STATEMENTS OF FINANCIAL AFFAIRS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 41).

¹⁸² APPLICATION TO EMPLOY / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 327, AND 330 FOR AUTHORIZATION TO EMPLOY PROFESSIONALS UTILIZED IN THE ORDINARY COURSE OF BUSINESS NUNC PRO TUNC TO THE COMMENCEMENT DATE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S. D.N.Y. 2010). (No.80).

¹⁸³ *See* 11 U.S.C. §§ 1204, 1206.

¹⁸⁴ ORDER SIGNED ON 10/20/2010 AUTHORIZING THE DEBTORS TO EMPLOY PROFESSIONALS UTILIZED IN THE ORDINARY COURSE OF BUSINESS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 398).

¹⁸⁵ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 345(B), 363(B), 363(C), AND 364(A) AND FED. R. BANKR. P. 6003 AND 6004 REQUESTING (I) AUTHORITY TO (A) CONTINUE TO OPERATE THE DEBTORS' CASH MANAGEMENT SYSTEM, (B) HONOR CERTAIN PREPETITION OBLIGATIONS ON ACCOUNT OF SERVICE CHARGES RELATED THERETO, AND (C) MAINTAIN EXISTING

disperse funds.¹⁸⁶ According to their filings, Blockbuster cash management system involved \$46 million flowing through accounts at over 200 banks.¹⁸⁷ Due to the complexity of its cash management system, Blockbuster did not want to open new “debtor in possession” bank accounts.¹⁸⁸ Accordingly, Blockbuster filed a motion to preserve the cash management system.¹⁸⁹ The court granted this motion on an interim basis on the filing date,¹⁹⁰ and permanently on October 21, 2010.¹⁹¹

Blockbuster also sought to continue its insurance programs via its first-day motions.¹⁹² In this motion, Blockbuster requested the court allow it to pay both prepetition and postpetition insurance obligations.¹⁹³ Blockbuster also sought to maintain various liability programs through different carriers.¹⁹⁴ In addition, it sought to modify the automatic stay with respect to worker’s

BANK ACCOUNTS AND BUSINESS FORMS; AND (II) AN EXTENSION OF TIME TO COMPLY WITH SECTION 345(B) OF THE BANKRUPTCY CODE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 8).

¹⁸⁶ *Id.* at 8.

¹⁸⁷ *Id.* at 9.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ INTERIM ORDER SIGNED ON 9/23/2010 GRANTING (I) AUTHORITY TO (A) CONTINUE TO OPERATE THE DEBTORS CASH MANAGEMENT SYSTEM, (B) HONOR CERTAIN PREPETITION OBLIGATIONS ON ACCOUNT OF SERVICE CHARGES RELATED THERETO, AND (C) MAINTAIN EXISTING BANK ACCOUNTS AND BUSINESS FORMS AND (II) AN EXTENSION OF TIME TO COMPLY WITH 11 U.S.C. SECTION 345(B), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 58).

¹⁹¹ FINAL ORDER SIGNED ON 10/20/2010 GRANTING (I) AUTHORITY TO (A) CONTINUE TO OPERATE THE DEBTORS CASH MANAGEMENT SYSTEM, (B) HONOR CERTAIN PREPETITION OBLIGATIONS ON ACCOUNT OF SERVICE CHARGES RELATED THERETO, AND (C) MAINTAIN EXISTING BANK ACCOUNTS AND BUSINESS FORMS AND (II) AN EXTENSION OF TIME TO COMPLY WITH 11 U.S.C. SECTION 345(B), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 391).

¹⁹² MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§105(A), 363(B), AND 503(B) AND FED. R. BANKR. P. 4001, 6003, AND 6004 FOR (I) AUTHORITY TO (A) CONTINUE THE DEBTORS' INSURANCE PROGRAMS AND (B) PAY ALL OBLIGATIONS IN RESPECT THEREOF, AND (II) TO DIRECT FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH INSURANCE OBLIGATIONS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 12).

¹⁹³ *Id.* at 7-12.

¹⁹⁴ Such programs include “various property, casualty, workers’ compensation, and management liability related insurance coverage for liabilities relating to, among other things, general commercial claims, property damage, workers’ compensation, automobile damage, general foreign liability, directors’ and

compensation claims.¹⁹⁵ This motion was granted on an interim basis on the filing date¹⁹⁶ and the court permanently granted the motion on October 21, 2010,¹⁹⁷ allowing Blockbuster's banks to receive, honor, process, and pay these claims, to the extent funds were available.¹⁹⁸ A failure to pay insurance premiums would vest the right of carriers to terminate programs vital to carrying on Blockbuster's business.¹⁹⁹

Blockbuster also sought permission to continue honoring certain employee obligations via first-day motion.²⁰⁰ Effectively, Blockbuster felt it needed to continue business as usual, to

officers' liability, fiduciary liability, crime, excess umbrella, and various other product and property related and general liabilities." *Id.* at 7; AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4).

¹⁹⁵ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§105(A), 363(B), AND 503(B) AND FED. R. BANKR. P. 4001, 6003, AND 6004 FOR (I) AUTHORITY TO (A) CONTINUE THE DEBTORS' INSURANCE PROGRAMS AND (B) PAY ALL OBLIGATIONS IN RESPECT THEREOF, AND (II) TO DIRECT FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH INSURANCE OBLIGATIONS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) at 11-12. (No. 12).

¹⁹⁶ INTERIM ORDER SIGNED ON 9/23/2010 (I) AUTHORIZING DEBTORS TO (A) CONTINUE THEIR INSURANCE PROGRAMS AND (B) PAY ALL OBLIGATIONS IN RESPECT THEREOF, AND (II) DIRECTING FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH INSURANCE OBLIGATIONS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 58).

¹⁹⁷ FINAL ORDER SIGNED ON 10/20/2010 (I) AUTHORIZING DEBTORS TO (A) CONTINUE THEIR INSURANCE PROGRAMS AND (B) PAY ALL OBLIGATIONS IN RESPECT THEREOF, AND (II) DIRECTING FINANCIAL INSTITUTIONS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH INSURANCE OBLIGATIONS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 394).

¹⁹⁸ *Id.*

¹⁹⁹ Not only would Blockbuster be exposed to risk of a virtually unlimited proportion, it was also required by several state and federal laws to maintain several of these programs. Because Blockbuster sought to emerge from Chapter 11 as a going concern, it was necessary to maintain these payments. AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4).

²⁰⁰ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 363(B), AND 507 AND FED. R. BANKR. P. 6003 AND 6004 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) FOR BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) (No. 9). These obligations included compensation, garnishment, supplemental workforce, independent contractor, reimbursement, payroll tax, incentive, and employee benefit obligations, in addition to severance and retention plans. *Id.*; AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4).

every possible extent, concerning employee compensation to be viable. A freeze on compensation would severely limit its ability to emerge from Chapter 11 as a going concern, as it could result in a flight of talent from the workforce.²⁰¹ Talent flight is a common problem in bankruptcy, recently evidenced in the Borders' Chapter 11.²⁰² In addition, Blockbuster would need to meet general staffing needs to account for natural attrition.²⁰³ On a more personal level, Blockbuster employees relied on these contracts to pay bills.²⁰⁴ The court, understanding this analysis, approved this motion on an interim basis on September 23²⁰⁵ and permanently on October 21, 2010.²⁰⁶

While death is not guaranteed, corporations must face the other inevitability of “life”—taxes. Not meeting these responsibilities could have disastrous effects on a business. Accordingly, Blockbuster filed for the ability to pay “valid and undisputed taxes,” (as though they would willingly pay taxes they disputed and deemed “invalid” outside of bankruptcy) that it incurred through its business operations.²⁰⁷ A failure to pay taxes could result in liens, frustrating the deleveraging purpose of bankruptcy.

²⁰¹ See, e.g. Jeff Amy, *Deposed Arby's owner says it's not his fault that workers weren't paid*, PRESS-REGISTER (Oct. 14, 2010) http://blog.al.com/live/2010/10/deposed_arbys_owner_says_its_n.html.

²⁰² Up to 47 corporate employees, including two high level executives left during Borders' Chapter 11 case, causing serious staffing issues. Jason Boog, *Borders Has Lost 47 Corporate Employees Since Bankruptcy*, GALLEYCAT (Apr. 14, 2011) http://www.mediabistro.com/galleycat/borders-has-lost-47-corporate-employees-since-bankruptcy_b27761.

²⁰³ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 363(B), AND 507 AND FED. R. BANKR. P. 6003 AND 6004 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) FOR BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS, *In re Blockbuster, Inc.* at 13-14. (No. 9).

²⁰⁴ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re Blockbuster, Inc.* at 38.

²⁰⁵ INTERIM ORDER SIGNED ON 9/23/2010 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) DIRECTING BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS, *In re Blockbuster, Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 52).

²⁰⁶ FINAL ORDER SIGNED ON 10/20/2010 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) DIRECTING BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS, *In re Blockbuster, Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 392).

²⁰⁷ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 363(B), 507(A)(8), AND 541 AND FED. R. BANKR. P. 6003 AND 6004 REQUESTING AUTHORITY TO PAY PREPETITION TAXES AND ASSESSMENTS, *In re Blockbuster, Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 10) Such taxes include sales, use, franchise, income, real and personal property, and annual report taxes, in

Another important aspect of taxes, for both mega-corporations like Blockbuster and individuals with a modest net worth, is the ability to realize the benefits of losses and credits. Blockbuster filed a motion to implement procedures to protect the potential value of its net operating tax loss carryforward amounts, net unrealized built-in losses in its assets, and certain other tax and business credits.²⁰⁸ Blockbuster was concerned with transactions that could pose a serious risk under change of ownership tests, which could destroy the company's tax attributes.²⁰⁹ These tax attributes, according to Blockbuster, were valuable assets.²¹⁰

Additionally, Blockbuster attempted to carry on in the ordinary course of business through Chapter 11 was requesting the authority to continue selected customer programs.²¹¹ To Blockbuster, part of remaining competitive in the market hinged on honoring certain programs developed to “ensure customer satisfaction, promote rental and sales growth, meet competitive pressures, develop and sustain customer loyalty, improve profitability, and generate goodwill.”²¹² Competitors had already taken a significant portion of Blockbuster's market share forcing it into bankruptcy,²¹³ so an inability to honor customer programs could provide a stumbling block in the reorganization efforts.

A significant portion of Blockbuster's prepetition competitive advantage was its stellar relationship with key studios.²¹⁴ Blockbuster positioned itself to receive a number of exclusive

addition to business license assessments, along with any penalties and interest associated with these taxes.
Id.

²⁰⁸ Additionally, the motion proposed restrictions on certain transfers. The procedures proposed in the motion served to notify stockholders of an injunction prohibiting acquiring ownership of such stock above a certain threshold while imposing restrictions to ensure Blockbuster received the full benefits of the automatic stay. AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 39-40.

²⁰⁹ *Id.* at 40.

²¹⁰ *Id.*

²¹¹ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A) AND 503(B)(1) FOR AUTHORIZATION TO HONOR CERTAIN PREPETITION CUSTOMER PROGRAMS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 14).

²¹² *Id.* at 7; AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 41.

²¹³ Ruth Sara Lee, *Corporate Reorganization as Corporate Reinvention: Borders and Blockbuster in Chapter 11*, HARVARD BUSINESS LAW REVIEW, <http://www.hblr.org/2011/03/corporate-reorganization-as-corporate-reinvention-borders-and-blockbuster-in-chapter-11/>.

²¹⁴ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. (No. 4).

rights.²¹⁵ To maintain this advantage and, on an even more basic level, to procure product for its customers, Blockbuster filed a motion authorizing the payment of both prepetition and postpetition obligations.²¹⁶ Success in the movie and video game rental business hinges on a constant stream of product; if Blockbuster lost access to new video games, it “essentially would be out of business.”²¹⁷ The importance of this motion is hard to overstate, as Blockbuster had little control over the product it received from the studios.²¹⁸ In the same motion, Blockbuster requested that it be allowed to pay the secured studios’ legal expenses as an administrative expense, to help Blockbuster maintain its relations with the studios.²¹⁹ The court granted this motion on an interim basis on September 27, 2010.²²⁰ Following some objections in response contesting this action, the court eventually granted Blockbuster’s motion on October 27, 2010.²²¹

Similarly, to maintain its competitive advantage, Blockbuster needed a cost-effective manner to transport the product from the studios to Blockbuster and, ultimately, from

²¹⁵ *Id.*

²¹⁶ MOTION TO AUTHORIZE /DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105, 363(B)(1), AND 503(B) AND FED R. BANKR. P. 6003 AND 6004 REQUESTING (I) AUTHORITY TO PAY CERTAIN PREPETITION CLAIMS OF MOVIE STUDIOS AND GAME PROVIDERS AND (II) ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR ALL UNDISPUTED OBLIGATIONS ARISING POSTPETITION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 16).

