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### Borders Group, Inc.'s Final Chapter: How A Bookstore Giant Failed In The Digital Age

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# **Borders Group, Inc.'s Final Chapter: How A Bookstore Giant Failed In The Digital Age**

By: Will Hooper and Mary Katherine Rawls

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## **A. Introduction**

In 1995, Borders Group, Inc. was the second largest bookstore in America, boasting massive superstores that housed more titles of books, DVDs, and videos than any of its competitors. Despite its early strength and success, a series of unfortunate business decisions and a general failure to keep up with the times sent Borders spiraling down a path to financial ruin. This paper documents the birth, rapid growth, and eventual downfall of Borders Bookstores through the lens of its Chapter 11 Bankruptcy.

## **B. Background**

### **I. *Early Success in Ann Arbor***

The beginning of Borders Bookstores can be traced back to 1971, when brothers Thomas and Louis Borders opened their first bookstore in Ann Arbor, Michigan. Ann Arbor, which was the home of the University of Michigan, was one of the “best-read cities in America” at the time,<sup>1</sup> and the brothers capitalized on this advantageous location by strategically stocking a large variety of titles according to their popularity amongst the college crowd.<sup>2</sup> The first store was an immediate success, and the brothers soon relocated to an innovative 10,000 square foot building that featured two stories.<sup>3</sup> The bookstore’s massive size was unheard of – as Benita “Be” Kaimowitz, a Borders employee in the seventies, described, “[w]e’re talking about 1974 . . . [t]here were no big bookstores.”<sup>4</sup>

Needing to manage their large inventory of books, the brothers developed an innovative inventory management system that could monitor sales trends and replenish specific titles as they were sold.<sup>5</sup> At first, the inventory management system was based on a card stock system, but the company eventually turned the system into a sophisticated computer software program.<sup>6</sup> This inventory management system was ahead of its time and contributed greatly to Borders’s success since it streamlined shelving costs and allowed Borders Group to offer a wider variety of titles at much lower costs than its rivals.<sup>7</sup> Additionally, the computer software was so effective that

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<sup>1</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>2</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>3</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>4</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>5</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>6</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

Borders eventually formed the company “Book Inventory Systems” to generate revenue by selling the system to other independent book vendors.<sup>8</sup>

Borders employees considered it a privilege to work for the store.<sup>9</sup> Interested candidates had to demonstrate a high level of literary knowledge by passing a qualifying test before landing a job with the company, and because of Borders’s selectivity, this was considered a prestigious honor.<sup>10</sup> Border’s early culture has been described as a collegial environment where “[e]verybody cleaned the store; everybody pitched in on customer service . . . [a]nd everyone took pride in their knowledge of literature, science, publishing, and well, knowledge.”<sup>11</sup> Joe Gable, a manager of the store whose goal was to “make the Ann Arbor Borders the best bookstore in America,” compared the store’s employees to Google search engines, recalling that, “there was a time when I could say out loud almost any Google-y type question, and someone within earshot would know the answer.”<sup>12</sup> Sharon Gambin, who worked for Borders for three decades, made the following remarks regarding working for Borders: “We worked when we didn’t have to work because we didn’t know we were working. We would go into the store when it was closed to do more work . . . That’s how much we loved what we did.”<sup>13</sup> The Ann Arbor community also adored the store that served as its “gathering place and community center, just up the street from the university’s main campus.”<sup>14</sup>

As business flourished, Borders grew ready to expand. Borders unleashed its first large “superstore” model bookstore in 1985 and subsequently opened five more throughout the Midwest.<sup>15</sup> The superstores were unlike any other bookstores of the time – they featured coffee bars and lounge areas to provide customers with unique in-store experiences that set Borders apart from its competitors. Between the new superstores and Business Inventory Systems,

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<sup>7</sup> Nathan Bomey, *Borders’ rise and fall: a timeline of the bookstore chain’s 40-year history*, THE ANN ARBOR NEWS, July 18, 2011.

<sup>8</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>9</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>10</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>11</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>12</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>13</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>14</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>15</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

Borders brought in sales of \$32.2 million and had a net income of \$1.9 million in 1988.<sup>16</sup> This success left Borders with the desire to drastically expand further, and in 1988 Borders hired Robert DiRomulado, a Harvard MBA and Drexel Institute of Technology graduate, to lead the company into becoming a national brand.<sup>17</sup>

Borders's aggressive expansion efforts proved successful. By 1992, Borders had quadrupled in size and was valued at approximately \$190 million,<sup>18</sup> and Borders was considered by many to be the prominent bookstore chain of the early nineties.<sup>19</sup>

## **II. A New Chapter For Borders: The Formation of Borders Group, Inc.**

Borders caught the attention of Kmart Corporation ("Kmart"), which wanted to expand its presence in the retail book industry. Kmart saw Borders as its opportunity, and acquired the superstore bookstore chain in 1992 for approximately \$125 million.<sup>20</sup> The Borders brothers did not stay on after the sale,<sup>21</sup> but the bookstore's success continued: in its first year as a wholly owned subsidiary of Kmart, Borders's sales were \$224.8 million – a 15.8% increase from 1992.<sup>22</sup>

Kmart paired Borders with Walden Books ("Walden"), Kmart's other wholly owned subsidiary bookstore chain, and named the siblings "Borders-Walden Group."<sup>23</sup> In 1994, there were approximately 44 Borders superstores in 22 states and the District of Columbia and 1,159

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<sup>16</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>17</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS. DiRomulado has been given most of the credit for Borders Group's successful move into the national market. *Id.*

<sup>18</sup> *Company News; Kmart to Purchase Borders Bookstores Chain*, N.Y. TIMES, Oct. 3, 1993.

<sup>19</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>20</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS. ; Shira Ovide, *Borders Bankruptcy: Everything You Need To Know*, THE WALL STREET JOURNAL, Feb. 11, 2011.

<sup>21</sup> Nathan Bomey, *Where are they now? Borders brothers long gone from Ann Arbor as chain nears bankruptcy*, Ann Arbor News, Feb. 14, 2011.

<sup>22</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>23</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

Walden mall-based bookstores in 50 states and the District of Columbia.<sup>24</sup> In this year, the overall sales for the Borders-Walden Group reached approximately \$1.5 billion.<sup>25</sup> The Borders-Walden merger has been criticized as being unsuccessful for distracting Borders Group from keeping pace with its competitors, such as Barnes & Noble, which at the time was experiencing significant growth.<sup>26</sup> The two siblings never successfully synergized mainly because Walden's business model differed significantly from Borders's – Walden bookstores were small mall-based stores whereas Borders's stores were large superstores.

Only two years after Kmart acquired Borders, Kmart spun off the Borders-Walden Group to form Borders Group, Inc. in August 1994.<sup>27</sup> DiRomulado reappeared to serve as Borders Group's CEO.<sup>28</sup> Under his direction, Borders Group had the highest sales-per-square-foot ratio in the industry in 1994, which was primarily due to its sophisticated computerized inventory system that allowed it to track customers' purchasing trends and quickly replenish its supply of popular titles.<sup>29</sup>

In May of 1995, Borders Group made its initial public offering of stock to finance the spin off from Kmart.<sup>30</sup> When the initial public offering consummated on June 1, 1995, Kmart's ownership interest in Borders Group had been reduced to 13%.<sup>31</sup> Borders Group thereafter eliminated Kmart's ownership interest on August 15, 1995 when it purchased and retired the remaining shares that Kmart owned.<sup>32</sup>

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<sup>24</sup> Kmart 1995 Form S-3

<sup>25</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>26</sup> Bob Minzesheimer and David Lieberman, *What happened to send Borders into Chapter 11?*, USA Today, Feb. 16, 2011.

<sup>27</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>28</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>29</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>30</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>31</sup> Borders Group Inc.'s 1997 Form 10-K. Borders Group, Inc. paid its proceeds from the IPO to Kmart and Kmart also sold some shares. *Id.* Borders Group paid 13.50 per share, or 72.8 million for 5.39 million shares in August of 1995. *Id.*

<sup>32</sup> Borders Group Inc.'s 1997 Form 10-K.

### III. *The Plot of Fatal Mistakes: More Stores and More DVDs, CDs, and Hard Copies . . .*

At the time of its initial public offering in 1995, Borders Group was the second largest operator of book superstores as well as the largest operator of mall-based bookstores in America.<sup>33</sup> In that year, Borders Group unleashed another aggressive expansion strategy, pursuant to which it opened 41 Borders book and music superstores and also announced plans to open 80 more superstores during 1996 and 1997.<sup>34</sup> Borders Group's growth exceeded this plan, however; it also opened 52 new superstores from January 1998 to 1999.<sup>35</sup> The bookstores' large sizes were a competitive advantage for Borders Group in the nineties when hard copy books were still in demand.<sup>36</sup> Competitors could not afford to stock even "a fraction" of the thousands of titles Borders Group's superstores housed.<sup>37</sup>

In the mid-nineties, while all of its competitors were "going digital,"<sup>38</sup> Borders Group turned to selling more pre-recorded music and DVDs.<sup>39</sup> In fact, Borders Group actually acquired several CD Superstores, including Planet Music, Inc., to solidify its presence in this market.<sup>40</sup> Moreover, it significantly remodeled its bookstores to feature prerecorded music and DVDs.<sup>41</sup> Borders Group believed that this combination of product offerings would create "unique opportunities to cross-sell merchandise to both its book and music customers."<sup>42</sup> As such, the majority of the Borders book and music superstores averaged 30,000 square feet with 8,500

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<sup>33</sup> Borders Group Inc.'s 1996 Form S-3.

<sup>34</sup> Borders Group Inc.'s 1996 Form S-3. In 1995, Borders Group superstores experienced average sales per square foot of \$273 and average sales per superstore of \$7.4 million.

<sup>35</sup> Nathan Bomey, *Borders' rise and fall: a timeline of the bookstore chain's 40-year history*, THE ANN ARBOR NEWS, July 18, 2011.

<sup>36</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

<sup>37</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

<sup>38</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

<sup>39</sup> *Borders Group, Inc. – Company Profile, Information, Business Description, History, Background Information on Borders Group, Inc.*, REFERENCE FOR BUSINESS.

<sup>40</sup> Borders Group Inc.'s 1997 Form 10-Q. Borders Group operated 9 music stores under Planet Music and CD Superstore's names.

<sup>41</sup> As of 1996, it had incorporated music sales units into 113 of its 129 superstores. Borders Group Inc.'s 1997 Form 10-K.

<sup>42</sup> Borders Group Inc.'s 1997 Form 10-K.



square feet designed entirely for music, 400 square feet designated for videos, and 1,500 square feet devoted to the coffee bar.<sup>43</sup> Each superstore carried on average 128,000 book titles, 50,000 SKUs of music, and 9,300 SKUs of videotapes.<sup>44</sup> Peter Wahlstrom, who tracked Barnes & Noble Stock for an investment research firm, recounted Borders Group's baffling business choices during this time by stating, "[Borders Group] made a pretty big bet in merchandising. [It] went heavy into CD music sales and DVD, just as the industry was going digital. And at the same time, Barnes & Noble was pulling back."

As of 1996, Borders Group operated 976 Walden stores. The Walden stores were not profitable for the company, which Borders Group blamed on "sluggish" mall-traffic.<sup>45</sup> Pursuant to a restructuring plan implemented in 1993<sup>46</sup>, Borders Group began closing underperforming Walden stores in 1995, and by January of 1997, it had closed a total of 223 Walden stores.<sup>47</sup>

Borders Group's inventory management system, touted as being "the most sophisticated inventory management system in the retail book industry," helped it successfully operate its superstores.<sup>48</sup> As previously mentioned, this inventory software featured an "expert" technology that could predict which titles would sell and forecast this demand for each store, which reduced costs, increased inventory turnover, and allowed Borders Group to provide a broad selection of titles.<sup>49</sup> Notably, the Walden stores did not initially utilize the inventory management software, and although Borders Group attempted to integrate the system into those stores, complete integration never occurred.<sup>50</sup>

Borders Group's unique distribution system also allowed it to efficiently stock inventory.<sup>51</sup> Publishers shipped books directly to one of the distribution facilities, which

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<sup>43</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>44</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>45</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>46</sup> Borders Group Inc.'s 1997 Form 10-K. Initially, the Company's plan was to close 187 underperforming Walden Stores.

<sup>47</sup> Borders Group Inc.'s 1997 Form 10-K. In 2004, Borders Group began converting Waldenbooks stores into Borders Group Express stores.

<sup>48</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>49</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>50</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>51</sup> Borders Group Inc.'s 1997 Form 10-K.

promptly processed the books for shipment to retail stores.<sup>52</sup> Additionally, Borders Group could generally return unsold books to publishers at cost.<sup>53</sup> This lean distribution system coupled, with its advanced inventory management system, allowed Borders Group to have less publisher returns than competitors and reduced freight expenses.<sup>54</sup> Borders Group steadily increased its number of distribution centers, and by 2006 had a total of 16 distribution facilities.<sup>55</sup>

#### **IV. *Screw the World Wide Web - Let's Head Overseas!***

In the late nineties, Borders Group decided to enter the overseas book market. In 1997, it acquired Books Etc., which was a London-based book retailer that had 23 stores that each averaged between 2,000 to 5,000 square feet, and also opened a Borders store in Singapore.<sup>56</sup> In the next year, Borders Group acquired a 19.9% strategic investment in Paperchase Products limited, a stationary and art materials retailer based in the UK.<sup>57</sup> By July of 2004, Borders Group had increased its ownership interest in Paperchase to 97%.<sup>58</sup> Border's international presence peaked in 1997 when it operated 41 stores in the UK, 20 in Australia, three in Puerto Rico, two in New Zealand, one in Singapore, and one in Ireland.<sup>59</sup>

In May 1998, Borders Group, through its subsidiary, Borders Online, Inc., launched its e-commerce site Borders.com to "enhance the shopping experience by offering products to customers in a variety of channels."<sup>60</sup> The website was short-lived, however. Borders Group struggled significantly with Borders.com, and made the fatal decision to outsource its e-commerce operations to Amazon.com, Inc. ("Amazon.com") in August of 2001.<sup>61</sup> As demonstrated by its agreement with Amazon.com, Borders Group seriously underestimated the growth potential of online book shopping. Under the agreement, Amazon.com was the seller of

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<sup>52</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>53</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>54</sup> Borders Group Inc.'s 1997 Form 10-K.

<sup>55</sup> Borders Group, Inc.'s 2007 Form 10-K.

<sup>56</sup> Borders Group, Inc.'s 1998 Form 10-K.

<sup>57</sup> Borders Group, Inc.'s 1998 Form 10-K.

<sup>58</sup> Borders Group, Inc.'s 2005 Form 10-K.

<sup>59</sup> Borders Group, Inc.'s 2007 Form 10-K.

<sup>60</sup> Borders Group, Inc.'s 2007 Form 10-K.

<sup>61</sup> Borders Group, Inc.'s 2007 Form 10-K.

record for all online sales and Borders Group only received referral fees from Amazon.<sup>62</sup> Further, Borders Group only recognized revenue under this arrangement when customers opted to pick up items in stores after purchasing online.<sup>63</sup> Experts consider this decision to have been Borders Group's death wish.<sup>64</sup> Ironically, Amazon.com ended up heading the e-commerce movement that drove customers away from Borders Group's stores, which ultimately led to its demise. As one reporter stated years later, in relinquishing Borders.com to Amazon.com, Borders Group "had perhaps already sealed its bankruptcy denouement."<sup>65</sup>

Borders Group audaciously continued to ignore the transformation of the book industry. It turned its cheek to the digital changes in the industry, and kept expanding its physical store footprint into the new millennium.<sup>66</sup> These aggressive expansion efforts came to a screeching halt in 2005, however, when Borders Group, after suffering significant losses, finally acknowledged that the retail book industry was no longer viable and that consumers generally preferred electronic formats of movies, books, and music over hard copies.<sup>67</sup> The retail book market had also become increasingly competitive and hard copy books had become commoditized – mega non-bookstore retailers, such as Wal-Mart, entered the market and could sell books at a much lower price.<sup>68</sup> In addition, e-commerce had become the prevalent forum for book purchasing, and most major book retailers, unlike Borders Group, had already fine-tuned their own e-commerce websites by this time.<sup>69</sup> A book shopper of the era, Jennifer Geier, summed up what was happening well when she said, "I'll go to Borders to find a book, and then I'll go to Amazon to find it."<sup>70</sup> Inevitably, Borders Group's profit margins shrank significantly

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<sup>62</sup> Borders Group, Inc.'s 2005 Form 10-K.

<sup>63</sup> Borders Group, Inc.'s 2005 Form 10-K.

<sup>64</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011.

<sup>65</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011.

<sup>66</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011. Borders released that it planned to expand domestically and internationally in 2004 and 2005 and to also remodel hundreds of existing superstores during this time. *Id.*

<sup>67</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>68</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>69</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

<sup>70</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

as a result to its failure to adapt to these market changes.<sup>71</sup> 2006 was the last year that Borders Group made a profit.<sup>72</sup>

## V. *Oops! We Slept Through Digital Revolution . . . Can We Now Have Access?*

In 2007, realizing that it had fatally underestimated the Internet's impact on the industry, Borders Group frantically sought to fix its previous mistakes by turning its focus to "leverag[ing] innovation, technology, and strategic alliances to differentiate the Company's business," which it hoped to achieve through its recently-launched Borders Rewards Loyalty Program and planned re-launch of Borders.com.<sup>73</sup> These efforts were utterly untimely, however; by the time Borders.com was re-launched, approximately a decade had passed since e-commerce transformed the industry.<sup>74</sup> Because it had outsourced its website to Amazon.com for approximately seven years, Borders Group lacked the requisite expertise to operate a successful website. Borders Group did, however, find success in its customer loyalty programs in which 12 million new members joined from 2009 to 2011.<sup>75</sup> Borders Rewards Plus, which required customers to pay for membership to receive additional discounts, had approximately 42.4 million enrollees as of 2011.<sup>76</sup>

Moreover, because the recorded music industry had become obsolete, Borders Group was forced to remodel almost all of its superstores, as the stores had been designed to devote on average 2,700 square feet to prerecorded music.<sup>77</sup> Borders Group's international presence had also become a losing venture, and it therefore it began shutting down its international operations.<sup>78</sup> In fiscal year 2007, Borders Group experienced its first year-end loss in net

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<sup>71</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>72</sup> Yuki Noguchi, *Why Borders Failed While Barnes & Noble Survived*, NPR, July 19, 2011.

<sup>73</sup> Borders Group, Inc.'s 2007 Form 10-K.

<sup>74</sup> Bob Minzesheimer and David Lieberman, *What Happened to send Borders into Chapter 11?*, USA TODAY, Feb. 16, 2011.

<sup>75</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>76</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>77</sup> Borders Group, Inc.'s 2008 Form 10-K. Borders Group converted these areas into Paperchase shops that sold gifts and stationary items. *Id.*

<sup>78</sup> Borders Group, Inc.'s 2008 Form 10-K. Borders Group subsequently sold all of its operations in the UK and Ireland in 2007 and did the same in Australia and New Zealand in 2010. Borders Group, Inc.'s

income, which equaled \$151.3 million.<sup>79</sup> Recognizing that things were not improving, Borders Group put itself up for sale in 2008, but there were no interested buyers.<sup>80</sup>

Borders Group's troubles were also evident by its disturbingly high turnover of CEOs – the company had five different CEOs in five years, including three different CEOs from 2009 to 2010 alone.<sup>81</sup> Executives were recruited from the supermarket and department store industries, and therefore lacked experience in book retailing.<sup>82</sup> According to Joe Gable, who moved from the Ann Arbor store to Border Group's corporate offices in 1996, with each new executive came a new grandiose idea for a “concept store,” which only distracted the company from cultivating the core of Borders Group's business, which was “a focus on customer service and selection.”<sup>83</sup> Gable recalled running into a frequent shopper of the first store, who told him:

I have something to confess to you . . . You know I was a loyal Borders customer for over 20 years. I wouldn't even think of going anyplace else. I will never again go to Borders . . . It used to be I was able to find what I want, and if I couldn't find it myself someone would help find it for me. Now I go in there, and not only do they have this (nonbook) stuff, but nobody knows if you have the book or not.<sup>84</sup>

Borders Group's last CEO was Bennett LeBow, an established tobacco executive, who was named the company's CEO on June 3, 2010 after he invested 25 million in Borders Group.<sup>85</sup>

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2009 Form 10-K. As of 2011, the only international interests that Borders Group had were under franchise agreements with companies that were unaffiliated with Borders Group.

<sup>79</sup> Borders Group, Inc.'s 2009 Form 10-K. As of 2011, the only international interests that Borders Group had were under franchise agreements with companies that were unaffiliated with Borders Group. *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>80</sup> Nick Brown, *Borders, unable to find white knight, to liquidate*, REUTERS, July 18, 2011.

<sup>81</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20. George Jones resigned on January 5, 2009 and was replaced with Ron Marshall, who resigned on January 26, 2010 and was replaced by Mike Edwards as the interim CEO. Lebow became the CEO on June 3, 2010.

<sup>82</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>83</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>84</sup> Todd Leopold, *The death and life of a great American bookstore*, CNN, Sept. 12, 2011.

<sup>85</sup> Jeffrey A. Trachtenberg, *Two Executives Leave Borders*, THE WALL STREET JOURNAL, Jan. 4., 2011. LeBow and William Ackman, owner of Pershing Square Capital Management, LP, held 30% of Borders Group stock as of 2010. Id.

Mike Edwards, who joined the in 2009 and served as CEO of Borders Group, Inc. from 2010 to 2011, suggested that Borders Group’s most critical mistakes were “opening too many stores and making them too big, expanding internationally, buying back stock and failing to get the Internet right.”<sup>86</sup> Unlike its competitors, such as Amazon, which Mike Edwards reported “ha[d] been investing in technology [and] creating a great online book experience for years,” and Barnes & Noble, which he reported “never looked at international, they never took on more than they could, they kept their balance sheet healthy and ultimately resonated with the core reader customer,” Borders Group had made catastrophic moves.<sup>87</sup>

These bad business decisions had devastated Borders Group. After suffering a combined loss of \$344 million in 2008 and 2009,<sup>88</sup> Borders Group realized that something had to be done or else Borders would be forced to shut its doors. Accordingly, Borders Group launched an aggressive cost reduction initiative, and it announced that it planned to reduce expenses by \$120 million in 2009 alone.<sup>89</sup> In 2008, Borders Group secured a \$42.5 million loan from Pershing Square Capital Management to provide some relief.<sup>90</sup> Moreover, Borders Group closed a total of 264 stores in 2009 and 2010 and essentially eliminated its international presence.<sup>91</sup> Borders Group also reduced its full-time workforce by 5,600 and part-time workforce by 3,300 from 2008 to 2010.<sup>92</sup>

In 2010, when there were an estimated 6.6 million “e-readers” in the US and Amazon, Barnes & Noble, and Sony had already saturated the eBook market,<sup>93</sup> Borders Group also made a

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<sup>86</sup> Nathan Bomey, *Exclusive interview with Borders CEO Mike Edwards: ‘We are here fighting to the end’*, THE ANN ARBOR NEWS, May 5, 2011.

<sup>87</sup> Nathan Bomey, *Borders plans to liquidate, ending 40-year-old bookstore chain*, THE ANN ARBOR NEWS, July 18, 2011.

<sup>88</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011.

<sup>89</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011.

<sup>90</sup> Nathan Bomey, *Borders’ rise and fall: a timeline of the bookstore chain’s 40-year history*, THE ANN ARBOR NEWS, July 18, 2011. LeBow owned Pershing Square Capital Management, and pursuant to this loan became the CEO of Borders.

<sup>91</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20. Borders Group sold its interest in Paperchase for approximately \$31.2 million, of which \$25 million was used to pay down the Prepetition Term Loan. Id.

<sup>92</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>93</sup> Mya Frazier, *The Three Lessons of the Borders Bankruptcy*, FORBES, Feb. 16, 2011.

last ditch effort catch up with the times by launching an eBook store.<sup>94</sup> Borders Group never developed its own eBook device like its competitors, however, and as one reporter wrote, “you barely knew that [Borders Group] sold e-books for devices like the Kobo and Cruz. (Have you even heard of those?).”<sup>95</sup> Months after Borders Group filed its voluntary petition for Chapter 11 relief, however, Mike Edwards still remained confident “that the company would be able to compete in the emerging electronic books segment without its own e-reader.”<sup>96</sup>

## **VI. *Conditions Continued to Worsen***

The cost-reduction initiatives were not enough to pull Borders Group out of its hole. By 2010, Borders Group’s market share in the book retail industry was essentially inconsequential – it held a 8.1% market share while its competitors Amazon.com and Barnes & Noble held 22.5% and 17.3%, respectively.<sup>97</sup> Further, its impaired financial condition had remained stagnant – Borders Group again reported a loss, equal to \$74.4 million, for the quarter ended Oct. 30, 2010.<sup>98</sup>

Borders Group was also essentially illiquid by December 2010.<sup>99</sup> It owed some \$350 million to creditors in 2008, and was forced to restructure its debt twice between 2008 and 2011.<sup>100</sup> Eventually, it could not pay its publishers for inventory, and began withholding payments owed to publishers to preserve cash to essentially force publishers into postponing payment due dates.<sup>101</sup> In the following month, it additionally began withholding payments due to

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<sup>94</sup> Bob Minzesheimer and David Lieberman, *What Happened to send Borders into Chapter 11?*, USA TODAY, Feb. 16, 2011. Borders Group is reported to have not had enough money to develop its own eBook device, and therefore it invested in Kobo Inc., which developed the eBook store for Borders Group to offer Kobo’s device for sale. Nathan Bomey, *Borders plans to liquidate, ending 40-year-old bookstore chain*, THE ANN ARBOR NEWS, July 18, 2011.

<sup>95</sup> Josh Sanburn, *5 Reasons Borders Went out of Business (and What Will Take Its Place)*, TIME, July 19, 2011.

<sup>96</sup> Nathan Bomey, *Exclusive interview with Borders CEO Mike Edwards: ‘We are here fighting to the end’*, THE ANN ARBOR NEWS, May 5, 2011.

<sup>97</sup> Mike Spector, *Borders in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011.

<sup>98</sup> Mike Spector, *Borders in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011.

<sup>99</sup> Borders Group hit an all time low in January 2010 when it recorded a net loss of \$110.2 million, operating loss of \$84.9 million, and net sales of \$2.3 billion. Borders Group, Inc.’s 2010 Form 10-K

<sup>100</sup> Josh Sanburn, *5 Reasons Borders Went out of Business (and What Will Take Its Place)*, TIME, July 19, 2011.

<sup>101</sup> Jeffrey A. Trachtenberg, *Two Executives Leave Borders*, THE WALL STREET JOURNAL, Jan. 4, 2011.

landlords.<sup>102</sup> Moreover, Borders Group's stock prices had plummeted – the stock that hit its all-time high of \$44.88 in 1998 had become penny stock and was delisted by the NYSE in 2011 for its failure to rise above an average monthly price of \$1.00 in six months.<sup>103</sup> By the end of 2010, Borders Group operated a total of 642 stores – a drastic reduction from the 1,329 stores it operated in 2005.<sup>104</sup>

## **VII. A Last Ditch Attempt to Avoid Bankruptcy**

By the end of 2010, Borders Group recognized that it had to refinance its existing credit facility to avoid filing bankruptcy.<sup>105</sup> At that time, Borders Group owed around \$196 million under a revolving credit agreement with Bank of America, which was secured by a first priority security interest in its accounts receivable, inventory and cash along with a second priority security interest in certain other assets, and also owed approximately \$48 million under a term loan from GA Capital, secured by a first priority security interest in Borders Group's equity in certain subsidiaries, intellectual property, and fixed assets, as well as a second priority security interest in the rest of its assets.<sup>106</sup> Refinancing this existing debt thus became Borders Group's prerogative. It warned investors that if it did not refinance its debt, "it could violate its credit agreement in the first quarter and experience a liquidity shortfall."<sup>107</sup>

Borders Group hired the law firm Kasowitz, Benson, Torres & Friedman to advise it on refinancing and specifically charged it with "keep[ing] the company out of bankruptcy court."<sup>108</sup> Borders found some promise in GE Capital, which committed to provide a \$550 million senior

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<sup>102</sup> Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions, Docket No. 20.

<sup>103</sup> Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions, Docket No. 20.

<sup>104</sup> Debtors' Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing, Docket No. 27.

<sup>105</sup> Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions, Docket No. 20.

<sup>106</sup> Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions, Docket No. 20.

<sup>107</sup> Jeffrey A. Trachtenberg, *A Borders Group Supplier Holds Off*, THE WALL STREET JOURNAL, Jan. 3, 2011.