²¹⁷ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 42. Blockbuster claimed that under the Canadian Lien Agreement, a failure to pay these claims would cause a default likely resulting in a likely shutdown of the Canadian operations.

²¹⁸ *Id.* at 43.

²¹⁹ MOTION TO AUTHORIZE /DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105, 363(B)(1), AND 503(B) AND FED R. BANKR. P. 6003 AND 6004 REQUESTING (I) AUTHORITY TO PAY CERTAIN PREPETITION CLAIMS OF MOVIE STUDIOS AND GAME PROVIDERS AND (II) ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR ALL UNDISPUTED OBLIGATIONS ARISING POSTPETITION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) at 22. (No. 16).

²²⁰ INTERIM ORDER SIGNED ON 9/27/2010 PURSUANT TO 11 U.S.C. SECTIONS 105, 363(B)(1), AND 503(B) AND FED. R. BANKR. P. 6003 AND 6004 REQUESTING (I) AUTHORITY TO PAY CERTAIN PREPETITION CLAIMS OF MOVIE STUDIOS AND GAME PROVIDERS AND (II) ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR ALL UNDISPUTED OBLIGATIONS ARISING POSTPETITION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 114).

²²¹ FINAL ORDER SIGNED ON 10/27/2010 GRANTING (I) AUTHORITY TO PAY CERTAIN PREPETITION CLAIMS OF MOVIE STUDIOS AND GAME PROVIDERS AND (II) ADMINISTRATIVE EXPENSE PRIORITY STATUS FOR ALL UNDISPUTED OBLIGATIONS ARISING POSTPETITION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 469).

Blockbuster to the consumer.²²² With the rise of by-mail subscriptions, maintaining relationships with common carriers took on increased importance. One of Blockbuster's competitive advantages was a 28-day non-compete window after a movie's release.²²³ While discussing the 28-day advantage in a 2010 interview, CEO Jim Keyes stated that a "majority of our business—as much as 80%—has been in new releases."²²⁴ A delay in shipping could effectively destroy this advantage, one of the few Blockbuster maintained at the time it filed for Chapter 11 protection. Rather than attempt to set up new contracts, Blockbuster filed a motion to allow it to maintain its existing common carriers and fulfill prepetition debts,²²⁵ which the court granted the same day on an interim basis.²²⁶ Like many of the other first-day motions, the court approved the motion on October 21, 2010.²²⁷

Blockbuster also filed a first-day motion for authority to honor certain prepetition obligations to selected vendors, suppliers, and service providers.²²⁸ Blockbuster needed to maintain receiving product from these vendors to maintain its inventory in stores, protecting its revenue streams and its value as a going concern.²²⁹ The court approved this motion on an interim basis on September 27, 2010²³⁰ and permanently on October 21, 2010.²³¹

²²² MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A) AND 363 REQUESTING (I) AUTHORITY TO PAY PREPETITION CLAIMS OF COMMON CARRIERS, AND (II) DIRECTION OF BANKS AND OTHER FINANCIAL INSTITUTIONS TO HONOR RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 13).

²²³ *See id.*; AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 44-45; Carr, *supra* note 117.

²²⁴ Carr, *supra* note 117.

²²⁵ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A) AND 363 REQUESTING (I) AUTHORITY TO PAY PREPETITION CLAIMS OF COMMON CARRIERS, AND (II) DIRECTION OF BANKS AND OTHER FINANCIAL INSTITUTIONS TO HONOR RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 13).

²²⁶ INTERIM ORDER SIGNED ON 9/23/2010 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN PREPETITION CLAIMS OF COMMON CARRIERS AND OTHER LIEN CLAIMANTS, AND (II) DIRECTING BANKS AND OTHER FINANCIAL INSTITUTIONS TO HONOR RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 56).

²²⁷ FINAL ORDER SIGNED ON 10/20/2010 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN PREPETITION CLAIMS OF COMMON CARRIERS AND OTHER LIEN CLAIMANTS, AND (II) DIRECTING BANKS AND OTHER FINANCIAL INSTITUTIONS TO HONOR RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 395).

²²⁸ MOTION TO AUTHORIZE / DEBTORS' MOTION PURSUANT TO 11 U.S.C. §§ 105(A), 363(B), AND 503(B) REQUESTING AUTHORITY TO HONOR CERTAIN UNDISPUTED PREPETITION OBLIGATIONS OF CERTAIN ESSENTIAL VENDORS, SUPPLIERS, AND SERVICE PROVIDERS, *In re* Blockbuster, Inc. Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 15).

²²⁹ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 45-46.

The final first-day motion filed by Blockbuster requested entry of an order confirming the pre-negotiated terms of the DIP financing.²³² Six parties filed an objection to this motion.²³³ This motion is explored in more detail in the following section.

Reading the first-day motions, one gets the picture of a company convinced it could succeed, or at least appearing so. The motions reflect a commitment to the prepetition plan. However, Blockbuster would soon realize its flaws.

e. DIP Financing

As discussed above, Blockbuster's decision to file for Chapter 11 protection was highly prepared and negotiated. Blockbuster explored several options for obtaining DIP financing.²³⁴ When searching for a DIP lender, debtors frequently look to existing creditors, as these creditors

²³⁰ INTERIM ORDER SIGNED ON 9/27/2010 AUTHORIZING THE DEBTORS TO PAY CERTAIN UNDISPUTED PREPETITION OBLIGATIONS OF CERTAIN ESSENTIAL VENDORS, SUPPLIERS, AND SERVICE PROVIDERS, *In re* Blockbuster, Inc. Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 106).

²³¹ FINAL ORDER SIGNED ON 10/20/2010 AUTHORIZING THE DEBTORS TO PAY CERTAIN UNDISPUTED PREPETITION OBLIGATIONS OF CERTAIN ESSENTIAL VENDORS, SUPPLIERS, AND SERVICE PROVIDERS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 396).

²³² MOTION TO APPROVE DEBTOR IN POSSESSION FINANCING / DEBTORS' MOTION FOR ENTRY OF AN ORDER, ON AN INTERIM AND FINAL BASIS, (I) AUTHORIZING THE DEBTORS TO OBTAIN POSTPETITION SUPERPRIORITY FINANCING PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 364(C), 364(D)(1), AND 364(E), (II) AUTHORIZING DEBTORS' USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, (III) GRANTING LIENS AND SUPERPRIORITY CLAIMS TO DIP LENDERS PURSUANT TO 11 U.S.C. § 364, (IV) PROVIDING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, AND (V) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULES 2002, 4001(B), 4001 (C), AND 6004, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 17).

²³³ See OBJECTION TO MOTION TO APPROVE DIP FINANCING, *In re Blockbuster Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010); OBJECTION TO MOTION TO INTERIM ORDER AND ENTRY OF FINAL ORDER RE: DIP FINANCING, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010); OBJECTION TO MOTION LIMITED OBJECTION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010); OBJECTION TO MOTION FOR ENTRY OF AN ORDER, ON AN INTERIM AND FINAL BASIS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010); OBJECTION TO MOTION FOR ENTRY OF AN ORDER, ON AN INTERIM AND FINAL BASIS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010); OPPOSITION TO DIP MOTION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010).

²³⁴ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010) at 20; Christopher Norton, *Blockbuster In The Market For \$150M DIP Loan*, LAW360, <http://www.law360.com/bankruptcy/articles/174715/blockbuster-in-the-market-for-150m-dip-loan>.

seek to prevent a further deterioration of their interests.²³⁵ Blockbuster explored this option, looking to obtain its DIP financing largely from its senior bondholders. In the weeks prior to the filing, it was reported that Blockbuster sought in the area of \$150 million in DIP financing.²³⁶ Blockbuster itself claimed to have negotiated with “two separate large, financially capable” parties regarding DIP financing.²³⁷

Eventually, Blockbuster settled on a plan with its existing bondholders worth \$125 million.²³⁸ The terms of the reorganization exchanged the company’s 11¾ percent senior secured notes for equity in the reorganized Blockbuster.²³⁹ Upon exiting Chapter 11, the \$125 million DIP loan would convert to an exit loan facility upon consummation of the plan and a new exit revolving credit facility of up to \$50 million.²⁴⁰ The court initially allowed Blockbuster access to \$20 million.²⁴¹

On October 27, 2010, the court approved the Debtor’s DIP financing agreement (“DIP Facility”), allowing the Senior Secured Creditors to give Blockbuster up to \$125 million in principal for post-petition financing.²⁴² In return for the DIP loans, the Senior Secured

²³⁵ BRYAN CAVE, *Bankruptcy, Restructuring and Creditors’ Rights: Debtor-in-Possession Lenders*, <http://www.bryancave.com/debtor-in-possession-lenders-practices>.

²³⁶ Norton, *supra* note 234.

²³⁷ AFFIDAVIT OF JEFFERY J. STEGNEGA, *In re* Blockbuster, Inc. at 23.

²³⁸ PLAN SUPPORT AGREEMENT, at http://google.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHtmlSection1?SectionID=8038996-471395-494995&SessionID=i5lcFC33MvGSNd7.

²³⁹ *Id.*; Blockbuster Corporate, *News Release: To Implement Recapitalization, Company Initiates "Pre-Arranged" Chapter11 Proceedings Blockbuster Stores and Operations Conducting Business in the Ordinary Course Secures \$125 Million DIP Financing Commitment*, <http://investor.blockbuster.com/phoenix.zhtml?c=99383&p=irol-newsArticle&id=1474126>.

²⁴⁰ PLAN SUPPORT AGREEMENT, *supra* note 238.

²⁴¹ BRIDGE ORDER (I) AUTHORIZING POSTPETITION SUPERPRIORITY SECURED FINANCING (II) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL (III) GRANTING ADEQUATE PROTECTION AND (IV) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULES 4001(B) AND 4001(C), *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 85).

²⁴² FINAL ORDER (I) AUTHORIZING POSTPETITION SUPERPRIORITY SECURED FINANCING PURSUANT TO 11 U.S.C. §§ 105(A), 361, 362, 364(C)(1), 364(C)(2), 364(C)(3), 364(D)(1) AND 364(E), (II) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, AND (III) GRANTING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Feb. 21, 2011) at 1-2. (No. 470).

Noteholders received adequate protection from the court and held a lien with administrative priority and superpriority on the Revolving DIP loan.²⁴³ Furthermore, all debtors associated with Blockbuster agreed to waive and release all claims against the Senior Secured Noteholders.²⁴⁴ The court also held the Senior Secured Obligations, the prepetition claims against Blockbuster, to constitute legal, valid, and binding obligations of the Debtors.²⁴⁵

An important part of the DIP Facility was the roll-up provision.²⁴⁶ A roll-up provision is when postpetition financing pays, in whole or in part, prepetition secured debt.²⁴⁷ Here, the Senior Secured Notes, the prepetition claims by the Senior Secured Noteholders, constituted “Roll-Up Notes.”²⁴⁸ As a result, the prepetition secured claims owed to the Senior Secured Noteholders were secured by the DIP liens on the DIP collateral. Additionally, the Senior Secured Notes were given superpriority claims on top of their continuing claims and liens as Senior Secured Notes.²⁴⁹ Thus, the prepetition debt owed to the Senior Secured Noteholders was given the same priority as the postpetition debt owed to the Senior Secured Noteholders.²⁵⁰

This type of manipulation of the securities is known as “cross-collateralization” and allows lenders to obtain additional security for both their postpetition loans and prepetition claims.²⁵¹ How the Senior Secured Noteholders handled the prepetition security and postpetition loans is common in Chapter 11 proceedings.²⁵² DIP Lenders tend to be the Secured Creditors of

²⁴³ *Id.*

²⁴⁴ *Id.* at 9.

²⁴⁵ *Id.* at 8.

²⁴⁶ *Id.* at 18.

²⁴⁷ George W. Kuney, *Article: Hijacking Chapter11*, 21 EMORY BANKR. DEV. J. 19, 63 (2004).

²⁴⁸ FINAL ORDER (I) AUTHORIZING POSTPETITION SUPERPRIORITY SECURED FINANCING PURSUANT TO 11 U.S.C. §§ 105(A), 361, 362, 364(C)(1), 364(C)(2), 364(C)(3), 364(D)(1) AND 364(E), (II) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, AND (III) GRANTING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, *In re Blockbuster, Inc.*, No. 10-14997 (S.D.N.Y. Feb. 21, 2011) at 18. (No. 470).

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ Kuney, *supra* note 247 at 60.

²⁵² *See id.* at 56.

the prepetition claims; accordingly, the DIP Lenders use the DIP financing agreement to preserve their collateral and seniority.²⁵³

Another important provision of the DIP Facility was the carve-out expenses.²⁵⁴ The DIP Facility maintained that a carve-out of the proceeds must go to the payment of court fees and expenses incurred by the trustee.²⁵⁵ More importantly, a carve-out of the proceeds must go to the payment of fees owed to any professionals or professional firms retained by the Debtors.²⁵⁶ This provision is also commonly found in DIP Financing agreements, ensuring that the debtor's lawyers will be paid from the bankruptcy proceedings.²⁵⁷ Such was the case for Blockbuster. Thus, through the combination of cross-collateralization, roll-up notes, and carve-outs for professional fees, the Senior Secured Creditors and the debtor's counsel, Weil Gotshal, were able to use the Chapter 11 proceedings to their advantage over unsecured creditors.