<sup>108</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Hires Restructuring Lawyers*, THE WALL STREET JOURNAL, Jan. 15, 2011. This firm would later represent Borders Group in its chapter 11 case.



secured credit facility in January 2011 to replace both the existing revolving credit facility and the existing term loan, which would give Borders Group access to the cash that was necessary to allow it to continue operations without filing bankruptcy.<sup>109</sup> The commitment, however, was subject to several conditions that Borders Group ultimately could not satisfy. The deal with GE required that Borders Group secure \$125 million in subordinate financing, that \$175 million of the \$550 million loan be syndicated, and that Borders Group prepare a store closure plan.<sup>110</sup> Since most of the stores' leases had significant term remainders, devising a store closing plan would require that Borders Group obtain considerable concessions from landlords.<sup>111</sup>

GE Capital advised Borders Group to try to convince vendors to accept "IOUs" to restructure the payment deadlines so to preserve Borders Group's cash.<sup>112</sup> Because it had already been withholding payments, however, several publishers who were owed money refused to continue to send books to Borders Group. In attempt to salvage its relationships with its publishers as well as to preserve its cash, Borders Group scheduled meetings to explain the refinancing strategy to them in hopes that they would be understanding and graciously postpone payment due dates to help Borders Group avoid filing bankruptcy.<sup>113</sup> Borders Group also asked publishers to volunteer to convert their accounts receivables into interest bearing promissory notes to help meet GE's junior financing requirement.<sup>114</sup> Most publishers, however, were reluctant because they were not sold on Borders Group's strategy to emerge from its dilemma. For instance, one particular publisher who had refused to accept a promissory note in exchange for missed payments stated that "[i]n order to accept the note, you have to believe that their strategy will work, but their strategy is to continue to do what they've been doing."<sup>115</sup>

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<sup>109</sup> Mike Spector, *Borders Group in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011.

<sup>110</sup> Michael J. De La Merced and Julie Bosman, *Borders Gets \$550 Million Loan Commitment*, THE NEW YORK TIMES, Jan. 27, 2011.

<sup>111</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

<sup>112</sup> Mike Spector, *Borders Group in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011.

<sup>113</sup> Jeffrey A. Trachtenberg, *Borders Wants Suppliers to Accept Delayed IOUs*, THE WALL STREET JOURNAL, Jan. 5, 2011.

<sup>114</sup> Mike Spector, *Borders Group in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011.

<sup>115</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

Notably, at the same time that Borders Group was trying to dodge bankruptcy, its competition was doing quite well. In particular, Barnes & Noble experienced its largest sales day in the company's history on December 23rd and saw sales rise 9.3% for the nine-week period ended January 1, 2011, mainly due to its successful Nook e-reader.<sup>116</sup>

As a result of its withholding payments to vendors and landlords from December 2010 through January 2011, Borders Group was approximately \$178.8 million past due in amounts owed to vendors and \$18.6 million past due in amounts owed to landlords.<sup>117</sup> While Borders Group eventually negotiated with its publishers and landlords for an out-of-court restructuring of debts, these proposed arrangements were contingent upon the Debtors securing a new credit facility.<sup>118</sup> Further, neither Lebow nor Ackman, Borders Group's two largest investors, were willing to step up to help Borders Group this time.<sup>119</sup> Unfortunately, Borders Group failed to secure any third-party capital providers or trade vendors to convert outstanding accounts receivable into junior notes, and as a result, the restructuring talks with publishers and landlords fell through.<sup>120</sup> Consequently, Borders Group could not meet GE's requirements and was thus unable to refinance its existing credit facility, making bankruptcy unavoidable.<sup>121</sup> Borders Group CEO Lebow released the news of Borders Group's surrender with the following statement:

It has become increasingly clear that in light of the environment of curtailed customer spending, our ongoing discussions with publishers and other vendor related parties, and the company's lack of liquidity, Borders Group does not have the capital resources it needs to be a viable competitor and which are essential for it to move forward with its business strategy to reposition itself successfully for the long term . . . We are confident that, with the protection afforded under Chapter 11 and with the support of employees, publishers, suppliers, and creditors, and the reading public, a successful reorganization an

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<sup>116</sup> Jeffrey A. Trachtenberg, *A Borders Group Supplier Holds Off*, THE WALL STREET JOURNAL, Jan. 3, 2011.

<sup>117</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

<sup>118</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

<sup>119</sup> Michael J. De La Merced and Julie Bosman, *Borders Gets \$550 Million Loan Commitment*, THE NEW YORK TIMES, Jan. 27, 2011.

<sup>120</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>121</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

be achieved enabling Borders Group to emerge from the process as a stronger and more vibrant book seller.<sup>122</sup>

## **C. Borders Files for Bankruptcy**

### **I. *Chapter 11 - Beware: This Title Is A Spoiler***

In preparation for its filing for Chapter 11 relief, Borders Group retained restructuring advisor Jefferies & Co.<sup>123</sup> to begin seeking post-petition debtor-in-possession (“DIP”) financing.<sup>124</sup> Only five out of 40 debtor-in-possession financing lenders Jefferies contacted were interested. None of these five lenders, however, would agree to provide financing on an unsecured basis as either an administrative expense pursuant to section 364(a) or (b) of the Bankruptcy Code or as a junior lien under section 364(c), as required by section 503(b)(1), which sets out when claims may be categorized as administrative expenses.<sup>125</sup>

GE Capital made the most attractive proposal – it proposed to commit \$550 million under a senior secured credit facility, which, unlike their prior prepetition proposal, was more favorable in that it did not mandate that Borders Group acquire \$125 million in junior financing.<sup>126</sup> After extensive negotiations, GE submitted its revised term sheet and committed to provide a \$450

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<sup>122</sup> Shira Ovide, *Borders Bankruptcy: Everything You Need To Know*, THE WALL STREET JOURNAL, Feb. 11, 2011.

<sup>123</sup> Mike Spector, *Borders Group in Talks with Restructuring Advisers*, THE WALL STREET JOURNAL, Jan. 7, 2011. Jefferies & Co. represented Blockbuster, Inc.’s bondholders and also advised Circuit City creditors. *Id.*

<sup>124</sup> *Debtor In Possession Financing*, SHEPPARDMULLIN. Section 364 of the Bankruptcy Code permits the trustee or DIP to “obtain credit.” DIP financing generally consists of high interest loans that provide interim financing to debtors during bankruptcy and requires court approval. *Id.* These loans are usually revolving, asset-based working-capital facilities that provide the debtor immediate cash as well as ongoing cash throughout the reorganization process so that it can continue to operate. Mike Spector and Jeffrey A. Trachtenberg, *Borders Seeks Possible Bankruptcy Financing*, THE WALL STREET JOURNAL, Jan. 28, 2011.

<sup>125</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20. If the DIP borrows in the “ordinary course of business,” the lender’s claim is a first-priority administrative expense under section 364(a). 11 U.S.C. § 364(a). If the loan is outside of the ordinary course of business, a creditor may be able to get administrative priority by court order under section 364(b) if the debt is unsecured. 11 U.S.C. § 364(b).

<sup>126</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

million senior secured DIP credit facility.<sup>127</sup> However, because this Post-Petition DIP commitment would fall senior to the Borders Group's existing credit facilities, GE refused to proceed without the consent of the Prepetition Term Lenders, who initially opposed the plan.<sup>128</sup> Eventually, on February 14, 2011, all parties – Borders Group, GE Capital, and GA Capital – agreed to GE Capital's revised \$505 DIP loan.<sup>129</sup> This loan would give Borders Group access to \$400 million to be used on an interim basis during the reorganization.<sup>130</sup>

On February 16, 2011, only two days after the DIP financing facility was agreed upon, Borders Group and its seven subsidiaries<sup>131</sup> (hereinafter collectively referred to as “Borders Group”) filed voluntary petitions for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of New York.<sup>132</sup> Although Borders Group blamed “external and competitive factors” for prompting their bankruptcy,<sup>133</sup> analysts instead cited its failure to adapt to the technological changes of industry as being chiefly to blame.<sup>134</sup> News of the bankruptcy came as no surprise to most. Jim McTevia, a turnaround consultant with McTevia & Associates at the time, responded to news of the filing by stating, “It’s not news to me . . . [t]he handwriting was on the wall for this company two years ago.”<sup>135</sup>

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<sup>127</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>128</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>129</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>130</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>131</sup> *Debtors’ Motion Pursuant to Fed. R. Bankr. 1015(b) Requesting Joint Administration of Chapter 11 Cases*, Docket No. 3. The subsidiaries were the following entities: Borders International Services, Inc., Borders, Inc., Borders Direct, LLC, Borders Group Properties, Inc., Borders Online, Inc., Borders Online, LLC, and BGP (UK) Limited. *Id.*

<sup>132</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1.

<sup>133</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>134</sup> Mya Frazier, *The Three Lessons of the Borders Group Bankruptcy*, FORBES, Feb. 16, 2011.

<sup>135</sup> Nathan Bomey, *Borders Group plans to liquidate, ending 40-year-old bookstore chain*, THE ANN ARBOR NEWS, July 18, 2011.

The case was assigned to Judge Martin Glenn. The debtors operated their businesses as a debtors-in-possession (“DIPs”) pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.<sup>136</sup> Borders Group retained Kasowitz, Benson, Torres & Friedman, LLP, a national law firm headquartered in New York City, to file its petition.<sup>137</sup> David M. Friedman, who was known for representing creditors in large bankruptcies, including creditors in Enron’s bankruptcy,<sup>138</sup> was to serve as Borders Group’s lead counsel.<sup>139</sup> It was speculated that the firm got the account because of ties between CEO Lebow and Marc Kasowitz, a partner of the law firm.<sup>140</sup>

At the time of filing, Borders Group had total assets worth approximately \$1.28 billion, total debts worth approximately \$1.29 billion, more than 500 holders of debt securities, 72,072.31 shares of common stock outstanding.<sup>141</sup> Moreover, Borders Group employed approximately 17,500 people.<sup>142</sup> Borders Group reported that Pershing Square Capital Management, L.P. and Lebow Gamma Limited Partnership, UBS AG, and Bennett S. Lebow owned more than 5% of Border’s voting securities.<sup>143</sup> In fact, LeBow and Ackman (the owner of Pershing Square Capital Management) together owned more than 30% of Borders Group’s stock.<sup>144</sup> The Wall Street Journal predicted that LeBow would lose approximately \$125 million as a result of the bankruptcy.<sup>145</sup>

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<sup>136</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>137</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>138</sup> Ashby Jones, *Borders Group Files for Chapter 11: Meet the Lawyer Who Will Run It*, THE WALL STREET JOURNAL, Feb. 16, 2011.

<sup>139</sup> Ashby Jones, *Borders Group Files for Chapter 11: Meet the Lawyer Who Will Run It*, THE WALL STREET JOURNAL, Feb. 16, 2011.

<sup>140</sup> Ashby Jones, *Borders Group Files for Chapter 11: Meet the Lawyer Who Will Run It*, THE WALL STREET JOURNAL, Feb. 16, 2011. LeBow served on the board of the Vector Group, which is the holding company for Liggett Group, which was one of Kasowitz’s clients. *Id.*

<sup>141</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1. The outstanding common stock figure was current as of October 31, 2010.

<sup>142</sup> Joseph Checkler and Jeffrey A. Trachtenberg, *Bookseller Borders Begins a New Chapter . . . 11*, THE WALL STREET JOURNAL, Feb. 17, 2011.

<sup>143</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1.

<sup>144</sup> Mike Spector and Jeffrey A. Trachtenberg, *Chapter 11 for Borders Group, New Chapter for Books*, THE WALL STREET JOURNAL, Feb. 12, 2011.

<sup>145</sup> Mike Spector and Jeffrey A. Trachtenberg, *Chapter 11 for Borders, New Chapter for Books*, THE WALL STREET JOURNAL, Feb. 12, 2011. In December of 2010, Ackman made a last ditch effort to save

Borders Group moved for approval to retain consulting firm AP Services, LLC to provide interim management and restructuring services, investment bank Jefferies & Company, Inc. to continue to provide financial and restructuring advisory services, firm Garden City Group, Inc. to act as the claims agent, and DJM Property Management to provide lease and real estate advisory services during the reorganization process.<sup>146</sup>

Borders Group filed a consolidated list of the thirty largest unsecured creditor claims pursuant to Fed. R. Bankr. P.1007(d), which consisted primarily of publishers.<sup>147</sup> Penguin Putnam, Inc. held the highest unsecured claim worth \$41.1 million while Hachette Book Group and Simon & Schuster, Inc. held the next highest unsecured claims, which were worth \$36.9 million and \$33.8 million, respectively.<sup>148</sup> The six largest claims totaled to \$182 million.<sup>149</sup> As the largest group of unsecured creditors by far, the publishers would prove to have significant control over how the reorganization was conducted.

## **II. *Borders Group Seeks “Rebirth” in Bankruptcy***

Although Borders Group was essentially an irrelevant player in the eBook market as well as in the e-commerce arena, it nevertheless entered the reorganization process hopeful that reorganization would allow it to “eliminate[e] burdensome costs,” which would enable it to continue to be viable in the industry.<sup>150</sup> Borders Group believed that once it eliminated these burdensome costs, which it characterized as “negatively impacting what, at core, is a strong business,” it could successfully regain presence in the industry’s revolutionized digital landscape.<sup>151</sup> In the first hearing on February 16th, Friedman described the case to be “a poster

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his investment by offering to provide \$960 million of his personal funds to finance a merger of Borders Group and Barnes & Noble, which never happened. *Id.* After he realized that the investment “wasn’t good,” Ackman jokingly called himself a “stuck holder” in the company. Shira Ovide, *Borders Bankruptcy: Blow to Bill Ackman*, Bennett Lebow, THE WALL STREET JOURNAL, Feb. 16, 2011.

<sup>146</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1.

<sup>147</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1.

<sup>148</sup> *Borders Group, Inc.’s Voluntary Petition*, Docket No. 1.

<sup>149</sup> Jeffrey A. Trachtenberg, *Major Book Imprints Are Owed Millions*, THE WALL STREET JOURNAL, Feb. 17, 2011.

<sup>150</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>151</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20. More specifically, Borders Group stated that its five areas of focus during the reorganization were to: (i) [c]ontinu[e] to expand and enhance the Borders Group Rewards Plus customer

child . . . for why Chapter 11 exists and what hopefully Chapter 11 can accomplish.”<sup>152</sup> It appears that Borders Group entered reorganization naively optimistic, “seeking rehabilitation, indeed, seeking rebirth,” as Friedman put it -- once again ignoring the realities of its status in the transformed industry.<sup>153</sup>

**a. First Day Motions**

It would have been impossible for Borders Group and its subsidiaries to meet various time deadlines of the Bankruptcy Rules of Procedure and Bankruptcy Codes’ default provisions. Thus, in addition to the aforementioned motions to approve the retention of firms to provide professional services and the list of unsecured creditors, Borders Group also filed various “housekeeping” first-day motions on the Petition Date that are typical in a case of its size.<sup>154</sup> For instance, Borders Group moved for joint administration of the cases pursuant to Bankruptcy Rule 1015(b).<sup>155</sup> Chief U.S. Bankruptcy Judge Arthur J. Gonzalez, acting in Justice Martin Glenn’s absence, granted the motion. Borders Group and its subsidiaries’ (hereinafter collectively referred to as “Borders Group”) cases were therefore to be administrated under a single docket

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program; (ii) [s]trengthen[]their position as a purveyor of content by aggressively growing Borders Group.com and eBook market share; (iii) [e]xpand[] and enhance[e] the company’s overall retail mix, including non-book offerings, to improve profitability and offset the digital effect; (iv) aggressively reduce costs across the business, including costs in the supply chain network and store portfolio; and (v) on a stand-alone basis and in conjunction with strategic partners, make improvements at the store-level and in systems to enhance and differentiate the customer experience. *Id.*

<sup>152</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>153</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>154</sup> Jay M. Goffman and Grenville R. Day, *First Day Motions and Orders in Large Chapter 11 Cases: (Critical Vendor Financing, DIP Financing and Cash Management Issues)*, 12 J. BANKR. L. & PRAC. 59 (2003).