The DIP Facility spelled out seven circumstances that could terminate the Debtor's authority to use the proceeds of the DIP financing or prepetition collateral.²⁵⁸ One such circumstance was an "Event of Default" under the DIP loan documents.²⁵⁹ In Section 8 of the DIP Facility, the agreement listed a multitude of events that would constitute "Default."²⁶⁰ Other circumstances included: (i) an outstanding payment for post-petition final judgment in excess of

²⁵³ *Id.* at 55.

²⁵⁴ FINAL ORDER (I) AUTHORIZING POSTPETITION SUPERPRIORITY SECURED FINANCING PURSUANT TO 11 U.S.C. §§ 105(A), 361, 362, 364(C)(1), 364(C)(2), 364(C)(3), 364(D)(1) AND 364(E), (II) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, AND (III) GRANTING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, *In re Blockbuster, Inc.*, No. 10-14997 (S.D.N.Y. Feb. 21, 2011) at 34. (No. 470).

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ Kuney, *supra* note 247 at 67.

²⁵⁸ FINAL ORDER (I) AUTHORIZING POSTPETITION SUPERPRIORITY SECURED FINANCING PURSUANT TO 11 U.S.C. §§ 105(A), 361, 362, 364(C)(1), 364(C)(2), 364(C)(3), 364(D)(1) AND 364(E), (II) AUTHORIZING POSTPETITION USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, AND (III) GRANTING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, *In re Blockbuster, Inc.*, No. 10-14997 (S.D.N.Y. Feb. 21, 2011) at 21-22. (No. 470).

²⁵⁹ *Id.*

²⁶⁰ 8.1 Events of Default, Senior Secured, Super-Priority DEBTOR-IN-POSSESSION REVOLVING CREDIT AGREEMENT.

\$250,000, (ii) the debtor's failure to provide updates about financing, and (iii) a conversion from Chapter 11 to a Chapter 7 case.²⁶¹

Overall, the DIP Financing agreement between the Debtors and the Senior Secured Noteholders was an example of how senior creditors and Bankruptcy professionals could expertly use the Bankruptcy Code to control Chapter 11 cases. The provisions of the DIP Facility ensured that the largest Chapter 11 bankruptcy would be driven by a select few.

f. The Unsecured Creditors Committee

As a cursory glance at Blockbuster's filings demonstrates, and common sense suggests, Blockbuster had an almost indeterminate number of unsecured creditors and an estimated \$486 million in unsecured claims. The goal of an unsecured creditors committee is to provide a fiduciary acting to preserve the maximum value possible for unsecured creditors of a debtor.²⁶² On October 1, 2010, the United States Trustee appointed nine members to the Official Committee of Unsecured Creditors. The nine were The Bank of New York Mellon Trust Company, N.A., Scott Siegel, David A. Segal, Universal Studios Home Entertainment LLC, Integrated Process Technologies, AT&T Services, Inc., Weingarten Realty, Developers Diversified Realty Corp., and Centro Properties Group.²⁶³

On October 6, 2010, the unsecured creditors committee announced that Cooley LLP would represent it as legal counsel.²⁶⁴ Cooley had one of the largest bankruptcy practices in the country at the time,²⁶⁵ making its selection unsurprising.

g. Administrative Expenses – Professional Fees

²⁶¹ *Id.*

²⁶² THE MERIDIAN GROUP, *Role of Unsecured Creditors Committee*, http://www.themeridiangrp.com/resources/white_papers/role_of_unsecured_creditors.pdf.

²⁶³ RUST OMNI, *Blockbuster Inc. Committee: Committee Website*, <http://www.omnimgt.com/sblite/templates/a/Default.aspx?clientId=CsgAAncz%2b6a3n6wQGyzvZt0x9%2fqwlgDrlSz710oWljLqxRZTzsC%2fNQ4nIOWe9RbaqqyvCR%2fTf10%3d>.

²⁶⁴ COOLEY LLP, *Cooley to Advise Unsecured Creditors Committee in Blockbuster Video Bankruptcy*, (Oct. 6, 2010), <http://www.cooley.com/showpressrelease.aspx?Show=64344>.

²⁶⁵ *Id.*

Administrative expenses are given priority under the Bankruptcy Code.²⁶⁶ Section 503 of the Code defines administrative expenses.²⁶⁷ One of the major carve outs for administrative expenses is:

reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant.²⁶⁸

Blockbuster retained several leading law and accounting firms²⁶⁹ in the course of this case. As one would expect, these organizations cost a significant amount of money.

Alvarez & Marshall served as chief restructuring officer in Blockbuster's Chapter 11.²⁷⁰ Throughout its representation of Blockbuster, Alvarez & Marshall filed eight quarterly fee statements seeking reimbursement.²⁷¹ The total amount billed by Alvarez & Marshall for fees and expenses was \$6,274,423.²⁷²

²⁶⁶ See 11 U.S.C. § 507.

²⁶⁷ See 11 U.S.C. § 503.

²⁶⁸ 11 U.S.C. § 503(b)(4).

²⁶⁹ Three of the "Big Four" accounting firms handled various portions of Blockbuster's bankruptcy.

²⁷⁰ See ORDER SIGNED ON 10/27/2010 AUTHORIZING THE DEBTORS TO (I) RETAIN ALVAREZ & MARSHALL NORTH AMERICA, LLC TO PROVIDE THE DEBTORS A CHIEF RESTRUCTURING OFFICER AND CERTAIN ADDITIONAL PERSONNEL AND (II) DESIGNATE JEFFREY J. STEGENGA AS CHIEF RESTRUCTURING OFFICER FOR THE DEBTORS NUNC PRO TUNC TO THE COMMENCEMENT DATE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 468).

²⁷¹ See APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION / FIRST QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Apr. 29, 2011) (NO. 1867); STATEMENT / SECOND QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Jul. 14, 2011) (NO. 2162); STATEMENT / THIRD QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Dec. 22, 2011) (NO. 2714); STATEMENT / FOURTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Dec. 22, 2011) (NO. 2715); STATEMENT / FIFTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Apr. 30, 2012) (NO. 2924); STATEMENT / SIXTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Jul. 31, 2012) (NO. 2950); STATEMENT / SEVENTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Oct. 12, 2012) (NO. 2979); STATEMENT / EIGHTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Jan. 24, 2013) (NO. 2987).

²⁷² See APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION / FIRST QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 1867); STATEMENT / SECOND QUARTERLY FEE STATEMENT, *In re*

As discussed earlier, Weil Gotshal represented Blockbuster as lead counsel. In the firm's first application for fees, it attempted to charge \$3,078,770.25 in fees and \$102,072.66 in expenses.²⁷³ The court reduced the fees to \$2,463,016.20, but awarded the expenses in full.²⁷⁴

In its second application, Weil Gotshal requested \$3,846,128.25 in fees and \$133,318.61 in expenses.²⁷⁵ The third application sought fees of \$955,533.25 and expenses of \$45,998.10.²⁷⁶ These applications drew an objection from the US Trustee.²⁷⁷ Shortly after, the court awarded fees of \$3,028,853.65 and \$716,651.44, respectively.²⁷⁸ Expenses of \$131,278.35 and \$45,383.78 were also granted.²⁷⁹

Blockbuster, Inc. (NO. 2162); STATEMENT / THIRD QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2714); STATEMENT / FOURTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2715); STATEMENT / FIFTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2924); STATEMENT / SIXTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2950); STATEMENT / SEVENTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2979); STATEMENT / EIGHTH QUARTERLY FEE STATEMENT, *In re* Blockbuster, Inc. (NO. 2987).

²⁷³ FIRST APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR WEIL, GOTSHAL & MANGES, LLP, DEBTOR'S ATTORNEY, PERIOD: 9/23/2010 TO 1/31/2011, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Mar. 15, 2011). (No. 1323).

²⁷⁴ ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2011). (No. 2038).

²⁷⁵ SECOND APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR WEIL, GOTSHAL & MANGES LLP, DEBTOR'S ATTORNEY, PERIOD: 2/1/2011 TO 6/30/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2011). (No. 2347).

²⁷⁶ THIRD APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR WEIL, GOTSHAL & MANGES LLP, DEBTOR'S ATTORNEY, PERIOD: 7/1/2011 TO 11/30/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2011). (No. 2753).

²⁷⁷ OBJECTION TO MOTION /OBJECTION OF THE UNITED STATES TRUSTEE REGARDING APPLICATIONS FOR INTERIM COMPENSATION, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2011). (No. 2817).

²⁷⁸ ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2012). (No. 2906).

²⁷⁹ *Id.*

Other law firms were retained as special counsel to handle various aspects of the case from litigation to intellectual property.²⁸⁰ One of these firms, Ray & Glick, billed \$291,250.00 in fees for its services from the filing through the end of January 2011, of which \$233,000.00 was awarded.²⁸¹ For its work from February 2011 through June of that year, Ray & Glick charged \$876,750.00.²⁸² The court granted \$743,150.00.²⁸³

Also retained as special counsel was the Chaiken Legal Group.²⁸⁴ For its work, the court approved \$189,220.00²⁸⁵ and \$297,599.00.²⁸⁶ Additionally, Bloodworth Carroll received \$315,266.00 for its legal work on behalf of Blockbuster.²⁸⁷ Vinson & Elkins served as special

²⁸⁰ ORDER SIGNED ON 11/23/2010 AUTHORIZING DEBTORS TO EMPLOY AND RETAIN RAY & GLICK, LTD. AS SPECIAL COUNSEL, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 615).

²⁸¹ See FIRST APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR RAY & GLICK, LTD., SPECIAL COUNSEL, PERIOD: 9/23/2010 TO 1/31/2011, *In re Blockbuster Inc.* (992); ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc. (No. 2038).

²⁸² SECOND APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR RAY & GLICK, LTD., SPECIAL COUNSEL, PERIOD: 2/1/2011 TO 6/30/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 2326).

²⁸³ ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

²⁸⁴ ORDER SIGNED ON 11/23/2010 AUTHORIZING DEBTORS TO EMPLOY AND RETAIN CHAIKEN LEGAL GROUP, P.C. AS SPECIAL COUNSEL, *In* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 616).

²⁸⁵ ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc. (No. 2038).

²⁸⁶ ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

²⁸⁷ ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc. (2038); ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

counsel for certain litigation and corporate governance matters.²⁸⁸ For this work, they were paid \$119,050.00 in fees and compensated \$2,634.60 for expenses.²⁸⁹

As mentioned earlier, Blockbuster employed Rothschild, Inc. as financial special counsel and investment banker.²⁹⁰ The court approved fees of \$437,333.34 and expenses of \$49,844.41 from Rothschild's first application for compensation.²⁹¹ From its second and third application, the court awarded \$2,731,879.27 in fees and \$22,201.86 in expenses.²⁹²

In addition to law firms, other professionals are needed to guide a company through Chapter 11. Blockbuster retained Deloitte as a tax advisor and Deloitte FAS for providing a valuation.²⁹³ Deloitte Tax filed two fee applications, requesting a total of \$582,765.00 in fees and \$966.12 in expenses.²⁹⁴ Another accounting firm, Ernst & Young, served as Blockbuster's

²⁸⁸ ORDER SIGNED ON 10/5/2011 AUTHORIZING DEBTORS' APPLICATION TO EMPLOY AND RETAIN VINSON & ELKINS, LLP AS SPECIAL COUNSEL ON CERTAIN LITIGATION AND CORPORATE GOVERNANCE MATTERS PURSUANT TO SECTIONS 327(E) AND 330 OF THE BANKRUPTCY CODE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 2455).

²⁸⁹ ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

²⁹⁰ ORDER SIGNED ON 11/2/2010 AUTHORIZING THE RETENTION AND EMPLOYMENT OF ROTHSCHILD INC. AS FINANCIAL ADVISOR AND INVESTMENT BANKER, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 511).

²⁹¹ ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In* Blockbuster, Inc. (No. 2038)

²⁹² ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

²⁹³ ORDER SIGNED ON 11/9/2010 AUTHORIZING THE RETENTION AND EMPLOYMENT OF DELOITTE TAX LLP AS TAX ADVISOR NUNC PRO TUNC TO THE COMMENCEMENT DATE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 582); ORDER SIGNED ON 2/8/2011 AUTHORIZING THE RETENTION AND EMPLOYMENT OF DELOITTE FINANCIAL ADVISORY SERVICES, LLP AS VALUATION SERVICES PROVIDER NUNC PRO TUNC TO NOVEMBER 10, 2010, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 986).

²⁹⁴ *See* FIRST APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR DELOITTE TAX LLP, OTHER PROFESSIONAL, PERIOD: 9/23/2010 TO 1/31/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 1333) (requesting a fee of \$412,112.50 and expenses of \$966.12); SECOND APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR DELOITTE TAX LLP, OTHER PROFESSIONAL, PERIOD: 2/1/2011 TO 4/30/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr.

internal auditors.²⁹⁵ In its first application for compensation, Ernst & Young asked for \$216,150.85 in fees and nominal expenses.²⁹⁶ The second application requested \$235,054.51 in fees.²⁹⁷ Between the two applications, the court granted a total of \$360,964.29 in fees.²⁹⁸ A third accounting firm, PricewaterhouseCoopers served as an independent auditor.²⁹⁹ Its operations were expanded to include the role of accounting advisors on February 28, 2012.³⁰⁰ For its work, the court awarded PricewaterhouseCoopers \$1,395,478.92 in fees and \$23,575.50 in expenses.³⁰¹

S.D.N.Y. 2010). (No. 2380) (requesting a fee of \$170,652.50 and no expenses); ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc. (No. 2038); ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906).

²⁹⁵ ORDER SIGNED ON 4/4/2010 PURSUANT TO 11 U.S.C. §§ 327, 328(A), AND 330, FED. R. BANKR. P. 2014(A) AND 2016, AND LOCAL BANKRUPTCY RULES 2014-1 AND 2016-1 AUTHORIZING THE RETENTION AND EMPLOYMENT OF ERNST & YOUNG, LLP, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 1578).

²⁹⁶ FIRST APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR ERNST & YOUNG LLP, AUDITOR, PERIOD: 12/9/2010 TO 1/31/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 1869). The application requested only \$55.00 in expenses.

²⁹⁷ SECOND APPLICATION FOR INTERIM PROFESSIONAL COMPENSATION FOR ERNST & YOUNG LLP, AUDITOR, PERIOD: 2/1/2011 TO 5/31/2011, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 2359).

²⁹⁸ ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re* Blockbuster, Inc. (No. 2906) (granting \$235,054.51 in fees); ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc., (No. 2038) (granting \$172,920.68 in fees and \$55.00 in expenses).

²⁹⁹ ORDER SIGNED ON 2/8/2011 AUTHORIZING THE RETENTION AND EMPLOYMENT OF PRICEWATERHOUSECOOPERS, LLP AS INDEPENDENT AUDITORS TO THE DEBTORS NUNC PRO TUNC TO THE COMMENCEMENT DATE, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 985).

³⁰⁰ ORDER SIGNED ON 2/28/2012 AUTHORIZING THE DEBTORS TO EXPAND THE SCOPE OF THEIR RETENTION OF PRICEWATERHOUSECOOPERS, LLP AS ACCOUNTING ADVISORS, *In re* Blockbuster, Inc., Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 2853).

³⁰¹ See ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re* Blockbuster, Inc. (2038); ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION

Consultants for the Committee of Unsecured Creditors also received substantial payment. Its legal counsel, Cooley, received over two million dollars in fees and almost seventy thousand dollars in expenses.³⁰² Working as financial advisor on behalf of the Committee of Unsecured Creditors, FTI Consulting, Inc. received fees of \$707,333.00 and expenses of \$25,164.70.³⁰³

Karotkin filed a motion on behalf of Blockbuster to establish a deadline and procedures for administrative claims on May 19, 2011.³⁰⁴ A day later, the court set a deadline of June 15, 2011.³⁰⁵

IV. The § 363 Sale

a. Road to the § 363 Sale

As previously mentioned, Blockbuster's decision to commence its Chapter 11 bankruptcy proceeding stemmed from several months of negotiations.³⁰⁶ When filing for bankruptcy,

FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re Blockbuster, Inc.* (No. 2906).

³⁰² See ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re Blockbuster, Inc.* (No. 2038) (granting \$1,475,597.20 in fees and \$30,834.37 in expenses); ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re Blockbuster, Inc.* (No. 2906) (granting \$636,462.50 in fees, \$37,163.05 in expenses for the second compensation application and \$56,420.50 in fees, \$338.25 in expenses for the third compensation application).

³⁰³ See ORDER SIGNED ON 6/28/2011 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM SEPTEMBER 23, 2010 THROUGH JANUARY 31, 2011, *In re Blockbuster Inc.* (2038); ORDER SIGNED ON 4/4/2012 GRANTING APPLICATIONS FOR ALLOWANCE OF INTERIM COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES INCURRED FROM FEBRUARY 1, 2011 THROUGH NOVEMBER 30, 2011, *In re Blockbuster Inc.* (No. 2906).

³⁰⁴ STATEMENT / DEBTORS' EX PARTE MOTION, PURSUANT TO 11 U.S.C. § 503(A), FED. R. BANKR. P. 3003(C)(3) AND LOCAL RULE 3003-1, TO ESTABLISH A DEADLINE AND PROCEDURES FOR FILING CERTAIN ADMINISTRATIVE CLAIMS AND APPROVE THE FORM AND MANNER OF NOTICE THEREOF, *In re Blockbuster, Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 1914).

³⁰⁵ ORDER SIGNED ON 5/20/2011 ESTABLISHING A DEADLINE AND PROCEDURES FOR FILING CERTAIN ADMINISTRATIVE CLAIMS AND APPROVING THE FORM AND MANNER OF NOTICE THEREOF, *In re Blockbuster, Inc.*, Case No.1:10-bk-14977 (Bankr. S.D.N.Y. 2010). (No. 1918).

Blockbuster originally intended to confirm a Chapter 11 plan of reorganization with its creditors.³⁰⁷ In order to reach confirmation of a Chapter 11 plan, Blockbuster entered into a Plan Support Agreement (“PSA”) with the Senior Secured Noteholders.³⁰⁸ The PSA called for the conversion of the Senior Secured Notes into equity to help provide Blockbuster the DIP financing necessary to continue its ordinary course of business during restructuring.³⁰⁹ The court eventually approved the DIP Facility after extensive negotiations with the Creditors’ Committee.³¹⁰ Thus, due to the liquidity runway of the DIP Facility and support of key constituencies, Blockbuster originally hoped to confirm a plan of reorganization within the time frame set forth in the PSA.³¹¹

However, in the end, Blockbuster failed to accomplish the objectives set out in the PSA, depriving it of any chance to reach an agreement with creditors to confirm a plan of reorganization.³¹² First, Blockbuster suffered poor holiday sales in the last quarter of 2010.³¹³ As a result, Blockbuster continued to experience deteriorating business operations.³¹⁴ Second, Blockbuster could not reach a consensus with DIP Lenders regarding a long-term business plan.³¹⁵ Third, perhaps most importantly, Blockbuster defaulted on its DIP Facility, constituting a “Termination Event” and a “Roll-Up Event” under both the PSA and the DIP facility.³¹⁶

³⁰⁶ DEBTOR’S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS’ ASSETS, *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. Feb. 21, 2011) at 3, ¶ 3. (No. 947).

³⁰⁷ *Id.*

³⁰⁸ *Id.*

³⁰⁹ *Id.* at 4, ¶ 4

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.* at 4, ¶ 5.

³¹³ *Id.*

³¹⁴ *Id.*

³¹⁵ *Id.*

Accordingly, the Senior Secured Noteholders terminated Blockbuster's DIP financing.³¹⁷ Consequently, after consulting with the Steering Committee, Blockbuster determined that the Plan was no longer feasible.³¹⁸

With its original plan in shambles, Blockbuster was forced in a different direction. The choice of action Blockbuster pursued involved a sale of the company's assets.³¹⁹ Blockbuster agreed with the Steering Committee to pursue a sale of substantially all of the company's assets on an expedited basis under § 363 of the Bankruptcy Code.³²⁰ Both Blockbuster and the Steering Committee believed this approach would maximize the value of Blockbuster's estates.³²¹

Recognizing that the DIP Lenders were only willing to provide financing for a limited period of time, Blockbuster determined to select one of two proposals from among particular members of the Steering Committee who had expressed an interest in serving as a stalking horse bidder.³²² A stalking horse bid is the initial bid on a bankrupt company's assets from an interested buyer, who is chosen by the debtor, generally in concert with the committee of unsecured creditors.³²³ Blockbuster required these two proposals be furnished by January 28, 2011 so that the sale process could advance promptly.³²⁴

³¹⁶ *Blockbuster defaults on DIP Loan and Changes Course, Seeks Approval of Procedures to Sell All Its Assets*, CHAPTER 11 CASES (Feb. 21, 2011), <http://chapter11cases.com/blockbuster-defaults-on-dip-loan-and-changes-course-seeks-approval-of-procedures-to-sell-all-its-assets/>.

³¹⁷ *Id.*

³¹⁸ DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re Blockbuster, Inc.* at 4, ¶ 5. (No. 947).

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ *Id.* at 5, ¶ 6.

³²² *Id.*

³²³ *Definition of 'Stalking Horse Bid'*, INVESTOPEDIA (April 25, 2013 11:15 AM), <http://www.investopedia.com/terms/s/stalkinghorsebid.asp>

³²⁴ DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D)

After thoroughly evaluating both proposals, Blockbuster chose Cobalt Video Holdco, LLC (“Cobalt Video”) as its stalking horse bidder.³²⁵ Cobalt Video, led by Carl Icahn, existed solely to acquire Blockbuster’s assets.³²⁶ Cobalt Video was formed by funds managed by Monarch Alternative Capital LP, Owl Creek Asset Management LP, Stonehill Capital Management LLC and Varde partners, Inc., all Senior Secured Note holders of Blockbuster.³²⁷ The four entities comprising Cobalt Video collectively held more than half of Blockbuster’s outstanding 11.75% Senior Secure Notes.³²⁸ After reaching a Purchase Agreement with Cobalt Video, as a stalking horse bidder, Blockbuster filed a motion to authorize an auction process for the Company.³²⁹

b. The Motion

On February 21, 2011, the Debtors filed a motion for sale of the property pursuant to 11 U.S.C. § 363(b).³³⁰ Blockbuster divided the motion into two basic requests.³³¹ First, Blockbuster moved, pursuant to 11 U.S.C. §§ 105, 362, 363, 364, 365 and 503, for the court to

ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS’ ASSETS, *In re* Blockbuster, Inc. at 4, ¶ 5. (No. 947).

³²⁵ *Blockbuster Initiates Process to Sell Company, Enters into “Stalking Horse” Purchase Agreement with Investor Group*, BUSINESSWIRE, (Feb. 21, 2011, 3:47 PM), <http://www.businesswire.com/news/home/20110221006024/en/Blockbuster-Initiates-Process-Sell-Company-Enters-%E2%80%9CStalking>.

³²⁶ *Id.*

³²⁷ *Blockbuster defaults on DIP Loan and Changes Course, Seeks Approval of Procedures to Sell All Its Assets*, CHAPTER11 CASES (Feb. 21, 2011), <http://chapter11cases.com/blockbuster-defaults-on-dip-loan-and-changes-course-seeks-approval-of-procedures-to-sell-all-its-assets/>.

³²⁸ *Id.*

³²⁹ *Id.*

³³⁰ DEBTOR’S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS’ ASSETS, *In re* Blockbuster, Inc. at 1. (No. 947).

³³¹ *Id.*

approve: (i) bid procedures in connection with the § 363 sale; (ii) stalking horse expense reimbursement; (iii) sale notice for the auction; (iv) assumption procedures for the assignment of executory contracts and unexpired leases; (v) prioritization of the sale-related administrative expenses, and (vi) injunction (“Administrative Stay”³³²) to enjoin any collection efforts for administrative expenses occurring during the pre-sale period.³³³ Second, Blockbuster moved the court to approve the sale of its assets free and clear of all liens, claims, and encumbrances to the successful bidder.³³⁴

Blockbuster’s motion to request the court’s approval of the § 363 sale along with the sale procedures was nothing out of the ordinary.³³⁵ However, Blockbuster’s request for the court to enjoin collection efforts on any administrative expenses occurring between the commencement date and February 24, 2011 garnered much attention from other creditors.

c. Sale Terms

Under the terms of the proposed Purchase Agreement, the Cobalt Video agreed to pay either \$265 million or \$290 million, contingent upon an event, referred as the “Studio Condition” in the Purchase Agreement.³³⁶ For the Studio Condition to occur, two things must happen. First, at least five of the six major studios needed to continue their support of Blockbuster’s digital business and provide Blockbuster stores with physical copies of movies in sufficient amounts.³³⁷ Second, all of the studios that were secured creditors refrained from taking any administrative action to foreclose on the assets to secure payments under the Collateral Trust Agreement prior to the closing of the sale.³³⁸ If all these conditions were met, then the Studio Condition applied, setting the sale price at \$265 million.³³⁹

³³² This proposal to enjoin any payments on the administrative expenses prior to the efforts to sell Blockbuster’s efforts was an attempt by the Senior Secured Noteholders to bifurcate the administrative expenses between the expenses that occurred with the reorganization efforts and expenses that occurred to sell Blockbuster’s assets. This will be discussed further in the Administrative Relief section.