<sup>155</sup> *Debtors’ Motion Pursuant to Fed. R. Bankr. 1015(b) Requesting Joint Administration of Chapter 11 Cases*, Docket No. 3. Bankruptcy Rule 1015(b) provides that, “[i]f . . . two or more petitions are pending in the same court by or against . . . a debtor and an affiliate, the court may order a joint administration of the estates.” Fed. R. Bankr. P. 1015(b). Section 101 of the Bankruptcy Code defines the term “affiliate” to mean “a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with the power to vote, by the debtor, or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor.” 11 U.S.C. § 101(2)(B). Because all of the debtors were subsidiaries of Borders Group, Inc. or either managed by an affiliate of BGI, joint administration of the cases was appropriate.

instead of eight separate dockets.<sup>156</sup> Other first-day housekeeping motions that Borders Group filed included a motion to waive the requirement to file a list of creditors and equity security holders,<sup>157</sup> a motion for an additional thirty days to file their schedules and statements,<sup>158</sup> and a motion to consolidate its list of largest creditors.<sup>159</sup>

In addition, Borders Group filed several other customary first-day motions to allow it to operate during the reorganization, such as a motion to continue to pay certain employee obligations,<sup>160</sup> motion authorizing continuance of insurance policies,<sup>161</sup> motion to pay prepetition taxes and assessments,<sup>162</sup> motion to pay prepetition of distribution network vendors,<sup>163</sup> motion to honor certain prepetition customer programs,<sup>164</sup> motion to continue to use its cash management

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<sup>156</sup> When cases are jointly administered, they are administered under a single docket for procedural purposes only. The purpose of joint administration is to avoid the unnecessary time and costs involved with preparing and serving duplicate motions for every affiliated debtor. Sanford R. Landress, *First-Day Motions: Perils and Possible Pitfalls An Overview of First-Day Motions*, GREENE & MARKLEY, P.C.

<sup>157</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>158</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20. Borders Group asserted that the 14 days afforded under Bankruptcy Rule 1007(c) would be insufficient to complete the schedules and statements.

<sup>159</sup> This is required by Bankruptcy Rule 1007(d), which provides that a debtor shall file “a list containing the name, address and claim of the creditors that hold the 20 largest unsecured claims, excluding insiders.” Fed. R. Bankr. P. 1007(d).

<sup>160</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§105(a), 363(b), and 507 and Fed. R. Bankr. P. 6003 and 6004 For Authorization to (I) Pay Certain Employee Obligations and Maintain and Continue Employee Benefits Programs and (II) For Banks to Honor and Process Checks and Transfers Related to Such Obligations*, Docket No. 12.

<sup>161</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a), 362(d), 363(b), and 503(b) and Fed.R. Bankr. P. 4001, 6003, and 6004 For (I) Authority to (A) Continue the Debtors’ Insurance Policies 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 Obligaitons*, Docket No. 15.

<sup>162</sup> *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*, Docket No. 17.

<sup>163</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§105(a) and 363 Requesting (I) Authority to Pay Certain Prepetition Claims of Distribution Network Vendors and Other Lien Claimants, and (II) Direction of Banks and Other Financial Institutions to Honor Related Checks and Electronic Payment Requests*, Docket No. 16.

<sup>164</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a) and 503(b)(1) for Authorization to Honor Certain Prepetition Customer Programs*, Docket No. 18.



system, maintain existing bank accounts, and use corporate credit cards,<sup>165</sup> and motion to employ professionals in the ordinary course of business.<sup>166</sup>

Judge Gonzalez granted these first-day motions the same day they were filed on an interim basis.<sup>167</sup> First-day motions such as these are routinely granted and are generally noncontroversial.<sup>168</sup> As discussed below, however, some of Borders Group's other first-day motions proved to be more contentious.

#### **b. Motion to Approve the DIP Facility and Use of Cash Collateral**

One of the most critical first-day motions was the motion to seek approval for the postpetition DIP facility with GE Capital (the "DIP Facility"), which Borders Group had negotiated prior to filing its bankruptcy petition.<sup>169</sup> Because Borders Group lacked the necessary liquidity to continue to operate and remain a going concern, it requested that the court approve of its immediate use of its cash on hand – which was considered "Cash Collateral" securing Borders Group's revolving debt facility – and DIP Facility that was to refinance the Debtors' preexisting debt.<sup>170</sup>

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<sup>165</sup> *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 . . .*, Docket No. 21.

<sup>166</sup> *Order Pursuant to 11 U.S.C. §§105(a), 327, and 330 Authorizing Debtors to Employ Professionals Utilized in the Ordinary Course of Business, Nunc Pro Tunc To The Commencement Date*, Docket No. 384.

<sup>167</sup> *Order 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 (I) Waiving Requirement to File Lists of Creditors and Equity Security Holders . . .*, Docket No. 60.

<sup>168</sup> Sanford R. Landress, *First-Day Motions: Perils and Possible Pitfalls An Overview of First-Day Motions*, GREENE & MARKLEY, P.C. In general, first-day motions are granted pursuant to Bankruptcy Code § 105(a), which grants bankruptcy courts the power to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. *Id.*

<sup>169</sup> *Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 In Support of First Day Motions*, Docket No. 20.

<sup>170</sup> *Interim Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying Automatic Stay, and (6) Scheduling A Final Hearing*, Docket No. 69. Thus, the debtors asked the court to enter an interim order pursuant to § 364(c)-(d) of the Bankruptcy Code authorizing them to obtain the DIP financing, which was a "senior secured, superpriority, postpetition financing in the form of a first lien new money superpriority priming credit facility with a maximum outstanding principal of [\$505 million]." *Id.*

The DIP Facility consisted of a senior secured super-priority revolving credit facility with a maximum outstanding principal of \$505 million that was only to be used for the following three purposes: “(i): to finance the working capital needs and for general corporate purposes of the Debtors, (ii) to pay the fees, costs, and expenses incurred by the Debtors in connection with the chapter 11 cases; [and] (iii) to refinance the Prepetition Facilities.”<sup>171</sup> Further, pursuant to sections 364(c)(2), (c)(3), and (d) of the Bankruptcy Code, once the Prepetition Lenders were paid in full, the DIP Lenders were to receive a fully perfected first priority security interest in substantially all of the Debtors’ existing and after-acquired real property and personal assets (the “DIP Collateral”).<sup>172</sup>

Under section 364(d) of the Bankruptcy Code, this type of post-petition loan that is senior in priority to existing pre-petition liens is commonly referred to as a “priming lien,” and will only be authorized by a court after a notice and hearing if the debtor shows that it cannot get credit otherwise and that current lienholders are adequately protected should the proposed senior lien be granted.<sup>173</sup> Adequate protection is generally found to exist when amounts under a post-petition loan are applied towards outstanding prepetition debt.<sup>174</sup> Therefore, Borders Group, pursuant to section 363(e) of the Bankruptcy Code, requested that the court approve of its use of the DIP facility proceeds to pay the Prepetition Lenders in full (lenders of both the Prepetition Revolver Loans and Term Loans) in consideration for their adequate protection,<sup>175</sup> which the Prepetition Lenders had previously consented to.<sup>176</sup>

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<sup>171</sup> Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing, Docket No. 27.

<sup>172</sup> Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing, Docket No. 27.

<sup>173</sup> 11 U.S.C. § 364(d). John D. Ayer, Michael L. Bernstein, and Jonathan Friedland, *Obtaining DIP Financing and Using Cash Collateral*, JOURNAL: ISSUES AND INFORMATION FOR THE INSOLVENCY PROFESSIONAL.

<sup>174</sup> In determining whether there is adequate protection, the most critical inquiry “is whether the interest of the secured creditor whose lien is to be primed is being unjustifiably jeopardized.” Jill C. Walters and Lisa P. Sumner, *Priming Liens in Bankruptcy: “Don’t Throw Me Under the Bus!”*, POYNER SPRUILL PUBLICATIONS, Oct. 24, 2008 (quoting *In re Mosello*, 195 B.R. 277, 389 (Bankr. S.D. N.Y. 1996). Courts typically will find that there is adequate protection “when the debtor’s DIP loan is used to pay down the pre-petition lender’s outstanding debt.” *Id.*

<sup>175</sup> More specifically, Borders also agreed to provide adequate assurance by funding the “Prepetition Revolver Indemnity Account in the amount of \$500,000 upon the closing of the DIP Facility,” and by giving the following to the Prepetition Revolver Lenders: “(1) an exclusive lien on the Prepetition Revolver Indemnification Account and all amounts therein, (2) a lien on the DIP Collateral in an amount

There were several key events of default under the DIP Facility, one of which included Borders Group's failure to timely conduct the going out of business sales.<sup>177</sup> Further, because the DIP facility depended heavily on Borders's inventory as the primary collateral for the loans,<sup>178</sup> the DIP Lenders placed Borders Group on a tight deadline to decide whether to assume or reject unexpired leases to ensure that inventory would be sold.<sup>179</sup> Under this deadline, Borders Group had only 36 days from March 2nd to decide whether to assume or reject the leases unless it could secure the consent of landlords to extend the court's deadline.<sup>180</sup>

Judge Gonzalez, acting in Judge Glenn's absence, entered an interim order on February 17th approving the interim use of \$400 million cash collateral and the DIP facility and scheduled

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not to exceed \$500,000 . . . , (3) an adequate protection replacement lien . . . on the DIP Collateral, and (4) a superpriority administrative expense claim," all of which were to be junior to the DIP Liens and Superpriority Claims. *Debtors' Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing*, Docket No. 27.

<sup>176</sup> *Debtors' Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing*, Docket No. 27. Section §363(e) of the Bankruptcy Code provides that, "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e). Further, Section 361 provides that periodic cash payments, additional liens, and replacement liens are among the forms of adequate protection. 11 U.S.C. § 361. As of the Petition Date, \$244.7 million of the Prepetition debt was outstanding, and the book value of the inventory that secured the amounts due under the Prepetition loans was \$662 million.

<sup>177</sup> *Debtors' Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing*, Docket No. 27.

<sup>178</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>179</sup> The DIP lenders essentially gave Borders Group a 12-week deadline prior to any court deadline to either assume or reject unexpired leases. *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>180</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

the final hearing for approval of the DIP facility for March 15th.<sup>181</sup> In the hearing on February 17th, Judge Gonzalez informed Borders Group that it was required to promptly file a proposed budget detailing how the loans were to be used with the court as a condition to his entering the interim order.<sup>182</sup> In response, Borders Group promised to file a budget as an exhibit to the interim order.<sup>183</sup> Friedman expressed to Judge Gonzalez that he hoped they would do better than the budget since it did not “reflect all of the operational initiatives that [they] hoped [would] kick in.”<sup>184</sup>

**c. Emergency Motion to Close Over 200 Unprofitable Stores**

Under extreme pressure to begin closing stores, Borders Group also filed a first-day emergency motion requesting approval to immediately conduct an auction and liquidate the inventory of approximately 200 of its 642 stores that “were not saleable as going concerns.”<sup>185</sup> Borders Group listed several reasons why it was critical that these stores immediately liquidate, including that it was “losing approximately \$2 million per week at the [c]losing [s]tores,” and that the value of the inventory in the closing stores would decline if there were any delays in the

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<sup>181</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors’ Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>182</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>183</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>184</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>185</sup> *Debtors’ Emergency Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales and to Enter Into Agency Agreement with (A) Joint Venture Composed of Hilco Merchant Resources, LLC, SB Capital Group, LLC and Tiger Capital Group, LLC or (B) Other Successful Bidder at the Auction, (II) Approving Stalking Horse Fee, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting (A) State and Local “Fast Pay Laws And (B) Laws Restricting Store Closings, and (VI) Granting Related Relief*, Docket No. 7. Section 363(b) of the Bankruptcy Code provides that “[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b).

liquidation process.<sup>186</sup> Borders Group planned to begin the closing stores sales on February 19th when it could benefit from the increased sales traffic during the President's Day holiday.<sup>187</sup> Judge Gonzalez, however, advised Borders Group that it had the burden of demonstrating that the estate would suffer irreparable harm if the sales were not conducted immediately, and that the mere depreciation of the inventory due to a delayed store-closing sale would be insufficient to demonstrate such harm.<sup>188</sup>

As previously mentioned, Borders Group solicited bids prior to its filing bankruptcy for a stalking horse agent to conduct the store closing sales on the Commencement Date.<sup>189</sup> Hilco Merchant Resources LLC, Tiger, and SBK Capital formed one group of bidders (the "Hilco Group") and Gordon Brothers and Great American formed another group (the "Gordon Brothers Group"). From these two groups, the Hilco Group agreed to pay 74% of the guaranteed amount of inventory, and was selected to be the Stalking Horse Agent and share in half of the proceeds of the store closing sales.<sup>190</sup> In the auction held on the night of February 16th, the Hilco Group and Gordon Group, after bidding against each other for nine hours, joined teams to collectively

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<sup>186</sup> *Debtors' Emergency Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales and to Enter Into Agency Agreement with (A) Joint Venture Composed of Hilco Merchant Resources, LLC, SB Capital Group, LLC and Tiger Capital Group, LLC or (B) Other Successful Bidder at the Auction, (II) Approving Stalking Horse Fee, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting (A) State and Local "Fast Pay Laws And (B) Laws Restricting Store Closings, and (VI) Granting Related Relief*, Docket No. 7.

<sup>187</sup> *Debtors' Emergency Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales and to Enter Into Agency Agreement with (A) Joint Venture Composed of Hilco Merchant Resources, LLC, SB Capital Group, LLC and Tiger Capital Group, LLC or (B) Other Successful Bidder at the Auction, (II) Approving Stalking Horse Fee, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting (A) State and Local "Fast Pay Laws And (B) Laws Restricting Store Closings, and (VI) Granting Related Relief*, Docket No. 7.

<sup>188</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>189</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>190</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

win the bid.<sup>191</sup> Pursuant to this deal, the liquidators were to return 86% of the cost value of all merchandise through the sales, which was more attractive than the Hilco Group's initial offer to return 73%, and would result in approximately \$175 million dollars in proceeds.<sup>192</sup> Following the auction, Borders Group requested that the court approve the Agency Agreement outlining this arrangement with the Hilco-Gordon venture as the Liquidating Agent.<sup>193</sup>

Adam Shiff, an attorney employed by Kasowitz, Benson, Torres & Friedman who attended the auction, urged Judge Gonzalez in the hearing on February 17th to enter an order allowing the emergency store closing sales. To support this request, he stated that Borders Group had already entered into agreements with over a third of landlords to allow for the store closing sales and expected to do the same with others.<sup>194</sup> He also warned that the estate would suffer irreparable harm – a loss of \$2 million per week – should the unprofitable stores not be closed and their leases rejected as soon as possible.<sup>195</sup> Further, he claimed that the liquidator's guaranteed amount of return would decline should the sales not occur immediately because the inventory would lose value.<sup>196</sup> Lastly, and arguably most importantly, Shiff asserted that Borders Group would fail to meet the deadlines under the DIP budget as well as those under section 365(d)(3) of the Bankruptcy Code, which obligated Borders Group to perform all of its obligations under its unexpired leases until those leases were accepted or rejected, if the sale did not occur immediately.<sup>197</sup>

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<sup>191</sup> Kary, Tiffany, *Borders Group Wins Approval to Liquidate 200 Stores*, BLOOMBERG, Feb.17, 2011.

<sup>192</sup> Kary, Tiffany, *Borders Group Wins Approval to Liquidate 200 Stores*, BLOOMBERG, Feb.17, 2011.

<sup>193</sup> Kary, Tiffany, *Borders Group Wins Approval to Liquidate 200 Stores*, BLOOMBERG, Feb.17, 2011.

<sup>194</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>195</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>196</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

<sup>197</sup> *Transcript regarding Hearing Held on 02/17/2011 10:06 AM RE: Motion Requesting an Order Authorizing the Debtors to Conduct Store Closing Sales and Bulk Inventory Sales, Approving Procedures with Respect to Ordinary Course Store Closing Sales, and Granting Ancillary and Related Relief*, Docket No. 240.

The Bankruptcy Court granted the emergency motion, which authorized Borders Group to enter into the Agency Agreement with the liquidators to conduct the closing store sales for 200 stores with the option to later conduct an additional 75 store closing sales pursuant to section 363(b)(1) of the Bankruptcy Code, which Borders Group eventually did.<sup>198</sup>

**d. Motion to Establish Adequate Assurance Procedures for Utility Companies**

Because it was important for stores to remain open during the sale closing sales, Borders Group needed to ensure that utility companies would continue to provide service to these stores. Therefore, Borders Group moved in another first-day motion for an entry of an order approving its proposed adequate assurance for utility services.<sup>199</sup> By way of background, section 366 of the Bankruptcy Code allows a utility company to unilaterally terminate service if a debtor fails to provide “adequate assurance” of payment for future services to the satisfaction of the utility company within 30 days of the commencement date.<sup>200</sup> Although this is a common first-day motion in chapter 11 cases, it was of significant importance to Borders Group since an interruption in utility services would, as Borders Group asserted, “severely hinder [their] business operations” as well as the closing sales, and would impact the entire reorganization process because the market could misinterpret the lack of utility services “as indications of [Borders Group’s] imminent liquidation.”<sup>201</sup>

To provide utility companies with adequate assurances, Borders Group proposed to deposit approximately \$2.28 million in an interest-bearing escrow account within 30 days of the commencement date.<sup>202</sup> In addition, in accordance with section 366 of the Bankruptcy Code, Borders Group proposed a procedure by which dissatisfied utility companies could make first additional assurance requests to Borders Group then, if issues were not resolved, they could request a hearing with the Court.<sup>203</sup>

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<sup>198</sup> *Order Approving Agency Agreement, Store Closing Stores and Related Relief*, Docket No. 91.

<sup>199</sup> Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a), 363(b) and 366 For Entry of an Order Establishing Adequate Assurance Procedures with Respect to Their Utility Companies, Docket No. 41.

<sup>200</sup> 11 U.S.C. § 366. Section 366(c)(1)(A) of the Bankruptcy Code provides that “assurance of payment” can be in the form of a cash deposit. 11 U.S.C. § 366(c)(1)(A).

<sup>201</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a), 363(b) and 366 For Entry of an Order Establishing Adequate Assurance Procedures with Respect to Their Utility Companies*, Docket No. 41.

<sup>202</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a), 363(b) and 366 For Entry of an Order Establishing Adequate Assurance Procedures with Respect to Their Utility Companies*, Docket No. 41. Borders Group cited to other cases that Judge Glenn had resided over that allowed the use of an escrow account for this purpose, which Judge Glenn angrily commented was incorrect.

<sup>203</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105(a), 363(b) and 366 For Entry of an Order Establishing Adequate Assurance Procedures with Respect to Their Utility Companies*, Docket No. 41.

This motion was not noticed, and Borders Group subsequently called the Court to notify it that Borders Group wanted to delay the motion.<sup>204</sup> Judge Glenn warned Friedman that he did not want to see Borders Group bring emergency motions later in the case “because your utilities are about to shut off your utilities when we provided a date within the time limits with the Code and you elected to not go forward with it.”<sup>205</sup> In fact, he insisted that, if the motion was continued, Friedman should not expect him to grant any such emergency motions, stating sternly that “[i]t isn’t going to happen.”<sup>206</sup> Jeff Gleit, Friedman’s co-counsel, spoke up and assured Judge Glenn that they had been in contact with utilities and that he did not expect any emergency motions to later become necessary.<sup>207</sup>

**e. Motion to Reject Unexpired Leases & Motion to Approve Rejection Procedures**

Borders Group filed another first-day motion asking the court to retroactively reject four unexpired leases for property that Borders Group had already vacated prior to the Petition Date.<sup>208</sup> Because it planned to close at least 200 underperforming bookstores, Borders Group moved pursuant to sections 105(a) and 363 of the Bankruptcy Code for authorization to employ “expedited procedures for the future rejection of burdensome unexpired leases (the ‘Rejection

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<sup>204</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors’ Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>205</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors’ Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>206</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors’ Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>207</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors’ Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>208</sup> *Debtors’ Omnibus Motion Pursuant to 11 U.S.C. §§ 365(a) and 554(a) and Fed. R. Bankr. P. 6006, 6007, and 9014 for Approval of Rejection of Certain Unexpired Leases of Non-Residential Real Property and Authorization to Abandon Certain Property Effective as of the Commencement Date*, Docket No. 23. Borders Group cited authority for the proposition that Section 365 does not prohibit retroactive rejection. *Id.* Whenever leases are retroactively rejected, the breach is deemed to have occurred pre-Petition Date, and thus, any claims of the landlords are to be on an unsecured basis instead of administrative. Gregg Ficks, *Retro Rejection: Actions speak louder than words when landlords come before the bankruptcy court*, CCIM INSTITUTE, May.Jun.05.



Procedures’), and . . . authority to take any and all actions as may be necessary and appropriate to implement and effectuate the Rejection Procedures.”<sup>209</sup>

Borders Group therefore requested permission to reject additional unexpired leases in the future pursuant to section 365(a) of the Bankruptcy Code, which grants a debtor-in-possession the authority to reject an executory contract or unexpired lease subject to court approval and deadlines.<sup>210</sup> Borders Group also contemplated that rejecting leases would require it to abandon property, such as fixtures, furniture, and office equipment, which is only allowed when the standard of sections 544(a) of the Bankruptcy Code is met.<sup>211</sup> Accordingly, the motion also requested that Borders Group be allowed to abandon property in its rejection of the unexpired leases.<sup>212</sup>

### **III. *Publishers and Landlords Unite***

On February 24th, U.S. Trustee Tracey Hope Davis held a meeting in the Hilton Hotel in Manhattan to appoint the official unsecured creditors committee (hereinafter referred to as the “Committee”).<sup>213</sup> The Committee was comprised of the following group, which was dubbed a “who’s who of major publishers and landlords”:<sup>214</sup> (i) Penguin Group (USA), Inc.; (ii)

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<sup>209</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105, 365(a) and 544(a) Requesting Approval of Procedures for the Rejection of Unexpired Leases*, Docket No. 44.

<sup>210</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105, 365(a) and 544(a) Requesting Approval of Procedures for the Rejection of Unexpired Leases*, Docket No. 44. When courts determine whether an unexpired lease or executor contract should be rejected, the “business judgment” standard is applied, which is met if the rejection benefits the estate.

<sup>211</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105, 365(a) and 544(a) Requesting Approval of Procedures for the Rejection of Unexpired Leases*, Docket No. 44. Section 544(a) of the Bankruptcy Code provides that a debtor in possession may abandon, subject to court approval, “property of the estate . . . that is of inconsequential value and benefit to the estate” only when the court finds that the property is either burdensome to the estate, or the property is of inconsequential value and inconsequential benefit to the estate. 11 U.S.C. § 544(a).

<sup>212</sup> *Debtors’ Motion Pursuant to 11 U.S.C. §§ 105, 365(a), and 544(a) Requesting Approval of Procedures for the Rejection of Unexpired Leases*, Docket No. 44. Judge Glenn later granted this motion on March 4th. *Order Pursuant to 11 U.S.C. §§ 365(a) and 554(a) and Fed. R. Bankr. P. 6006, 6007 and 9014 Approving the Rejection of Certain Unexpired Leases of Non-Residential Property and Authorizing the Abandonment of Certain Personal Property Effective as of the Commencement Date*, Docket No. 258.

<sup>213</sup> Mike Spector, *Borders Group’ Publishers, Landlords Band Together in Bankruptcy*, THE WALL STREET JOURNAL, Feb. 25, 2011. Under section 1102(a) of the Bankruptcy Code, “the United States Trustee shall appoint a committee of creditors holding unsecured claims.” 11 U.S.C. §1102(a).

<sup>214</sup> Mike Spector, *Borders Group’ Publishers, Landlords Band Together in Bankruptcy*, THE WALL STREET JOURNAL, Feb. 25, 2011.

HarperCollins Publishers, LLC; (iii) Random House, Inc.; (iv) The Perseus Books Group; (v) Sony Music Entertainment; (vi) GGP Limited Partnership<sup>215</sup>; and (vii) Simon Property Group. The Committee hired Bruce Beuchler of Lowenstein Sandler, LLP, who had previously represented the publishers, to represent them as counsel.<sup>216</sup> With the Committee in place, Borders Group now needed to devise a business plan to the satisfaction of the Committee. It was crucial that Borders Group's business plan appease the publisher members so that they would convince publishers to recommence shipping inventory on a credit basis,<sup>217</sup> as well as the landlord members since they would play a critical role in helping Borders Group secure concessions from landlord.<sup>218</sup> While unsecured creditors committees are typically less influential than debt investors and hedge funds in Chapter 11 cases, this particular committee, as the Wall Street Journal put it, "arguably [held] [Borders Group's] future in their hands."<sup>219</sup>

During the hearing held on March 2nd, which was Judge Glenn's first debut in the case, Friedman, in getting Judge Glenn up to speed on the case, stressed that Borders Group "could not emerge [from bankruptcy] without the support of its landlords and publishers."<sup>220</sup> Friedman provided that at this time most publishers were again delivering inventory to stores, albeit on a cash-only basis.<sup>221</sup> Friedman also provided that Borders Group desperately needed landlords to consent to an extension of time to reject or assume leases to give it more time to reorganize since the DIP Lenders had imposed a shorter deadline than that allowed by the Code.<sup>222</sup> As of March

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<sup>215</sup> Shira Ovide, *Borders Group Bankruptcy: Headache for Landlords*, THE WALL STREET JOURNAL, Feb. 16, 2011. GGP was the landlord of more than 5% of the company's total stores.

<sup>216</sup> *Application of the Official Committee of Creditors for an Order Authorizing and Approving the Employment and Retention of Lowenstein Sandler as Its Counsel Nunc Pro Tunc To February 24, 2011*, Docket No. 350.

<sup>217</sup> Jeffrey A. Trachtenberg, *Major Book Imprints are Owed Millions*, THE WALL STREET JOURNAL, Feb. 17, 2011. Many publishers had stopped sending inventory to the stores as of the Petition Date.

<sup>218</sup> Jeffrey A. Trachtenberg, *Major Book Imprints are Owed Millions*, THE WALL STREET JOURNAL, Feb. 17, 2011.

<sup>219</sup> Mike Spector, *Borders Group' Publishers, Landlords Band Together in Bankruptcy*, THE WALL STREET JOURNAL, Feb. 25, 2011.

<sup>220</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>221</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>222</sup> Rejection constitutes a breach of the lease. 11 U.S.C. § 365(g). During the period before the debtor determines to assume or reject a lease, a landlord cannot suspend its obligations under the lease. *Id.* Pursuant to § 365(d)(4), a debtor has a period of 120 days plus a 90-day extension, which is granted "for

2nd, this deadline gave Borders Group only thirty-six days to determine whether to reject or accept leases or else be forced to begin liquidating stores unless, however, landlords consented to an extension of the time to reject or assume leases beyond the court deadline.<sup>223</sup> As previously discussed, because the DIP facility was asset-backed and the inventory was the most valuable collateral, the DIP Lenders set their deadline in advance of the court's deadline as a precautionary measure to ensure that inventory could be sold before any leases were deemed rejected pursuant to court deadline, which would require Borders Group to vacate the properties.<sup>224</sup> The DIP Lenders' deadline, which Judge Glenn was later very critical of,<sup>225</sup> would prove to be highly problematic for Borders Group as the case proceeded.

Attorney Beuchler, on behalf of Committee, informed Judge Glenn that although the unsecured creditors appreciated the importance of Borders Group's timelines, from their perspective, it was "critically important" that Borders Group swiftly present a business plan to the Committee that would address the publishers' concerns.<sup>226</sup> Borders Group really needed publishers to recommence sending inventory on a credit basis as opposed to cash only basis, especially for it to be prepared for the next holiday season when large volumes of books are needed.<sup>227</sup> Beuchler also noted that the Committee took issue with some of the DIP facility's terms of which the Committee would later raise if they could not resolve the issues with Borders Group.<sup>228</sup>

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cause" with the consent of the landlord, to assume or reject a commercial lease before it is deemed rejected. 11 U.S.C. § 365(d)(4). As previously mentioned, the DIP lenders demanded that Borders Group decide whether to assume or reject twelve weeks prior to any court imposed deadline.

<sup>223</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>224</sup> *Transcript regarding Hearing Held on 03/15/2011 10:02AM*, Docket No. 409.