³³³ *Id.*

³³⁴ *Id.*

³³⁵ *See* Kuney, *supra* note 247 at 105.

³³⁶ *Blockbuster defaults on DIP Loan and Changes Course, Seeks Approval of Procedures to Sell All Its Assets*, CHAPTER11 CASES (Feb. 21, 2011), <http://chapter11cases.com/blockbuster-defaults-on-dip-loan-and-changes-course-seeks-approval-of-procedures-to-sell-all-its-assets/>.

³³⁷ *Id.*

³³⁸ *Id.*

³³⁹ *Id.*

Additionally, the Purchase Agreement contained price adjustments for the amounts of Blockbuster's cash and inventory at the closing of the sale and a proposed decrease up to \$5 million for reimbursement of the purchaser's expenses.³⁴⁰ The Purchase Agreement lacked any provision reimbursing Cobalt Video for any expenses in the event it was not the winning bidder.³⁴¹ However, if Cobalt Video terminated pursuant to Section 4.4 of the Purchase Agreement, it was entitled to an expense reimbursement.³⁴² This was Cobalt Video's only protection in the Purchase Agreement.³⁴³ The Purchase Agreement also gave the Cobalt Video another option, the Agency Alternative, which allowed it, under certain circumstances,³⁴⁴ to compel a conversion to a case under Chapter 7 of the Bankruptcy Code.³⁴⁵

In return for cash consideration, the Cobalt Video was to acquire all assets, except for Excluded Assets,³⁴⁶ defined in the proposed Purchase Agreement, or the proceeds of the disposition of the store liquidations if it elected the Agency Alternative.³⁴⁷ The assets exchanged

³⁴⁰ *Id.*

³⁴¹ *Id.*

³⁴² DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re* Blockbuster, Inc. at 25, ¶ 19. (No. 947).

³⁴³ *Id.*

³⁴⁴ Section 8.8(b) of Proposed Purchase Agreement, spell out the circumstances for the Purchaser to convert the case to a Chapter7 case. The circumstances pertain the Purchaser's ability to assume property leases. If the Purchaser cannot obtain the right to assume unexpired leases, then Purchaser may elect agency alternative, which leads to store liquidations.

³⁴⁵ *Blockbuster defaults on DIP Loan and Changes Course, Seeks Approval of Procedures to Sell All Its Assets*, CHAPTER11 CASES (Feb. 21, 2011), <http://chapter11cases.com/blockbuster-defaults-on-dip-loan-and-changes-course-seeks-approval-of-procedures-to-sell-all-its-assets/>.

³⁴⁶ The Proposed Purchase Agreement spelled out specific assets that would not acquired by the purchaser, which include defined Excluded Contracts, equity interests in the Sellers, any claim, right or interest of any Seller in or to any refund, rebate, abatement or other recovery for Taxes ending on or before the Closing Date, all rights and claims of the Sellers under the Transaction documents, all Debtor Benefits plans; and all restricted cash relating to cash collateralized letters of credit and/or Excluded liabilities. (link)

in the Purchase Agreement included all of the outstanding ownership interests in each of the foreign subsidiaries of Blockbuster, all Blockbuster's cash and cash equivalents, all Blockbuster's accounts and notes receivable, all deposits and deferred charges of Blockbuster, all tangible personal property related to Blockbuster's business operations, franchise agreements, intellectual property, and all goodwill associated with the company.³⁴⁸ The sale of the assets was to be free and clear of all liens, claims, encumbrances, and other interests except for those permitted encumbrances and assumed liabilities.³⁴⁹

The assumed liabilities in the proposed Purchase Agreement comprised the liabilities from the assumed contracts, unpaid wages to employees, employee benefits and tax expenses. However, the Purchase Agreement limited liabilities to an aggregate amount of \$1.6 million.³⁵⁰

The proposed Purchase Agreement also defined the allocation of proceeds coming from the auction sale.³⁵¹ "Carve-Out Expenses" were given first priority.³⁵² The amounts due to the DIP Agent or Senior Indenture Trustee received second priority.³⁵³ After satisfying the "Carve-Out Expenses" and amounts due to the DIP Agent, the proceeds went to satisfy the "Estimated Wind Down Expenses," the sellers' reasonable good faith estimate of expenses expected to incur with the closing of the bankruptcy estate.³⁵⁴ Fourth priority was a twenty million dollar deposit

³⁴⁷ DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re* Blockbuster, Inc. at 3, ¶ 3. (No. 947).

³⁴⁸ *Id.* at 14-15.

³⁴⁹ *Id.* at 26.

³⁵⁰ PROPOSED ASSET PURCHASE AND SALE AGREEMENT, Section 2.3: Assumption of Liabilities.

³⁵¹ DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re* Blockbuster, Inc. at 13-14. (No. 947).

³⁵² *Id.*

³⁵³ *Id.*

³⁵⁴ *Id.*

into the Purchase Price Adjustment Escrow.³⁵⁵ Fifth, the proceeds covered an amount due under the DIP Credit Agreement.³⁵⁶ The sixth priority was the Administrative Priority Expenses paid directly to the sellers.³⁵⁷ Seventh, the proceeds went to cover the amount due to the Roll-Up Noteholders under the DIP Facility.³⁵⁸ Last, any remaining proceeds went to the sellers.³⁵⁹ After facing various objections from major studios and other creditors, the Debtors later amended the allocation of proceeds defined in the proposed Purchased Agreement in order to receive court approval of the sale.

In addition, the Purchase Agreement laid out specific obligations with respect to the stores.³⁶⁰ First, Blockbuster needed to seek from all parties having leased properties an extension of at least 90 days for the purchaser to determine which leases to assume.³⁶¹ Second, Blockbuster needed to commence liquidation of 609 particular stores.³⁶² Along with commencing liquidation, Blockbuster needed to consult the purchaser as to how to conduct these liquidations and provide estimation of aggregate expenses.³⁶³ Third, for all leased properties not designated as a purchaser Assumed Contract, the purchaser had to either designate such leased property as any purchaser Assumed Contract or have the seller retain such leased property as an excluded asset.³⁶⁴ Fourth, the Purchase Agreement laid out a specific set of orders for Blockbuster to follow if the purchaser elected the Agency Alternative.³⁶⁵ Finally, Blockbuster also had other standard obligations, such as conducting the business in its ordinary course before close and not to use any trademark property upon close.³⁶⁶

³⁵⁵ *Id.*

³⁵⁶ *Id.*

³⁵⁷ *Id.*

³⁵⁸ *Id.*

³⁵⁹ *Id.*

³⁶⁰ *Id.* at 19-21.

³⁶¹ *Id.*

³⁶² *Id.*

³⁶³ *Id.*

³⁶⁴ *Id.*

³⁶⁵ *Id.*

³⁶⁶ *Id.*

Along with its standard features, the proposed Purchase Agreement contained several unique aspects not found in a typical § 363 asset sale.³⁶⁷ First, Blockbuster was only authorized to continue outstanding gift cards for 45 days from February 21, 2011.³⁶⁸ Second, as mentioned earlier, Cobalt Video had the right to convert the case to a Chapter 7 liquidation proceeding under special circumstances.³⁶⁹ Third, the agreement provided the Purchaser with an option to “direct the estates liquidation of their inventory under an agency agreement.”³⁷⁰ Cobalt Video had no obligation to continue operating any portion of Blockbuster’s business after close.³⁷¹ Thus, the proposed Purchase Agreement opened the door for Cobalt Video to close all Blockbuster’s “brick and mortar” stores that had proven to be dead weight.³⁷²

d. Blockbuster’s Business Justification for the § 363 Sale

Because Blockbuster’s sale of assets was outside the ordinary course of the business, Blockbuster needed to provide the court a sound business justification for the proposed sale. Once Blockbuster provided the court its justification for the sale, the court had to determine whether (i) Blockbuster had provided the interested parties with adequate and reasonable notice, (ii) the sale was fair and reasonable, and (iii) the purchaser proceeded in good faith.³⁷³

Here, Blockbuster stressed how expediting the sale process was critical to preserving and maximizing the company’s value.³⁷⁴ Blockbuster added that an asset sale under § 363 was the

³⁶⁷*Blockbuster defaults on DIP Loan and Changes Course, Seeks Approval of Procedures to Sell All Its Assets*, CHAPTER 11 CASES (Feb. 21, 2011), <http://chapter11cases.com/blockbuster-defaults-on-dip-loan-and-changes-course-seeks-approval-of-procedures-to-sell-all-its-assets/>.

³⁶⁸ *Id.*

³⁶⁹ *Id.*

³⁷⁰ *Id.*

³⁷¹ *Id.*

³⁷² *Id.*

³⁷³ DEBTOR’S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS’ ASSETS, *In re Blockbuster, Inc.* at 38, ¶ 33. (No. 947).

³⁷⁴ *Id.* at 38, ¶ 34.

only alternative due to the company's failing business model and liquidity constraints.³⁷⁵ Furthermore, Blockbuster emphasized that reorganization no longer provided a viable option because the DIP Lenders declined to provide any more financing.³⁷⁶ In other words, Blockbuster had no other choice.³⁷⁷

Blockbuster also maintained that the notice was reasonable because it would serve interested parties promptly and notice would be published in newspapers of general circulation.³⁷⁸ In order to prove the fairness of the sale price, Blockbuster asserted that implementing Cobalt Video's stalking horse bid as a minimum bid would guarantee a reasonable sale price.³⁷⁹ Moreover, the Agency Alternative, which gave the successful bidder the option to convert to a Chapter 7 case, provided the court another option in the event of a deficient sale price.³⁸⁰ In the motion, Blockbuster assured to the court that the DIP Lenders would consent to the sale; thus the purchaser would be free and clear of any and all liens, claims, encumbrances, and other interests, satisfying the conditions set forth in § 363(f).³⁸¹

Blockbuster also maintained that the asset sale met the good faith purchaser requirement under section 363(m), as the successful bidder would be a product of an arm's length, good-faith negotiation.³⁸² Furthermore, as a condition for the sale, the proposed Purchase Agreement required that the court find the successful bidder to be a good-faith purchaser based upon the record made at the sale hearing.³⁸³

As mentioned earlier, Cobalt Video only received protection through the Expense Reimbursement provision of the Purchase Agreement.³⁸⁴ The Expense Reimbursement was a contingent payment in the event that Cobalt Video terminated the Purchase Agreement under

³⁷⁵ *Id.*

³⁷⁶ *Id.*

³⁷⁷ *Id.*

³⁷⁸ *Id.* at 39, ¶ 35.

³⁷⁹ *Id.*

³⁸⁰ *Id.* at 39, ¶ 36.

³⁸¹ *Id.* at 40, ¶ 37.

³⁸² *Id.* at 41, ¶ 39.

³⁸³ *Id.*

³⁸⁴ *Id.* at 43, ¶ 43.

certain circumstances.³⁸⁵ Blockbuster justified the Expense Reimbursement provision as necessary to induce Cobalt Video to purchase the assets.³⁸⁶ Without the Expense Reimbursement, Blockbuster argued that Cobalt Video would not commit to purchasing the assets, which would be fatal to the estate.³⁸⁷ Accordingly, Blockbuster sought to make the Expense Reimbursement a superpriority claim in the proposed Purchase Agreement to induce the stalking horse bid.³⁸⁸ Thus, by alleging that Cobalt Video’s bid ensured a fair sale price, Blockbuster asserted that the prioritizing of the Expenses Reimbursement was necessary as well.³⁸⁹

e. Assumption and Assignment

In its motion to sell, Blockbuster sought to assume and assign certain contracts (“Designated Contracts”) to the successful bidder.³⁹⁰ The Purchase Agreement generally defined Designated Contracts as “executory contracts and unexpired leases that the Successful Bidder has designated it wants to assume.”³⁹¹ If a court finds that a debtor exercised sound business judgment in determining whether to assume an executory contract or unexpired lease, then the court should approve the assumption under § 365 of the Bankruptcy Code.³⁹² Additionally, § 365(b)(1) requires adequate assurance that the assignee had the ability to promptly cure the defaults of the assigned contracts.³⁹³

Here, Blockbuster maintained that the combination of the procedures defined by the Plan Agreement and the sale hearing provided the necessary assurance for the court to approve the assumption and assignment of contracts.³⁹⁴ Specifically, the sale hearing provided the court and

³⁸⁵ *Id.* at 42, ¶ 42.

³⁸⁶ *Id.* at 43, ¶ 43.

³⁸⁷ *Id.*

³⁸⁸ *Id.* at 42, ¶ 41.

³⁸⁹ *Id.*

³⁹⁰ *Id.* at 44, ¶ 45.

³⁹¹ *Id.* at 44, ¶ 45.