<sup>225</sup> *Transcript regarding Hearing Held on 03/15/2011 10:02AM*, Docket No. 409.

<sup>226</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>227</sup> *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

<sup>228</sup> Judge Glenn characterized the deadlines as "constrain[ing] the Court's provided by the Bankruptcy Code." *Transcript regarding Hearing Held on 03/02/2011 3:04PM RE: Debtors' Motion for Order Pursuant to 11 U.S.C. Section 365(a) and Fed. R. Bankr. P. 6004 and 6006 and 9014 Authorizing Debtors . . .*, Docket No. 253.

#### **IV. *Objection, Your Honor!***

The final hearing on the first day motions was set for March 15th, to be held before Judge Glenn.<sup>229</sup> Prior to the hearing, Borders Group moved to extend the time within which to reject or assume unexpired non-residential leases through September 14, 2011.<sup>230</sup> Once the hearing date for the first-day motions was established, objections (primarily of landlords and utility companies) ensued.

The Committee was unable to resolve its problems with the DIP facility outside of court. Therefore, on March 10th, the Committee filed an objection to the DIP financing and use of cash collateral. In the objection, the Committee requested that the DIP financing facility agreement be modified to “strike a reasonable balance among the competing interests of the Debtors, the DIP Lenders, Prepetition Lenders, and the Debtors’ unsecured creditors.”<sup>231</sup> In sum, the Committee considered the DIP facility’s terms to be “unreasonable, overreaching, and onerous,” and felt that the DIP Lenders had basically exploited Borders Group by “us[ing] [their] leverage to impose objectionable provisions on the Debtors.”<sup>232</sup> They accused the DIP financing facility of being “illusory” since Borders Group would not have available funds under what the Committee labeled to be “essentially a short term financing facility” during the later part of the third quarter of 2011, and as a result, they predicted that Borders Group would have to “consummate an exit plan” by June.<sup>233</sup>

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<sup>229</sup> *Notice of Hearing for Entry of Final Orders on “First Day” Relief and First Omnibus Hearing*, Docket No. 208.

<sup>230</sup> *Notice of Debtors’ Motion for Entry of An Order (I) Extending the Time Within Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property and (ii) Authorizing the Debtors to Enter Into Stipulations Further Extending the Time to Assume or Reject Unexpired Leases or Nonresidential Real Property*, Docket No. 209.

<sup>231</sup> *Objection of the Official Committee of Unsecured Creditors to the Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Post-Petition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling Final Hearing*, Docket No. 340.

<sup>232</sup> *Objection of the Official Committee of Unsecured Creditors to the Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Post-Petition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling Final Hearing*, Docket No. 340.

<sup>233</sup> *Objection of the Official Committee of Unsecured Creditors to the Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Post-Petition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing*

Some other terms of the DIP Facility that the Committee objected to were:

- (1) The DIP Lenders having liens on the proceeds of any avoidance actions that would allow them to satisfy their Superpriority Administrative Claims from those proceeds;<sup>234</sup>
- (2) The excessive amount of fees that the DIP Lenders required, especially with the “make whole” payment of \$1.46 million to the Prepetition Lenders;<sup>235</sup> and
- (3) The DIP Facility providing for a \$4 million carveout cap for the Borders Group’s and the Committee’s professionals, which the Committee felt was “unreasonably small.”

Borders Group, in response, stressed that although the agreement’s terms were not entirely preferable, they were the “best” terms that they could secure.<sup>236</sup> Essentially, in this response, it

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*Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling Final Hearing, Docket No. 340.*

<sup>234</sup> *Objection of the Official Committee of Unsecured Creditors to the Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Post-Petition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling Final Hearing, Docket No. 340.*

<sup>235</sup> *Objection of the Official Committee of Unsecured Creditors to the Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Post-Petition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling Final Hearing, Docket No. 340.* The committee contended that this make whole payment was an unfair penalty to Borders Group that should not be approved since Borders Group would only have to paid it if objections to the DIP Motion were filed and no other adverse actions were taken against the lenders.

<sup>236</sup> *Debtors’ Omnibus Reply in Support of Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, and (5) Modifying Automatic Stay, Docket No. 355.* Borders Group defended the DIP facility’s terms as being “the subject of hard bargaining pre-petition” and “. . . fair, reasonable, and most importantly, the best terms that are currently available to the Debtors in the marketplace.” *Id.* Borders Group agreed to revised terms to quiet the creditors committee, some of which included: (i) giving the committee and U.S. Trustee (a) three business days to object to any “amendments, modifications or supplements to the DIP Loan Documents,” and (b) three business days to object to the payment of the DIP Secured Parties out-of-pocket expenses; (ii) increasing the amount of the “investigation cap” that allowed the committee to “use the DIP Loan proceeds to investigate the liens and claims of the pre-Commencement Date” from \$50,000 to \$125,000; (iii) promising that the committee would receive “the reports, certificates, notices and other documentation required to be sent to the DIP Agents”; and (iv) extending the 60 day Challenge Period “to assert claims against the pre-Commencement Date secured lenders” to be three business days “following the adjudication of a timely filed Standing Motion,” which would no longer require the committee to commence an adversary proceeding within the 60-day period. *Id.*

begged the Committee to relent, because any continued objections would only impede or destroy the reorganization efforts by postponing Borders Group's use of its only financing option.

On March 10th, GGP Limited Partnership ("GGP"), which served on the Committee and was privy to approximately 36 lease agreements with Borders Group, filed an objection to Borders Group's motion to extend the date to assume or reject leases.<sup>237</sup> GGP asked that the Court condition the extension on Borders Group's performance of all Post-Petition obligations under section 365(d)(3).<sup>238</sup> Namely, Borders Group had failed to meet its Post-Petition obligation to pay "stub rent," which was rent from the Petition Date until February 28th.<sup>239</sup> Other landlords objected to the extension of the time to assume or reject leases on the basis that Borders Group had not proven that there was "cause" to do so, since Borders Group filed the motion soon after the Petition Date.<sup>240</sup> Seattle's Best, a Starbucks brand that had an agreement with Borders Group to operate Seattle's Best cafes in Borders stores, also objected to the motion in that it did not account for how Seattle's Best's interests, such as its trademarks, trade dress, and trade secrets, would be affected by the store closings.<sup>241</sup>

In an omnibus response to all objections to the extension of the deadline, Borders Group postulated that it needed time to "make informed determinations as to [its] lease portfolio" and

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<sup>237</sup> *Limited Objection of GGP Limited Partnership, As Agent, to Debtors' Motion for Entry of An Order (I) Extending the Time Within Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property and (II) Authorizing the Debtors to Enter Into Stipulations Further Extending The Time to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket No. 345. 32 of GGP's lease agreements were going concerns locations for Borders Group.

<sup>238</sup> *Limited Objection of GGP Limited Partnership, As Agent, to Debtors' Motion for Entry of An Order (I) Extending the Time Within Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property and (II) Authorizing the Debtors to Enter Into Stipulations Further Extending The Time to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket No. 345.

<sup>239</sup> *Limited Objection of GGP Limited Partnership, As Agent, to Debtors' Motion for Entry of An Order (I) Extending the Time Within Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property and (II) Authorizing the Debtors to Enter Into Stipulations Further Extending The Time to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket No. 345.

<sup>240</sup> *Limited Objection of GGP Limited Partnership, As Agent, to Debtors' Motion for Entry of An Order (I) Extending the Time Within Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property and (II) Authorizing the Debtors to Enter Into Stipulations Further Extending The Time to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket No. 345.

<sup>241</sup> *Limited Objection of Seattle's Best Coffee LLC To Debtors' Motion Requesting Approval of Procedures for the Rejection of Unexpired Leases*, Docket No. 302; see also Eric Morath, *Seattle's Best Steamed about Borders Group Store Closures*, THE WALL STREET JOURNAL, March 9, 2011.

that all stub rent would be paid by April 18th.<sup>242</sup> It cautioned that “any delay in filing th[e] Motion could jeopardize or even derail the Debtors’ reorganization efforts” particularly because the DIP Lenders would require that Borders Group liquidate stores with leases that were not assumed 12 weeks before the applicable court deadline to assume or reject.<sup>243</sup> To make matters worse, the DIP Lenders gave a similar 15-week deadline requiring that bid packages be sent to liquidators, which had already passed as of March 11th.<sup>244</sup> Because the DIP Lenders had extended this deadline to March 15th, which was the day of the hearing, Borders Group would therefore be in default under the DIP facility should Judge Glenn not grant the motion at the hearing.<sup>245</sup>

## V. *The Motions Continue*

At the hearing on March 15th, Borders Group again sought final court approval of its motion to provide adequate assurances to the utility companies. This hearing did not start off on the right foot for Borders Group’s counsel: Judge Glenn began the hearing outraged at attorney Jeff Gleit for plagiarizing, verbatim, another firm’s utilities motion from the Blockbuster bankruptcy case, which Judge Glenn presided over, without attributing his work to the attorneys who wrote the briefs.<sup>246</sup> He demanded that Gleit include in his fee application that the briefs were “substantially copied from the work product of another law firm,” and concluded that Borders Group’s counsel would not receive any fees for its work in connection with the utilities motion.<sup>247</sup>

Judge Glenn was also displeased with Borders Group’s counsel because it had not yet deposited in escrow the required \$2.3 million of adequate assurance for the utility companies as of the hearing date, which left only two days for counsel to do so under the Code’s 30-day time

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<sup>242</sup> *Debtors’ Omnibus Reply to Objections to Motion For An Entry of An Order Extending The Deadline to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket no. 357.

<sup>243</sup> *Debtors’ Omnibus Reply to Objections to Motion For An Entry of An Order Extending The Deadline to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket no. 357.

<sup>244</sup> *Debtors’ Omnibus Reply to Objections to Motion For An Entry of An Order Extending The Deadline to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket no. 357.

<sup>245</sup> *Debtors’ Omnibus Reply to Objections to Motion For An Entry of An Order Extending The Deadline to Assume or Reject Unexpired Leases of Nonresidential Real Property*, Docket no. 357.

<sup>246</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409. Judge Glenn specifically asked him who wrote the brief in support of the utilities motion that improperly recited Judge Glenn’s previous holdings in that Judge Glenn allowed escrow accounts.

<sup>247</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

period.<sup>248</sup> Despite his concerns, Judge Glenn begrudgingly granted the motion on an interim basis contingent upon the money being deposited into an escrow account by 5 pm on the next day.<sup>249</sup>

The motion to extend the time to reject or assume unexpired leases was also at issue in the hearing. Judge Glenn, who was markedly more content with this motion, found that the extension was in the best interests of the estate and entered a final order approving the motion.<sup>250</sup> In so doing, however, Judge Glenn expressed his disapproval of the DIP Facility's imposition of a deadline to assume or reject leases that "constrain[ed] the equitable discretion of the bankruptcy court."<sup>251</sup> On this note, Friedman subsequently rose to persuade Judge Glenn to enter a final order on the contentious DIP Facility.<sup>252</sup> He began by informing Judge Glenn that because Borders Group lacked access to any other forms of credit, "[w]ithout the [DIP financing], they're simply out of business."<sup>253</sup> Friedman also shared that Borders Group had resolved most issues with the Committee during their late night negotiations the night before.<sup>254</sup> Surprisingly, Judge Glenn did not sternly challenge the DIP motion. This may have either been because he failed to fully comprehend some of its terms, which he alluded to in the hearing,<sup>255</sup> or because the Committee had acquiesced to the facility in the late night negotiations. He made it apparent, however, that he was not fond of its terms. Nevertheless, Judge Glenn entered a final order on the uncontested DIP motion as well as on all of Border's other motions that were addressed in the hearing.<sup>256</sup>

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<sup>248</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>249</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>250</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409. Gilbert Saydah, an attorney with Kelley Dryre & Warren, which represented many of Borders Group's landlords, complimented Borders Group to Judge Glenn on its handling of the unexpired leases and provided that the landlords he represented understood that the extension was necessary since Borders Group's use of DIP financing depended on it. *Id.*

<sup>251</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>252</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>253</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>254</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409. One particular change was that the DIP Lenders had agreed to increase the carveout to \$6.5 million.

<sup>255</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409.

<sup>256</sup> *Transcript regarding Hearing Held on March 15, 2011 10:02 AM*, Docket No. 409. Because the unsecured creditors committee and representatives of Borders Group met late on the night before the hearing, a final order was not prepared to be entered as of the hearing date, but was entered on the next day. See *Final Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing*



The Committee's initial objections would prove to have been well founded as the case unfolded. Regardless, Borders Group was in a dilemma when it agreed to the DIP facility. While it repeatedly defended the DIP facility on the grounds that the terms were intensely negotiated, in reality, Borders Group had no other options and no bargaining power, which left it with no choice but to agree to the DIP facility's seemingly extortionate terms. As a result of their predicament, Judge Glenn and the Committee were likewise forced to accept the deal.

## **VI. Executives Want Serious Assurances**

On March 25th, Borders Group filed a highly controversial motion requesting that the court allow it to implement two employee bonus plans: (i) a key employee incentive plan (the "KEIP") to benefit 17 of its top executives; and (ii) a key employee retention plan (the "KERP") to benefit 25 of its director-level employees.<sup>257</sup> Depending on how quickly Borders Group successfully emerged from bankruptcy or was sold as in a section 363 sale as a going concern,<sup>258</sup> Borders Group could potentially fork out \$8.3 million pursuant to the bonus plans.<sup>259</sup> In Borders Group's opinion, it was imperative that the bonus plans were implemented as soon as possible since it was rapidly losing key employees and could not afford to lose any of the key employees identified in the plans.<sup>260</sup> These extravagant bonus plans immediately faced criticism.

Because Borders Group's goal was to exit bankruptcy either pursuant to a section 363 sale as a going concern or through the confirmation of a non-liquidating plan by August or September, it set the KEIP amounts to vary depending on how quickly Borders Group exited

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Superpriority Administrative Expense Status, (4) Granting Adequate Protection, and (5) Modifying Automatic Stay, Docket No. 404.

<sup>257</sup> Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements, Docket No. 457.

<sup>258</sup> Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements, Docket No. 457.

<sup>259</sup> Peg Brickley, Borders Group Seeks to Pay \$8.3 Million in Bonuses, THE WALL STREET JOURNAL, March 25, 2011.

<sup>260</sup> Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements, Docket No. 457.

bankruptcy so as to incentivize key executives to work towards this goal.<sup>261</sup> Under this plan, each of the five key executives could potentially earn a bonus amount ranging from 90% to 150% of their base salaries if Borders Group successfully exited bankruptcy prior to November 16th by either a confirmed non-liquidating plan or a section 363 sale (the “Qualifying Events”), with the maximum bonuses being available if a Qualifying Event occurred prior to August 16th.<sup>262</sup> Therefore, if one of the Qualifying Events occurred past November 16th or if Borders Group had to liquidate, no bonuses would be paid.<sup>263</sup> Mike Edwards stood to gain a whopping \$1.7 million under the extravagant bonus plan.<sup>264</sup> Interestingly, Edwards later said that it was “unlikely that the bonuses would actually be paid out” in an interview during which he predicted that Borders Group would successfully exit bankruptcy by September.<sup>265</sup>

The KERP focused on retaining director-level employees who Borders Group considered indispensable to the Borders Group’s day-to-day operations.<sup>266</sup> Like the KEIP, the plan was contingent on Borders Group successfully exiting bankruptcy pursuant to the same Qualifying Events. Each employee under the KERP would receive a lump sum worth 30% of his or her base salary if one of the Qualifying Events occurred before November 16th.<sup>267</sup> There was a tremendous disparity in the potential aggregate payouts under the two bonus plans— while the

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<sup>261</sup> *Notice of Hearing on Debtors’ Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 457.

<sup>262</sup> Peg Brickley, *Borders Group Seeks to Pay \$8.3 Million in Bonuses*, THE WALL STREET JOURNAL, March 25, 2011.

<sup>263</sup> Peg Brickley, *Borders Group Seeks to Pay \$8.3 Million in Bonuses*, THE WALL STREET JOURNAL, March 25, 2011.

<sup>264</sup> Peg Brickley, *Borders Group Seeks to Pay \$8.3 Million in Bonuses*, THE WALL STREET JOURNAL, March 25, 2011.

<sup>265</sup> Nathan Bomey, *Exclusive interview with Borders Group CEO Mike Edwards: ‘We are here fighting to the end’*, THE ANN ARBOR NEWS, May 5, 2011.

<sup>266</sup> *Notice of Hearing on Debtors’ Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 457.

<sup>267</sup> *Notice of Hearing on Debtors’ Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 457.

KEIP could potentially pay out \$7.1, the KEIP would only pay out \$933,000 and possibly an additional \$300,000 that could be awarded at Borders Group's discretion.<sup>268</sup>

Although the Committee did not object to the motion for approval of the bonus plans, the U.S. Trustee strongly opposed the plans on the grounds that the plans were "disguised retention plan[s] for insiders," which are prohibited as administrative expenses under section 503(c)(1) of the Bankruptcy Code.<sup>269</sup> She also expressed that Borders Group's presentment of the bonus plans "prior to the debtors' finalizing their business and operational plans [was] not a sound exercise of the debtors' business judgment."<sup>270</sup>

As of April 12th, two key executives and twenty-two director-level employees had resigned since March 25th when the plans were initially introduced.<sup>271</sup> Borders Group considered this indicative of how desperately it needed the Court to approve the bonus plans over the objection of the U.S. Trustee. Borders Group asserted that the KEIP, although it did apply to "insiders" and would have a retentive effect, did not fall under section 503(c)(1) of the Bankruptcy Code since the plan was not primarily "for the purpose of inducing such person to remain with the debtor's business," but instead served to incentivize executives to work to keep Borders Group a going concern because the bonuses were only triggered upon the Qualifying Events that were based on Borders Group emerging from Chapter 11.<sup>272</sup> In regard to the KERP,

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<sup>268</sup> *Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 For an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 457.

<sup>269</sup> Joseph Checkler, *U.S. Trustee Objects to Borders Group's Bonus Plan*, THE WALL STREET JOURNAL, April 8, 2011. In 2005, the Bankruptcy Code was amended to add Section 503(c)(1), which prohibits a court from allowing, as an administrative expense, incentive payments to "insiders" as defined in section 101(31) of the corporation that "are paid to induce an insider to remain with the debtors business or any severance payment" who includes, among others, directors and officers of the corporation. 11 U.S.C. §§ 503(C)(1), 101(31); *In re Borders Group, Inc.*, 453 B.R. 459 (Bankr. S.D. N.Y. 2011).

<sup>270</sup> Joseph Checkler, *U.S. Trustee Objects to Borders Group's Bonus Plan*, THE WALL STREET JOURNAL, April 8, 2011.

<sup>271</sup> *Response/Reply to the U.S. Trustee's Objection to Debtors' Motion to Authorize Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. Bankr. P. 6006 and 9014 for an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 598.

<sup>272</sup> *Response/Reply to the U.S. Trustee's Objection to Debtors' Motion to Authorize Notice of Hearing on Debtors' Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. Bankr. P. 6006 and 9014 for an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 598.

Borders Group asserted that section 503(c)(1) did not prohibit the KERP, which clearly was a retention plan, because the employees were not “insiders” but instead “non-executive managers.”<sup>273</sup>

By the hearing on April 22nd, however, Borders Group had drastically revised the KEIP after negotiations with the U.S. Trustee, who withdrew her objection.<sup>274</sup> The amended plan was more appropriately aligned with Borders Group’s bankruptcy goals of reducing costs and remaining a going concern.<sup>275</sup> Under the KEIP, the five highest-level executives could now receive bonuses ranging from 55% to 75% of their base salaries upon the occurrence the Qualifying Events. The percentage amount would increase depending on how promptly a Qualifying Event happened – the executives would get 77% base salary bonuses should a Qualifying Event occur by August 15, 2011 or 55% base salary bonuses should a Qualifying Event occur by November 16th.<sup>276</sup> To receive the aforementioned bonuses, Borders Group also had to have: (i) reduced its rent costs by May 31, 2011 by at least \$10 million for both 2011 and 2012; or (ii) reduced other costs by \$10 million by June 30th from “contract rejections or renegotiations,” which excluded “any real estate lease amendments, . . . any rejections of contracts or leases associated with any closing stores,” or any layoffs of employees by June 30th.<sup>277</sup> The five executives could each also receive an additional 75% base salary bonus if unsecured creditors received a distribution under a confirmed plan of at least \$73 million or a 125% base salary bonus if the distribution equaled at least \$95 million.<sup>278</sup>

Each of the ten lower-level executives stood to receive a 40% base salary bonus under the same terms described above; however, unlike the key executives, they were not entitled to any incentive payments based on distributions made to unsecured creditors.<sup>279</sup> The maximum

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<sup>273</sup> *Response/Reply to the U.S. Trustee’s Objection to Debtors’ Motion to Authorize Notice of Hearing on Debtors’ Motion Pursuant to Sections 363(b), 365(a) and 503(c) of the Bankruptcy Code and Fed. Bankr. P. 6006 and 9014 for an Order Authorizing (I) Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan, and (II) Assumption of Certain Employment Agreements*, Docket No. 598. Judge Glenn later held that the director-level employees were not “insiders” within the meaning of section 101(31)(b). *In re Borders Group, Inc.* 453 B.R. 459, 469 (Bankr. S.D. N.Y. 2011).

<sup>274</sup> *Transcript regarding hearing held on April 22, 2011*, Docket No. 1432.

<sup>275</sup> Peg Brickley, *Borders Group Seeks to Pay \$8.3 Million in Bonuses*, THE WALL STREET JOURNAL, March 25, 2011.

<sup>276</sup> *In re Borders Group, Inc.*, 453 B.R. at 466.

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.*

potential cost of the plans was now approximately \$3.9 million, which was \$4.4 million less than the previously proposed plans' amounts.<sup>280</sup> Judge Glenn, who wrote an opinion in support of his order, considered the compensation amounts to be reasonable since the total maximum amount under both plans “represented only 0.17% of Borders Group’s total revenue from 2010.”<sup>281</sup> Because Judge Glenn agreed with Borders Group that the bonus plans were critical to it meeting its bankruptcy goals and believed that the plans would benefit the estate because “an expedited emergence [would] minimize administrative costs, thereby helping to maximize stakeholder value,” he entered a final order authorizing the implementation of the revised bonus plans.<sup>282</sup>

## **VII. Borders Group’s Professionals “Lump” and “Rack up” Fees**

On March 22nd, professionals began filing their monthly fee statements. Kasowitz, Benson, Torres & Freidman LLP (“KBT&F”) sought \$1,273,867.00 in “reasonable” legal fees for the period of February 16th through March 31st alone.<sup>283</sup> Mercer (US) Inc. (compensation consultants), Jefferies & Company, Inc. (financial advisor), DJM Realty Services, LLC (real estate advisors), Garden City Group, Inc. (administrative agent), Dickinson Wright PLLC (special counsel to debtors), Deloitte Tax, LLP (tax advisors), Deloitte Consulting, LLP (consultants), Deloitte & Touche, LLP (accountants), Lowenstein Sandler, PC (counsel to Committee), and Baker & McKenzie (corporate counsel) also filed fee statements.<sup>284</sup> In total, the amount of fees requested for the first month during bankruptcy was approximately \$3.4

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<sup>280</sup> *Id.* at 473.

<sup>281</sup> *In re Borders Group, Inc.*, 453 B.R. at 474.

<sup>282</sup> *Order Pursuant to Sections 363(b), 365(a), and 503(c) of the Bankruptcy Code and Fed. R. Bankr. P. 6006 and 9014 Authorizing (I) The Implementation of (A) Key Employee Incentive Plan and (B) Key Employee Retention Plan And (II) The Assumption of Certain Employment Agreements*, Docket No. 697. Judge Glenn drafted an opinion to elaborate his justifications for granting the order, most likely because § 503(c)(1) had been added to the Code in 2005. He held that the KEIP met the “business judgment standard” under 503(c)(3) and that its primary purpose was to incentivize executives and therefore it did not violate section 503(c)(1) even though it had a retentive effect. *In re Borders Group, Inc.*, 453 B.R. at 471-73.

<sup>283</sup> *First Monthly Fee Statement of Kasowitz, Benson, Torres & Friedman LLP . . .*, Docket No. 675.

<sup>284</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744.

million.<sup>285</sup> At the same time Borders Group was racking up professional fees, it had experienced an aggregate loss of more than \$50 million for February and March.<sup>286</sup>

On April 29th, the U.S. Trustee objected to Borders Group paying any professionals.<sup>287</sup> As of this date, Borders Group had not filed its first operating report for the period of February 16th through March 31st, which the Trustee asserted would make it impossible to know if they were paying suppliers and other non-professional administrative expenses, and thus requested that their professionals not receive fees until the operating reports were filed and their United States Trustee's Fee were paid.<sup>288</sup> The Trustee also objected to KBT&F's fee statements in that they included "vague and lumped time,"<sup>289</sup> which made it impossible to gauge whether the amount of time spent on each project was reasonable.<sup>290</sup> She also objected to the number of KBT&F attorneys that were present in each hearing in that it was unreasonable, for example, to have 7 attorneys at the first-day hearing who were all billing their time.<sup>291</sup>

On May 5th, Borders Group entered a notice of a resolution of the Trustee's objection to KBT&F's fees.<sup>292</sup> KBT&F presented several concessions it made which included agreeing to: (i) reduce its charge for photocopies to \$.10 per page (which reduced the monthly statement by \$6,154.00); (ii) write off 2 out of 4 meals that were objected to (which reduced the monthly

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<sup>285</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744. Pursuant to the first day orders, Borders Group was given permission to pay 80% of reasonable professional fees at the conclusion of every month so long as there were no objections. *Id.*

<sup>286</sup> Eric Morath, *Borders Group Details Recent Losses*, THE WALL STREET JOURNAL, May 2, 2011.

<sup>287</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744.

<sup>288</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744.

<sup>289</sup> "Lumping" is where a lawyer reports multiple tasks into one entry. As of 2010, the Southern District of New York now has a standard where fees for only 30 minutes of time in a time entry that includes "lumped time" are allowed. Conray C. Tseng, *Recent Guidance in the Southern District of New York on Professional Fee Applications*, WEIL BANKRUPTCY BLOG: PROFESSIONAL FEES AND RETENTION, Sept. 23, 2010.

<sup>290</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744.

<sup>291</sup> *Notice of Objection of the United States Trustee to Monthly Statements for Compensation and Reimbursement of Expenses*, Docket No. 744.

<sup>292</sup> *Statement Regarding Resolution of the United States Trustee's Objection to First Monthly Fee Statement of Kasowitz, Benson, Torres & Friedman LLP . . .*, Docket No. 795.

statement by \$565.95); (iii) write off a half of the car and cab fare (which reduced the monthly statement by \$7,090.66); and (iv) reduce its total fees by \$10,048.96.<sup>293</sup> Borders Group had also filed its first operating report, which detailed the aforementioned massive losses that it incurred for the period.<sup>294</sup> Most other professionals similarly resolved billing issues with the Trustee.

Mercer (US) Inc., however, responded to the Trustee's objection by asserting that the Trustee's "attempt to *per se* disallow reimbursement of legal fees fail[ed] to meet the improvidence standards under section 328(a) and thus represent[ed] a collateral attack on the Retention Order . . . ."<sup>295</sup> Mercer sought fees of \$97,226.58 and reimbursement of \$17,402.02, which included \$16,496.35 in fees of its outside counsel, Freeborn & Peters, LLP, which had helped Mercer negotiate its retention agreement.<sup>296</sup> The Trustee objected to Mercer's reimbursement of outside counsel fees, but Judge Glenn held that because the engagement letter "separately provided for reimbursement of outside counsel fees in connection with retention and fee applications," that these fees were recoverable.<sup>297</sup> Judge Glenn did, however, disallow a small amount of the fees that Mercer sought to recover for work in connection to the employee bonus plans performed by Freeborn & Peters since Mercer was specifically retained under section 327 to perform this work.<sup>298</sup>

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<sup>293</sup> *Statement Regarding Resolution of the United States Trustee's Objection to First Monthly Fee Statement of Kasowitz, Benson, Torres & Friedman LLP . . .* , Docket No. 795.

<sup>294</sup> *Statement Regarding Resolution of the United States Trustee's Objection to First Monthly Fee Statement of Kasowitz, Benson, Torres & Friedman LLP . . .* , Docket No. 795.

<sup>295</sup> *Response of Mercer (US) Inc. to the U.S. Trustee's Objection to the First interim Application for Compensation for Services Rendered and Reimbursement of Expenses as Compensation. . .* , Docket No. 1115. Mercer asserted that a court cannot "modify the terms of a previously-approved retention agreement . . ." "unless the terms and conditions proved to be 'improvident' at the time they were approved of in light of then-unforeseen circumstances." *Id.* (citing *In re XO Comm., Inc.*, 323 B.R. 330, 339 (Bankr. S.D.N.Y. 2005)). Further, Mercer provided that "'improvidence' includes inadequate representation, resolution at an unexpectedly early stage of the proceedings, or that the results obtained were disappointing." (citing *In re Benassi*, 72 B.R. 44, 48-49 (D. Minn 1987)).