³⁹² *Id.*

³⁹³ *Id.* at 45, ¶ 46.

³⁹⁴ *Id.* at 45-46, ¶ 47.

other interested parties the opportunity to evaluate the ability of the Successful Bidder.³⁹⁵ If the successful bidder demonstrated sufficient financial health and resources during the hearing, then the court and other interested parties were assured that the successful bidder met the obligations of the assumed contracts.³⁹⁶ Blockbuster needed the court to approve these procedures because the assumption and assignment of the contracts would expedite the sale.³⁹⁷

f. Administrative Relief Requested

Along with seeking approval of the proposed Purchase Agreement and the sale procedures, Blockbuster sought administrative relief from the court.³⁹⁸ Specifically, it moved the court to prioritize all administrative expenses connected with § 363 sale and enjoin any collection efforts with respect to administrative expenses that occurred between the petition date of September 23, 2010 and February 24, 2011.³⁹⁹

Blockbuster first referred to § 364(c)(1) of the Bankruptcy Code as the legal basis for its relief.⁴⁰⁰ In particular, this section empowers a court to give priority to a particular debt or credit over other administrative expenses when a debtor in possession is unable to procure unsecured credit.⁴⁰¹ Additionally, § 105(a) of the Bankruptcy Code allows a court to issue any order, process, or judgment that is necessary to carry out the provisions under Chapter 11, including § 364(c)(1).⁴⁰²

In persuading the court to grant administrative relief, Blockbuster maintained that the § 363 sale was the only viable option, and therefore, the court should move in a direction that best serves the sale process.⁴⁰³ In explaining how the administrative relief best served the § 363 sale, Blockbuster alleged that such relief provides assurance to parties who supply goods and services

³⁹⁵ *Id.*

³⁹⁶ *Id.*

³⁹⁷ *Id.* at 44.

³⁹⁸ *Id.* at 49-54, ¶ 55-62.

³⁹⁹ *Id.*

⁴⁰⁰ *Id.* at 49, ¶ 55.

⁴⁰¹ *Id.* at 49, ¶ 55.

⁴⁰² *Id.* at 49-50, ¶ 55.

⁴⁰³ *Id.* at 52-54, ¶ 59-61.

to it, which maintained the value of the company for the sale.⁴⁰⁴ In particular, Blockbuster quoted that such relief was “essential to ensure creditors—such as movie studios, game providers, maintenance and janitorial service providers, landlords, utilities, and employees—are not further prejudiced on account of their extension of unsecured credit during the Sale Process Period.”⁴⁰⁵ Thus, the administrative relief allowed Blockbuster to continue paying employee salaries, professional fees, medical and workers’ compensation coverage premiums, certain customer obligations, and other essential costs and expenses during the sale process.⁴⁰⁶

g. Creditors Object to the Proposed Purchase Agreement

After filing its motion to sell its assets, Blockbuster faced objections from over 40 creditors, including major Hollywood movie studios and unsecured creditors.⁴⁰⁷ Even the United States Trustee filed an objection to the proposed purchase agreement.⁴⁰⁸ The common theme among the objections was that the sale agreement was highly unfavorable and discriminated among the administrative expenses.⁴⁰⁹ Accordingly, some of the creditors, including the United States Trustee, moved the court to convert the case to a Chapter 7 case.⁴¹⁰

In particular, counsel representing U.S. Trustee Tracy Hope Davis, described the Blockbuster’s efforts as a plan to “effectively impose a ‘virtual Chapter 7 within the Chapter 11 case[] that... will allow [the Senior Secured Noteholders] to improperly discriminate among the administrative expenses while retaining control over their efforts to maximize their recovery and minimize their expenses.”⁴¹¹ Moreover, the U.S. Trustee’s counsel maintained that Blockbuster and secured lenders appeared to be the only real beneficiaries of the proposed sale agreement.⁴¹²

⁴⁰⁴ *Id.* at 50, ¶ 57.

⁴⁰⁵ *Id.* at 53, ¶ 60.

⁴⁰⁶ *Id.* at 52, ¶ 58.

⁴⁰⁷ Azam Ahmed, *Bankruptcy Judge Approves Sale of Blockbuster*, NEW YORK TIMES (Mar. 10, 2011 8:14 PM), <http://dealbook.nytimes.com/2011/03/10/bankruptcy-judge-approves-sale-of-blockbuster/>.

⁴⁰⁸ *Id.*

⁴⁰⁹ *Id.*

⁴¹⁰ *Id.*

⁴¹¹ OBJECTION OF THE UNITED STATES TRUSTEE TO ORDER AUTHORIZING THE INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, *In re* Blockbuster Case No. 10-14997 (S.D.N.Y. March 2, 2011) at 9, ¶24. (No. 986).

⁴¹² *Id.* at 10, ¶ 27.

The numbers appear to validate the U.S. Trustee's assertions. The stalking horse bid ranged from \$265 million to \$290 million, yet the secured lenders held a combined secured claim of about \$630 million.⁴¹³ Hence, any competing bid would be very unlikely to pay off the Secured Lenders.⁴¹⁴ In supporting the request for the case to convert to Chapter 7, the U.S. Trustee's counsel highlighted how Blockbuster abandoned any meaningful reorganization activity, instead reducing the estate through the incurring of administrative expenses.⁴¹⁵ The Bankruptcy Code, under 11 U.S.C. § 1112(b), gives a court the power to convert a Chapter 11 proceeding to a Chapter 7 case if the movant establishes cause.⁴¹⁶ Here, the U.S. Trustee tried to establish cause under § 1112(b) by referring to the Senior Secured Noteholder's efforts in diminishing the estate.⁴¹⁷

Walt Disney Company ("Disney") raised a similar argument in its objection, maintaining that the Senior Secured Noteholders had dictated sale terms beneficial to themselves, while running up administrative expenses that were deteriorating the Debtor's estate.⁴¹⁸ Additionally, Disney criticized the proposed bid procedures, which it claimed were configured to enhance recoveries for the Senior Secured Noteholders.⁴¹⁹ Disney moved the court to modify the agreement to give administrative claims from creditors outside the Senior Secured Noteholders more priority.⁴²⁰

⁴¹³ *Id.*

⁴¹⁴ *Id.*

⁴¹⁵ *Id.* at 12, ¶ 34.

⁴¹⁶ *Id.* at 12, ¶ 32.

⁴¹⁷ *Id.*

⁴¹⁸ OBJECTION OF THE WALT DISNEY COMPANY TO DEBTORS' MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re* Blockbuster, No. 10-14997 (S.D.N.Y. Feb. 28, 2011) at 2. (No. 1001).

⁴¹⁹ *Id.* at 3.

⁴²⁰ *Id.* at 4.

Disney was just one of many creditors holding substantial administrative claims against Blockbuster.⁴²¹ However, Blockbuster’s request to bifurcate the administrative claims would prevent creditors, such as Disney, from obtaining payment of their claims.⁴²² Thus, Disney asserted that the proposed sale created “a large group of priority creditors who will have first claim on the few scraps left after the sale.”⁴²³ This left the court to decide whether it was “appropriate for bankruptcy courts to facilitate a sale that benefits nobody except the senior lenders.”⁴²⁴

In essence, several creditors outside the Senior Secured Noteholders and the United States Trustee criticized the proposed Purchase Agreement for “hijacking” the Chapter 11 case.⁴²⁵ A § 363 sale enables secured creditors to avoid the “lengthy process of negotiating, proposing confirming, and consummating a plan of reorganization—not to mention the potential for more pervasive scrutiny of transaction at multiple junctures by the court, creditors, the United States Trustee, and other parties present.”⁴²⁶ Because all transferred assets in a § 363 sale are free and clear of all interests and claims, the sale turns into a “federal unified foreclosure process orchestrated by secured creditors who are assisted by insiders of the debtor and the insolvency community.”⁴²⁷

Here, the Senior Secured Noteholders attempted to avoid the lengthy process of confirming a Chapter 11 plan by proposing a sale that would basically only benefit themselves. The Senior Secured Noteholders could not “hijack” the case without help from Blockbuster’s counsel, Weil Gotshal. At the risk of sounding cynical, Weil Gotshal also would receive guaranteed payment from the § 363 sale through the Carve-out Expenses, which were given first

⁴²¹

Ahmed, *supra* note 407.

⁴²² OBJECTION OF THE UNITED STATES TRUSTEE TO ORDER AUTHORIZING THE INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, *In re* Blockbuster Case No. 10-14997 (S.D.N.Y. March 2, 2011) at 12, ¶ 13. (No. 986).

⁴²³ Stephen J. Lubben, *Blockbuster and the Pushback by Unsecured Creditors*, NEW YORK TIMES (Mar. 11, 2011 10:57 AM) <http://dealbook.nytimes.com/2011/03/11/blockbuster-and-the-pushback-by-unsecured-creditors/>.

⁴²⁴ *Id.*

⁴²⁵ *See* Kuney, *supra* note 247.

⁴²⁶ *Id.* at 105.

⁴²⁷ *Id.* at 106.

priority in the allocation of proceeds.⁴²⁸ Unsurprisingly, over 40 creditors objected to such this proposal.⁴²⁹

In response to these objections, the Senior Noteholders asserted that their cash, and their cash alone, had kept Blockbuster alive.⁴³⁰ All the objections led to negotiations taking place on March 10, 2011.⁴³¹ From these negotiations, the parties amended the allocation of proceeds, giving more money upfront to trade creditors and large studios.⁴³²

h. Court's Approval of Motion for Sale of Property

Following this series of events, on March 17, 2011, the court granted Blockbuster's motion to sell the property.⁴³³ Specifically, the court first approved the bid procedures and the Expense Reimbursement.⁴³⁴ It noted that the Expense Reimbursement was necessary to preserve the estate and, in light of the size and nature of the sale, was reasonable.⁴³⁵ As a result, the Expense Reimbursement survived the termination of the stalking horse bid and constituted a superpriority administrative claim against the estate pursuant to § 364(1) of the Bankruptcy Code.⁴³⁶ The court also approved the assumption and assignment of the Designated Contracts.⁴³⁷

⁴²⁸ DEBTOR'S MOTION, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, AND FED. R. BANKR. P. 2002, 4001, 6004, 6006, 9008, AND 9014, FOR ENTRY OF: (I) AN ORDER APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION, AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY; AND (II) AN ORDER APPROVING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS, *In re Blockbuster, Inc.* at 13-14. (No. 947).

⁴²⁹ Ahmed, *supra* note 407.

⁴³⁰ Lubben, *supra* note 423.

⁴³¹ Ahmed, *supra* note 407.

⁴³² *Id.*

⁴³³ ORDER, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, 365 AND 503 FED. B. BANKR. P. 2002, 4001, 6004, 6006, 9008, 9014, AND 9019 APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY, *In re Blockbuster, Inc.*, Case No. 10-14997 (S.D.N.Y. Mar. 17, 2011) at 4. (No. 1336).

⁴³⁴ *Id.* at 4, 6-7.

⁴³⁵ *Id.* at 3.

⁴³⁶ *Id.* at 7.

Additionally, the court set the auction to take place on April 4, 2011 at 10:00 a.m., at the United States Bankruptcy Court for the Southern District of New York.⁴³⁸ Lastly, the court set March 31, 2011 as a deadline for all objections to the sale and scheduled a sale hearing the day after the auction to approve the successful bidders.⁴³⁹

Although the court approved the bid procedures and Expense Reimbursement, the original order for the allocation of proceeds had changed due to the objections from creditors.⁴⁴⁰ As mentioned earlier, movie studios argued that the terms of the sale were highly unfavorable to creditors outside the Senior Secured Noteholders.⁴⁴¹ On March 10, 2011, the studios and bondholders reached agreement altering the original allocations of proceeds.⁴⁴²

As a result, the Purchase Agreement granted the studios and other creditors more money upfront for what they were owed in addition to receiving a share of any offer exceeding the \$290 million bid.⁴⁴³ Specifically, the Purchase Agreement listed particular studios that received 50% of its aggregate liabilities owed.⁴⁴⁴ These studios included Twentieth Century Fox Home Entertainment LLC, Sony Pictures Home Entertainment Inc., Warner Home Video, a Division of Warner Bros. Home Entertainment Inc., Paramount Home Entertainment Inc., Universal Studios Home Entertainment LLC, The Walt Disney Company, and Summit Entertainment LLC.⁴⁴⁵ Furthermore, the Purchase Agreement capped the wind down expenses at \$12.5 million.⁴⁴⁶ Additionally, unsecured lenders could receive up to \$7.5 million of the estimated \$40 million

⁴³⁷ *Id.* at 8.

⁴³⁸ *Id.* at 4.

⁴³⁹ *Id.* at 5.

⁴⁴⁰ Ahmed, *supra* note 407.

⁴⁴¹ *Id.*

⁴⁴² *Id.*

⁴⁴³ *Id.*

⁴⁴⁴ ORDER, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, 365 AND 503 FED. B. BANKR. P. 2002, 4001, 6004, 6006, 9008, 9014, AND 9019 APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY, *In re* Blockbuster, Inc., Case No. 10-14997 (S.D.N.Y. Mar. 17, 2011) at 10, ¶ 16. (No. 1336).

⁴⁴⁵ *Id.* at 11, ¶ 16 n.5.

⁴⁴⁶ *Id.* at 11, ¶ 16.

owed to them.⁴⁴⁷ In the end, the court approved a Purchase Agreement that added four more priority stages to the original proposal, creating a total of twelve priority stages regarding the distribution of proceeds.⁴⁴⁸

The court also approved the administrative relief requested by Blockbuster.⁴⁴⁹ Consequently, it did not have to make any payment with respect to any administrative costs or expenses occurring from the commencement date of Chapter 11 through February 24, 2011.⁴⁵⁰ Moreover, no holder of a pre-sale period administrative claim could take any action until June 21, 2011 to collect such claim.⁴⁵¹ By approving the bid procedures and auction date and issuing administrative relief, the court set the stage for the ultimate sale of Blockbuster's assets and bring an end to the bankruptcy proceedings.

i. Dish Declared Winning Bidder after Auction

In accordance with the court order, Blockbuster conducted the auction from April 4, 2011 to April 6, 2011.⁴⁵² In the end, Dish Network Corp. ("Dish") was declared the successful bidder with a \$320 million bid.⁴⁵³ After price adjustments, acquiring Blockbuster's assets cost Dish roughly \$228 million in cash.⁴⁵⁴ Creditors of Blockbuster received about \$178.8 million from

⁴⁴⁷ Ahmed, *supra* note 407.

⁴⁴⁸ ORDER, PURSUANT TO 11 U.S.C. §§ 105, 363, 364, 365 AND 503 FED. B. BANKR. P. 2002, 4001, 6004, 6006, 9008, 9014, AND 9019 APPROVING (A) BID PROCEDURES, (B) STALKING HORSE EXPENSE REIMBURSEMENT, (C) NOTICE OF SALE, AUCTION AND SALE HEARING, (D) ASSUMPTION PROCEDURES AND RELATED NOTICES, (E) INCURRENCE OF SALE-RELATED ADMINISTRATIVE PRIORITY CLAIMS, AND (F) IMPOSITION OF AN ADMINISTRATIVE STAY, *In re* Blockbuster, Inc. at 10, ¶ 16. (No. 1336).

⁴⁴⁹ *Id.* at 13-17.

⁴⁵⁰ *Id.* at 13.

⁴⁵¹ *Id.*

⁴⁵² DEBTOR'S EMERGENCY MOTION, PURSUANT TO 11 U.S.C. §§ 105 AND 363 AND FED. R. BANKR. P. 2002, 4001, 6004, AND 9014, FOR ENTRY OF A SUPPLEMENTAL ORDER APPROVING AMENDED AND RESTATED ASSET PURCHASE AND SALE AGREEMENT BY AND AMONG BLOCKBUSTER, INC., THE DEBTOR SUBSIDIARIES PARTY THERETO, AND DISH NETWORK CORP., *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. April 21, 2011) at 3, ¶ 5. (No. 1692).

⁴⁵³ *Id.*

⁴⁵⁴ Hals, Tom & Baker, Liana, *Dish expands its scope with Blockbuster win*, REUTERS (April 6, 2011 5:39 PM) <http://www.reuters.com/article/2011/04/06/us-blockbuster-dishnetworkidUSTRE7351VA20110406>.

Dish's bid, with the remainder covering the expenses of the auction and other bankruptcy fees.⁴⁵⁵ Dish defeated the stalking horse bid, Cobalt Video.⁴⁵⁶ The next day, April 7, 2011, the court held a hearing to consider the sale motion and the outcome of the auction.⁴⁵⁷ During the sale hearing, Blockbuster produced the original Purchase Agreement, which Dish agreed to purchase subject to court approval. (What does this mean?) Dish targeted a closing date of April 21, 2011.

Although the original Purchase Agreement allowed certain executory or unexpired real property leases, known as the Designated Contracts, to be assumed and assigned to the Purchaser, Blockbuster did not seek the assumption and assignment of any contracts to Dish at the sale hearing.⁴⁵⁸ It explained its failure to assign contracts by noting the expedited timeframe and the multitude of objections filed as to proposed cure amounts and adequate assurance of future performance.⁴⁵⁹ Immediately thereafter, Blockbuster consulted with the Creditors' Committee and counsel for the objecting counterparties.⁴⁶⁰ Following these negotiations, Blockbuster agreed to enter into a revised sale order with Dish.⁴⁶¹

The court examined this revised sale order at a hearing on April 14, 2011.⁴⁶² At this hearing, the court approved the sale order, which ratified the original Purchase Agreement and authorized the parties to consummate the sale.⁴⁶³ The court order contained many findings of fact that were significant in closing the sale.⁴⁶⁴ First, it found that the auction was conducted in

⁴⁵⁵Ryan Lawler, *So Why Did Dish Really Buy Blockbuster?*, GIGAOM (Apr. 6, 2011 6:33 PM), <http://gigaom.com/2011/04/06/dish-blockbuster-acquisition/>.

⁴⁵⁶Mae Anderson, *Dish Network acquiring Blockbuster for \$228M*, HUFFINGTON POST (April 6, 2011 5:24 PM) http://www.huffingtonpost.com/2011/04/06/dish-network-acquiring-bl_n_845602.html.

⁴⁵⁷DEBTOR'S EMERGENCY MOTION, PURSUANT TO 11 U.S.C. §§ 105 AND 363 AND FED. R. BANKR. P. 2002, 4001, 6004, AND 9014, FOR ENTRY OF A SUPPLEMENTAL ORDER APPROVING AMENDED AND RESTATED ASSET PURCHASE AND SALE AGREEMENT BY AND AMONG BLOCKBUSTER, INC., THE DEBTOR SUBSIDIARIES PARTY THERETO, AND DISH NETWORK CORP., *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. April 21, 2011) at 3, ¶ 5. (No. 1692).

⁴⁵⁸*Id.* at 4, ¶ 7.

⁴⁵⁹*Id.*

⁴⁶⁰*Id.*

⁴⁶¹*Id.*

⁴⁶²*Id.* at 5, ¶ 8.

⁴⁶³*Id.*

good faith, as the parties received sufficient notice and a reasonable opportunity to object.⁴⁶⁵ Second, the court found the Purchase Agreement and any related agreement to be in good faith and from arm's-length position.⁴⁶⁶ Third, it found that neither the Dish nor its affiliates were an "insider" of any of the Blockbuster companies pursuant to § 101(31) of the Bankruptcy Code.⁴⁶⁷

Therefore, under this analysis, the court found Dish to be a good faith purchaser.⁴⁶⁸ As a good faith purchaser, Dish was entitled to all of the benefits and protections of § 363(m) of the Bankruptcy Code.⁴⁶⁹ Additionally, the court found that Blockbuster possessed full corporate authority to execute the Purchase Agreement and that consideration for the sale was reasonable.⁴⁷⁰ Furthermore, Blockbuster demonstrated both sound business purposes and compelling circumstances to justify the fact that the transaction was outside the ordinary course of business.⁴⁷¹ Most importantly, the court held that the transfer of assets vested Dish with "all right, title, and interest of the Debtors to the Assets free and clear of all Liens," and satisfied the standards set forth in § 363(f) of the Bankruptcy code.⁴⁷²

Even though the court approved the sale order, it still required Dish to provide the schedule of executory contracts and unexpired leases that it would assume and assign by no later than April 18, 2011.⁴⁷³ The court chose this date to accommodate the target closing date of April

⁴⁶⁴ ORDER, PURUSANT TO 11 U.S.C. §§ 105(A), 363, AND 365 AND FED. R. BANKR. P. 2002, 6004, 6006 AND 9014 AUTHORIZING AND APPROVING (A) THE SALE OF DEBTORS' ASSETS FREE AND CLEAR OF INTERESTS AND (B) PROCEDURES FOR THE ASSUMPTION AND ASSIGNMENT OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES TO THE PURCHASER, *In re* Blockbuster, No. 10-14997 (S.D.N.Y. Apr. 14, 2011). at 3. (No. 1602).

⁴⁶⁵ *Id.*

⁴⁶⁶ *Id.* at 5.

⁴⁶⁷ *Id.* at 6.

⁴⁶⁸ *Id.*

⁴⁶⁹ *Id.*

⁴⁷⁰ *Id.*

⁴⁷¹ *Id.* at 7.

⁴⁷² *Id.* at 7-8.

⁴⁷³ DEBTOR'S EMERGENCY MOTION, PURSUANT TO 11 U.S.C. §§ 105 AND 363 AND FED. R. BANKR. P. 2002, 4001, 6004, AND 9014, FOR ENTRY OF A SUPPLEMENTAL ORDER APPROVING AMENDED AND RESTATED ASSET PURCHASE AND SALE AGREEMENT BY AND AMONG BLOCKBUSTER, INC., THE DEBTOR SUBSIDIARIES PARTY THERETO, AND DISH NETWORK CORP., *In re* Blockbuster, Inc. at 5, ¶ 8. (No. 1692).

21, 2011.⁴⁷⁴ Shortly after the hearing on April 14, 2011, Dish informed Blockbuster that it did not have sufficient time to finalize its decision to designate the contracts, totaling an approximate 1,500 contracts.⁴⁷⁵ Consequently, Dish requested an amendment to the original Purchase Agreement that would extend the time to designate the assumed contracts through an additional post-closing period of 90 days.⁴⁷⁶ After negotiating with Dish, Blockbuster modified the assumption procedures set forth in sections 2.5 and 8.8 of the Purchase Agreement.⁴⁷⁷ Specifically, these modifications allowed Dish to assume executory agreements and lease agreements 90 days following the closing date.⁴⁷⁸ In return for this extended time, Dish covered all expenses and obligations relating to the pending contracts.⁴⁷⁹ Furthermore, Dish covered as much as \$4.9 million in professional fees and expenses and \$3.5 million in employee benefits in exchange for the extended 90 days.⁴⁸⁰

On April 21, 2011, the targeted closing date, Blockbuster filed a motion to extend Dish's time to designate which executory contracts and unexpired leases it wishes to maintain as part of the go-forward Blockbuster business.⁴⁸¹ The request for extended time was documented in sections 2.5 and 8.8 of the Modified Purchase Agreement.⁴⁸² Blockbuster emphasized Dish's pledge to cover all obligations from pending contracts to prove that no counterparty would be prejudiced by the modification.⁴⁸³

⁴⁷⁴ *Id.*

⁴⁷⁵ *Id.* at 5-6, ¶ 9.

⁴⁷⁶ *Id.*

⁴⁷⁷ *Id.*

⁴⁷⁸ *Id.* at 8, ¶ 11, n.7.

⁴⁷⁹ *Id.* at 12, ¶ 13.

⁴⁸⁰ Tiffany Kary, *Blockbuster Wins Bankruptcy Court's Final Approval to Sell Assets to Dish*, BLOOMBERG (Apr. 26, 2011 12:39 PM), <http://www.bloomberg.com/news/2011-04-26/blockbuster-wins-final-bankruptcy-court-approval-to-sell-assets-to-dish.html>.

⁴⁸¹ DEBTOR'S EMERGENCY MOTION, PURSUANT TO 11 U.S.C. §§ 105 AND 363 AND FED. R. BANKR. P. 2002, 4001, 6004, AND 9014, FOR ENTRY OF A SUPPLEMENTAL ORDER APPROVING AMENDED AND RESTATED ASSET PURCHASE AND SALE AGREEMENT BY AND AMONG BLOCKBUSTER, INC., THE DEBTOR SUBSIDIARIES PARTY THERETO, AND DISH NETWORK CORP., *In re* Blockbuster, Inc., No. 10-14997 (S.D.N.Y. April 21, 2011) at 12, ¶ 13. (No. 1692).

⁴⁸² *Id.* at 8, ¶ 11, n.7.

⁴⁸³ *Id.* at 12, ¶ 13.

The Senior Secured Noteholders objected to this motion.⁴⁸⁴ They argued that one revision, in particular, waived a \$3 million penalty for a delay in completing the sale.⁴⁸⁵ Lions Gate Films, Inc. also asserted that Dish and Blockbuster must honor a revenue-sharing agreement.⁴⁸⁶ A few days later, on April 26, 2011, the court granted Blockbuster's motion by approving the modified Purchase Agreement.⁴⁸⁷ As a result, the asset purchase agreement between Dish and Blockbuster officially closed, with Dish maintaining the ability to determine which contracts to assume after the closing date.

j. Why did Dish acquire Blockbuster?

Initially, Dish pursued the acquisition so that it could utilize the Blockbuster brand and physical locations for cross-sale opportunities.⁴⁸⁸ Soon after the auction closed, Tom Cullen, Executive Vice President of Sales for Dish, remarked that “[w]ith [Blockbuster’s] more than 1,700 store locations, a highly recognizable brand and multiple methods of delivery, Blockbuster will complement our existing video offerings while presenting cross-marketing and service extension opportunities for Dish Network.”⁴⁸⁹ Thus, evidence exists that Dish believed the acquisition gave it the ability to implement free or discounted Blockbuster rentals, adding value to its paid television subscribers.⁴⁹⁰

However, a large incentive existed for Dish in acquiring Blockbuster’s streaming rights to a number of video titles.⁴⁹¹ An acquisition of these rights could be used to expand Dish’s own streaming rights.⁴⁹² With \$3 billion of cash on hand, Dish could easily afford to purchase

⁴⁸⁴ Kary, *supra* note

⁴⁸⁵ 480. *Id.*

⁴⁸⁶ *Id.*

⁴⁸⁷ ORDER PURSUANT TO 11 U.S.C. §§ 105(A), 363 AND 365 AND FED. R. BANKR. P. 2002, 6004, 6006 AND 9014 AUTHORIZING AND APPROVING THE ASSUMPTION AND ASSIGNMENT OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES TO THE ASSIGNEE, *In re* Blockbuster, Inc., Case No. 10-14997 (S.D.N.Y. Apr. 26, 2011) (No. 1849).

⁴⁸⁸ Lawler, *supra* note 455.

⁴⁸⁹ *Id.*

⁴⁹⁰ *Id.*

⁴⁹¹ *Id.*

⁴⁹² *Id.*

Blockbuster.⁴⁹³ Thus, the Blockbuster acquisition made Dish a more viable competitor in streaming videos online at a reasonable expense.⁴⁹⁴ The acquisition also made sense in light of Dish's acquisition of satellite provider DBSD North America.⁴⁹⁵ However, Dish did not act quickly to make these synergies payoff.⁴⁹⁶ Even after acquiring more streaming rights, Dish faced stiff competition from old Blockbuster foes Hulu and Netflix.⁴⁹⁷

V. What's Next for Blockbuster?

Almost a year after Blockbuster declared bankruptcy, Dish announced Blockbuster Movie Pass to compete with services like Netflix and Hulu.⁴⁹⁸ In Blockbuster Movie Pass, Dish offered customers access to by mail, streaming, and television access in one bundle.⁴⁹⁹ This package appeared similar to the one Blockbuster planned to offer, with the addition of television service. The service originally cost \$10 a month, but was free for customers of Dish's \$39.99 monthly package.⁵⁰⁰

Dish's Blockbuster package sought to consolidate services to offer one product. Dish projected that it could offer more shows and movies than competitors Comcast, DirectTV, Netflix, and Qwickster.⁵⁰¹ These shows could be accessed via live television or streaming

⁴⁹³ Anderson, *supra* note 456.

⁴⁹⁴ *Id.*

⁴⁹⁵ *Id.*

⁴⁹⁶ Lawler, *supra* note 455.

⁴⁹⁷ Anderson, *supra* note 456.

⁴⁹⁸ Richard Lawler, *Dish Network, Blockbuster unveil Blockbuster Movie Pass all-inclusive entertainment service*, ENGADGET, (Sep. 23, 2011), <http://www.engadget.com/2011/09/23/dish-network-blockbuster-unveil-blockbuster-movie-pass-all-incl/>.

⁴⁹⁹ *Id.*

⁵⁰⁰ *Dish Unveils Blockbuster Movie Pass – Are You Sweating Yet, Netflix?* THE WRAP, <http://www.thewrap.com/movies/article/dish-unveils-blockbuster-streaming-are-you-sweating-netflix-31260>.

⁵⁰¹ David Daw, *DISH, Blockbuster Announce \$10/Month Alternative to Netflix*, PCWORLD, (Sep. 23, 2010), http://www.pcworld.com/article/240493/dish_blockbuster_announce_10_month_alternative_to_netflix.html.

media.⁵⁰² Additionally, customers were offered the ability to exchange DVDs and games at Blockbuster locations.⁵⁰³

However, betting on a platform including brick-and-mortar stores would once again prove costly. The Blockbuster Movie Pass program failed, with Dish abandoning it in October 2012.⁵⁰⁴ At this time, Dish scrapped plans to use Blockbuster as a nationwide streaming or mail service.⁵⁰⁵ The program evolved into a similar program, Blockbuster @Home.⁵⁰⁶

While Dish spokesman John Hall claimed that the company is looking to leverage its existing stores with television and streaming services, it continues to “evaluate each store on a case-by-case basis for its profitability and future potential.”⁵⁰⁷ Since acquiring Blockbuster in 2011, Dish has closed more than 2/3 of 1,700 stores it inherited.⁵⁰⁸ These closures resulted in the layoff of almost 40% of Blockbuster’s work force.⁵⁰⁹

Analysts doubt Dish’s interest in utilizing the brick-and-mortar stores. According to Charlie Moffat of Sanford C. Bernstein, “[i]t seems like whatever [Dish Chairman Charlie Ergen] had in mind for Blockbuster originally, it’s not that now, and it doesn’t seem like it’s getting a whole lot of corporate attention anymore.”⁵¹⁰ Perhaps some of the reason for the skepticism involves the limited risk Dish faced in acquiring Blockbuster.

Upon its acquisition by Dish, Blockbuster had around \$100 million in cash.⁵¹¹ A complete sale of the 1,700 stores was projected to net \$300 million.⁵¹² This combined amount

⁵⁰² *Id.*

⁵⁰³ *Id.*

⁵⁰⁴ Alex Sherman, *Blockbuster Hits Rewind on Plan to Return as Netflix Killer*, BLOOMBERG, (Oct. 5, 2012) <http://www.bloomberg.com/news/2012-10-04/dish-s-ergen-scraps-blockbuster-plans-after-wireless-delays.html>.

⁵⁰⁵ *Id.*

⁵⁰⁶ *Id.*

⁵⁰⁷ *Id.*

⁵⁰⁸ Shalini Ramachadran, *Dish to Shut 300 Blockbuster Sites; 3,000 Layoffs Loom*, WALL STREET JOURNAL, <http://online.wsj.com/article/SB10001424127887323940004578258143905519364.html>.

⁵⁰⁹ *Id.*

⁵¹⁰ *Id.*

⁵¹¹ Sherman, *supra* note 504.

could have netted Dish a profit, without using the brand for anything, according to Dish CEO Charlie Ergen.⁵¹³

With this information in mind, it is hard to predict the future of the Blockbuster brand. Dish could continue to move forward in utilizing Blockbuster as a streaming service or let the brand die altogether. As Ergen states, “[w]orst case, we’ll take our money after having wasted some time [on Blockbuster], not much money, and life goes on.”⁵¹⁴

⁵¹² *Id.*

⁵¹³ *Id.*

⁵¹⁴ *Id.*

Appendix A



Demise of Blockbuster

Todd Davis
John Higgins

Introduction

- I. Background Information
- II. Chapter 11
 1. The Plan
 2. The Petition
 3. DIP Financing
- III. § 363 Sale Process
 1. Proposed Purchase Agreement
 2. Court Approves Sale
 3. Dish is Winning Bidder
- IV. What's Next for Blockbuster

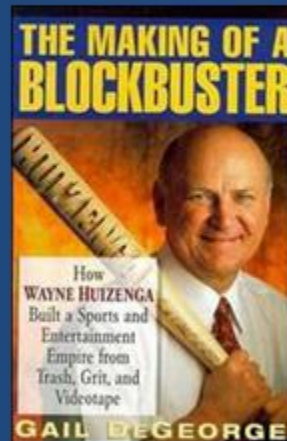
History

- Founded in 1985 by David Cook
- Tracked inventory using computers



Blockbuster Goes National

- Wayne Huizenga purchases in 1987
- One product business
- Sold to Viacom, 7 years later, for \$8.4 billion



Competition

- Subscription services
 - Netflix, Redbox
- Failed acquisition of Hollywood Video



Business Model

- “brick and mortar” plus
- 28-day window



The “plus”

- Kiosks
- By-mail
- Digital



Events Leading to Ch. 11

- Underestimating rise of new media
- Economic downturn



Last-ditch Efforts

- 2009
 - Slashed administrative expenses
 - Closed unprofitable stores
 - Two refinancing transactions

“The Plan”

- Use existing Senior Noteholders as DIP lenders
- Projected to reduce debt from \$1B to \$100M



Petition

- Filed September 23, 2010, S.D.N.Y.



Ch. 11 Plan Abandoned

- Why?
 1. Business Operations Continued to Struggle
 2. Blockbuster couldn't reach consensus with DIP lenders for a long-term business plan
 3. Blockbuster defaulted on DIP Financing Agreement



- **Feb. 21, 2011:** Motion for § 363 Sale and Administrative Relief

§ 363 Sale Terms

FOR SALE!

- **Purchase Price:** \$265 to \$290 Million
- **Acquisition:** Blockbuster's Assets, free & clear of all liens & claims
- **Stalking Horse Bidder:** Cobalt Video Holdco, LLC (Group from Senior Secured Noteholders)
- **Unique Aspects:**
 - Stop honoring outstanding Gift cards
 - No obligation to continue the business
 - Purchaser has right to convert to Chapter 7 case under special circumstances

Sound Business Justification

- Sound Business Justification needed because the sale was outside ordinary course of business:
 - Sale Process critical to preserve and maximize Blockbuster value
 - No other reasonable alternative b/c DIP Lenders declined to provide any more financing



Administrative Relief Requested

- Blockbuster asked to bifurcate the Administrative Expenses:
 1. Admin. Exp. from Commencement to § 363 Motion
 2. Admin Exp. After § 363 Motion
- Enjoin any Claimants from demanding payments till June, 2011
- Why? To Maintain Value of Sale



Objections to Purchase Agreement

- Over 40 creditors objected to Proposed Purchase Agreement
- Why? The Sale only benefits Senior Secured Noteholders
- Senior Secured Noteholders had up to \$630 Mil. in Claims
- Sale would only cover \$290 Mil., leaving nothing for other creditors



Approval of Amended Purchase Agreement

- **Mar. 17, 2011:** Court Approves Sale Order but amends Allocation of Proceeds
- Amendment gives more money to trade creditors and large studios upfront
- Court grants Administrative Relief
- **Auction Date:** April 4, 2011 at S.D.N.Y.



Original Allocation of Proceeds

1. Money for Carve-out Expenses
2. DIP Agent/Senior Indenture Trustee
3. Wind Down Expenses
4. \$20 Mil. For Critical Expenses
5. Amount due under DIP Credit Agreement
6. Outstanding Admin. Expenses
7. Roll-Up Notes
8. Sellers

vs.

Amended Allocation of Proceeds

1. Money for Carve-out Expenses
2. DIP Agent/Senior Indenture Trustee
3. Amount Due under DIP Agreement (other than Roll-up)
4. \$12.5 Mil. for Wind Down Expenses
5. Escrow Account
6. \$10 Mil. for Critical Expenses
7. Specified Studios (50% of owed liabilities)
8. \$3 Mil. to Specified Studios
9. Outstanding Admin. Expenses
10. Roll-Up Notes
11. \$4 Mil. To Admin. Account
12. Number of Priorities

Dish Network Declared Winning Bidder

- **April 6, 2011:** Court declares Dish the Winner
- **Bid Price:** \$320 Mil.
- However, only had to pay \$228 million after price adjustments
- **Closing Date:** April 21, 2011



Dish Revised the Sale Order

- **April 14, 2011:** Court found Dish to be good faith purchaser and held the vested assets to be free and clear of all liens and claims
- Dish revised Assumption Procedures of APA to give them more time to determine which contracts/leases to assume from Blockbuster
- **April 21, 2011:** Debtors filed motion to extend Dish time to chose assumed contracts/leases

Sale Process Concludes

- **April 26, 2011:** Court gave final approval of the revised APA, officially closing the sale process
- Dish still has additional 90 days to determine which contracts/leases to assume
- In return, Dish agreed to pay \$4.9 Mil. in Professional Fees and \$3.5 Mil. in Employment Benefits



What's Next?

- Blockbuster Movie Pass
- Further store closings
- Uncertain future

	dish	Comcast	DishTV	Netflix	Qwikster
Total number of movies and TV shows	116,000+*	53,600*	4,500*	31,700*	100,000+**
Free Returns included at no additional cost	DVDs and Blu-ray*	X	X	X	DVDs (charges for shipping)*
Games	✓	X	X	X	Some TBD, charges TBD
In-store exchanges (same-day?)	✓	X	X	X	X
On Demand streaming to TV and PC	34,000*	90,000	4,500	31,700	X

*Based on current offerings. **Based on current offerings. ©2011 Dish Network. All rights reserved. Blockbuster and Qwikster are trademarks of Blockbuster Inc. and Qwikster Inc. respectively. All other trademarks are the property of their respective owners.