<sup>296</sup> *Memorandum Opinion and Order (I) Overruling Objection Of the United States Trustee and (II) Granting In Part and Denying In Part First Interim Application of Mercer (US) Inc. as Compensation Consultant to the Debtors and Debtors In Possession For the Period from February 16, 2011 Through April 30, 2011*, Docket No. 1590.

<sup>297</sup> *Memorandum Opinion and Order (I) Overruling Objection Of the United States Trustee and (II) Granting In Part and Denying In Part First Interim Application of Mercer (US) Inc. as Compensation Consultant to the Debtors and Debtors In Possession For the Period from February 16, 2011 Through April 30, 2011*, Docket No. 1590.

<sup>298</sup> *Memorandum Opinion and Order (I) Overruling Objection Of the United States Trustee and (II) Granting In Part and Denying In Part First Interim Application of Mercer (US) Inc. as Compensation Consultant to the Debtors and Debtors In Possession For the Period from February 16, 2011 Through April 30, 2011*, Docket No. 1590. In the opinion, Judge Glenn provided that "[w]ork done on behalf of

The Trustee again objected to professionals' fee statements in June, which totaled approximately \$7.1 million, because Borders Group had not filed a disclosure statement and reorganization plan at this time, which according to the Trustee, made it impossible to "know[] whether the payment of these multimillion-dollar fees would hurt creditors."<sup>299</sup> This objection ended up being a nonissue since all professionals subsequently "held back their fees" and filed notices of resolutions.<sup>300</sup>

### VIII. *The Breakup with Seattle's Best*

On March 18th, Borders Group, in a further attempt to revitalize itself as a lean, mean, book-selling machine, filed a motion to take advantage of section 365 of the Bankruptcy Code by rejecting an agreement with Seattle's Best, a Starbucks brand, regarding cafes in Borders Group's retail stores.<sup>301</sup> The master licensing agreement with Seattle's Best gave Borders Group the right to operate Seattle's Best cafes, but required Borders Group to pay hefty royalty fees.<sup>302</sup> In this motion, Borders Group provided that the royalties fees were "excessive and have contributed to the Licensing Agreement being unprofitable . . ."<sup>303</sup> Borders Group did not file the agreement and requested that the public not have access, so the exact terms of the agreement

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the estate is compensable only if the professional performing the work is retained pursuant to section 327." *Id.* "Under section 330(a)(1)(B) of the Bankruptcy Code, a professional employed under section 327 may only be reimbursed for 'actual, necessary expenses.'" *Id.* Further, expenses are only necessary when they "were properly required to accomplish the task for which the professional was employed." *Id.*

<sup>299</sup> Rachel Slajda, *Borders Group Trustee Objects to Attys' Fees Again*, LEXIS NEXUS LAW360, June 21, 2011. The Trustee provided that "the Bankruptcy Court has the authority to reduce fees or expenses when they are disproportionate to the benefit to the estate, even if it already has approved the professional's retention under Sections 327 and 328 of the Bankruptcy Code." *Objection to Motion for First Interim Fees . . .*, Docket No. 1080. She requested that the court require a "hold back," which is where a percentage of fees are reduced, since Borders Group incurred losses of over \$180 million" and not filed a plan and disclosure statement. *Id.*

<sup>300</sup> *Statement Regarding Resolution of United State Trustee's Objection to the Monthly Fee Application of Dickenson Wright, PLLC . . .*, Docket No. 1091; *Statement Regarding Resolution of the United States Trustees Informal Objection to the Third Monthly Fee Statement of Lowenstein Sandler PC . . .*, Docket No. 1109.

<sup>301</sup> *Notice of Hearing on Debtors' Motion Pursuant to 11. U.S.C. §365(a) and Rules 6006 and 9014 of the Federal Rules of Bankruptcy Procedure to End Licensing Agreement with Seattle's Best Coffee, LLC*, Docket No. 868.

<sup>302</sup> *Notice of Hearing on Debtors' Motion Pursuant to 11. U.S.C. §365(a) and Rules 6006 and 9014 of the Federal Rules of Bankruptcy Procedure to End Licensing Agreement with Seattle's Best Coffee, LLC*, Docket No. 868.

<sup>303</sup> *Notice of Hearing on Debtors' Motion Pursuant to 11. U.S.C. §365(a) and Rules 6006 and 9014 of the Federal Rules of Bankruptcy Procedure to End Licensing Agreement with Seattle's Best Coffee, LLC*, Docket No. 868.



are unknown, but Borders Group clearly thought that they could operate in-store cafes cheaper without the Seattle's Best partnership, and believed that doing so would make Borders stores more viable in the future.<sup>304</sup>

Borders Group's motion to terminate the licensing agreement was granted.<sup>305</sup> In a press release, a spokesperson for Seattle's Best responded with condescension to the licensing agreement termination, stating, "We look forward to continuing to serve the many fans we've made at Borders Group through the 50,000 other places where our coffee can now be found."<sup>306</sup>

### **IX. *Borders's CEO Remains Confident in Company***

In a May 5, 2011 interview, Mike Edwards remained very optimistic about the company's outlook:

**AnnArbor.com:** Are you convinced that Borders can survive bankruptcy?

**Edwards:** Absolutely. ... We've done the consolidation ahead of the (steep rise in e-book sales). Our stores will remain profitable even with a downward trend for the next three to four years with significant leasehold reductions and flexibility.

...

So, yeah, I know we can come out. I know that we can move back to profitability significantly. In fact, it could be the turnaround of the century if you just look at our historic performance.<sup>307</sup>

In the same interview, Edwards indicated that the company was close to having a reorganization plan to present in court, subject to approval of and cooperation from the publishers.<sup>308</sup> He

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<sup>304</sup> Eric Morath, *Borders Group Seeks Coffee Break with Seattle's Best*, THE WALL STREET JOURNAL, May 19, 2011.

<sup>305</sup> *Order Granting Motion Pursuant to 11 U.S.C. § 365(a) and Rules 6006 and 9014 of the Federal Rules of Bankruptcy Procedure to Reject Master Licensing Agreement with Seattle's Best Coffee, LLC*, Docket No. 979.

<sup>306</sup> Eric Morath, *Borders Seeks Coffee Break with Seattle's Best*, THE WALL STREET JOURNAL, May 19, 2011.

<sup>307</sup> Nathan Bomey, *Exclusive Interview with Borders CEO Mike Edwards*, THE ANN ARBOR NEWS, May 5, 2011.

<sup>308</sup> Nathan Bomey, *Exclusive Interview with Borders CEO Mike Edwards*, THE ANN ARBOR NEWS, May 5, 2011.

envisioned Borders cutting unprofitable stores to realize a “dramatic” increase in profits, while focusing future growth on the online and e-book market segments.<sup>309</sup>

## **D. Sale Efforts**

### **I. *Suitors Emerge***

Despite Edwards’s insistence that Borders Group would successfully emerge from the reorganization, the company was actively marketing itself to potential buyers as a going concern, and claimed in a declaration filed on May 19 to have solicited multiple “promising offers.”<sup>310</sup> Although these potential buyers were not named at the time of the declaration, their identities soon came to light, and each seemed to show promise for keeping Borders Group alive.

The first potential acquiror to emerge was the private-equity firm Gores Group LLC (“Gores Group”), headed by Alec Gores, its billionaire chief executive and founder.<sup>311</sup> Gores Group was interested in Borders Group as a going concern, and sought to purchase just under half of Borders Group’s remaining stores.<sup>312</sup> The firm believed that it could better control its risk by operating Borders on a smaller scale, and planned to focus its efforts on shifting Borders’s overall business strategy toward an online retail model.<sup>313</sup> Gores Group also envisioned Borders capitalizing on the e-reader market by partnering with other companies, such as Hewlett Packard, to make Borders a destination for technology as well as books.<sup>314</sup>

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<sup>309</sup> Nathan Bomey, *Exclusive Interview with Borders CEO Mike Edwards*, THE ANN ARBOR NEWS, May 5, 2011.

<sup>310</sup> *Declaration of Holly Felder Etlin in Support of the Debtors’ Motion for Order Pursuant to 11 U.S.C. § 1121(d) Extending Their Exclusive Periods for Filing and Soliciting Acceptances of a Chapter 11 Plan*.

<sup>311</sup> Mike Spector and Jeffrey A. Trachtenberg, *Bidder Emerges for Borders Bookstores*, THE WALL STREET JOURNAL, June 2, 2011.

<sup>312</sup> Mike Spector and Jeffrey A. Trachtenberg, *Bidder Emerges for Borders Bookstores*, THE WALL STREET JOURNAL, June 2, 2011.

<sup>313</sup> Mike Spector and Jeffrey A. Trachtenberg, *Bidder Emerges for Borders Bookstores*, THE WALL STREET JOURNAL, June 2, 2011.; Mike Spector and Jeffrey A. Trachtenberg, *Borders in talk with Najafi Cos.*, THE WALL STREET JOURNAL, June 8, 2011.

<sup>314</sup> For example, Gore Group was apparently in talks with Hewlett Packard to showcase H.P.’s new ereader in its stores, which it would offer to its customers with e-book promotions. Mike Spector and Jeffrey A. Trachtenberg, *Immigrant Moguls Compete to Write Future of Borders*, THE WALL STREET JOURNAL, June 21, 2011.

Shortly after news of Gores Group’s interest in Borders leaked, a second private-equity firm, Najafi Companies (“Najafi”), emerged as another potential bidder hoping to acquire a significant number of Borders’s superstores to operate as a going concern.<sup>315</sup> Najafi, a Phoenix-based portfolio company headed by veteran investor Jahm Najafi, owned a number of book clubs, and had recently acquired Direct Brands, Inc., which included Book-of-the-Month Club, Doubleday Book Clubs, and Columbia House. Najafi had already consolidated the operations of his book clubs into a single unit, and believed that adding Borders Group to its portfolio would bolster those book clubs by creating synergies with Borders’s operations.<sup>316</sup> The firm also hoped to build on Borders’s strong customer base by offering them new goods and services.<sup>317</sup>

## II. *Borders Buys More Time From its Lenders*

As Borders Group negotiated with both Gores Group and Najafi, it also began to work out a deal with the DIP Lenders to amend the DIP Credit Agreement. As discussed earlier, under the original DIP Credit Agreement, Borders Group was required to take certain actions to liquidate stores at which it had neither assumed the underlying lease nor obtained an extension to make its assumption/rejection decision beginning fifteen weeks prior to the last day of the lease assumption/rejection period, which the court established to be September 14, 2011.<sup>318</sup> Specifically, for any leases that Borders Group had neither assumed nor obtained from the landlord an extension to assume/reject, the DIP Credit Agreement required Borders to:

- (1) Transmit bid solicitation packages to liquidate the stores by June 1, 2011;

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<sup>315</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders in talk with Najafi Cos.*, THE WALL STREET JOURNAL, June 8, 2011.

<sup>316</sup> Mike Spector and Jeffrey A. Trachtenberg, *Borders in talk with Najafi Cos.*, THE WALL STREET JOURNAL, June 8, 2011; Dennis Burman et al., *Opening Bidder Picked for Borders Auction*, THE WALL STREET JOURNAL, July 1, 2011.

<sup>317</sup> Mike Spector and Jeffrey A. Trachtenberg, *Bidder Emerges for Borders Bookstores*, THE WALL STREET JOURNAL, June 2, 2011.; Mike Spector and Jeffrey A. Trachtenberg, *Borders in talk with Najafi Cos.*, THE WALL STREET JOURNAL, June 8, 2011.

<sup>318</sup> *Motion to Approve/Debtors' Motion for an Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 Authorizing Debtors to Enter Into Second Amendment to Debtor in Possession Credit Agreement*. Section 365 of the Bankruptcy Code gives debtors the option to assume or reject unexpired leases, with Court approval, under certain conditions. Borders was not able to assume any of its leases, however, because certain creditors made clear that they would oppose any motion to assume any of the leases unless Borders Group were to be sold as a going concern or a plan of reorganization was confirmed. It was, however, able to obtain in most cases landlord consent to extend the deadline pursuant to section 365(d) (4)(B) of the Bankruptcy Code. *Motion to Authorize/Debtors' Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales, (II) Approving Bidding Procedures to Select Liquidating Agent to Conduct Store Closing Sales, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting Laws Restricting Store Closing Sales and (VI) Granting Related Relief*.

- (2) File an approval motion by June 8, 2011;
- (3) Enter into a stalking horse agency agreement by June 15, 2011; and
- (4) Obtain Court approval and begin store closings by June 22, 2011.<sup>319</sup>

As of June, Borders Group had not obtained extensions for the assumption/rejection deadline from landlords at 51 locations.<sup>320</sup> Accordingly, to avoid default under the DIP Credit Agreement, Border Group was forced to commence proceedings to liquidate those stores, and it begrudgingly filed a motion on June 9th requesting Judge Glenn to approve store closing sales at those locations.<sup>321</sup> Pursuant to the motion, an auction to select the liquidating agent was scheduled for June 16th.<sup>322</sup>

Unfortunately, the 51 stores covered by the June 9th motion included some of Borders Group's most profitable stores – stores that both Gores and Najafi wanted, and the lack of which could potentially ruin either deal.<sup>323</sup> Thus, Borders Group sought to renegotiate the terms of the DIP Credit Agreement in order to delay the liquidations, believing that it would soon strike a

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<sup>319</sup> *Motion to Approve/Debtors' Motion for an Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 Authorizing Debtors to Enter Into Second Amendment to Debtor in Possession Credit Agreement.*

<sup>320</sup> *Motion to Authorize/Debtors' Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales, (II) Approving Bidding Procedures to Select Liquidating Agent to Conduct Store Closing Sales, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting Laws Restricting Store Closing Sales and (VI) Granting Related Relief, Docket No. 999.*

<sup>321</sup> In the motion, Borders made it painfully clear that it did not want the motion to be granted, stating that “[t]he Debtors believe . . . that the stores to be liquidated pursuant to this Motion should not be liquidated under these circumstances . . . [t]his leaves the Debtors with a Hobson’s choice: the Debtors can proceed with store closing sales at these stores under these unfortunate circumstances or, if they refuse to do so, risk being placed into default by DIP lenders.” *Motion to Authorize/Debtors' Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales, (II) Approving Bidding Procedures to Select Liquidating Agent to Conduct Store Closing Sales, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting Laws Restricting Store Closing Sales and (VI) Granting Related Relief, Docket No. 999.*

<sup>322</sup> *Motion to Authorize/Debtors' Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales, (II) Approving Bidding Procedures to Select Liquidating Agent to Conduct Store Closing Sales, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting Laws Restricting Store Closing Sales and (VI) Granting Related Relief, Docket No. 999.*

<sup>323</sup> *Declaration of Holly Felder Etlin in Support of Debtors' Motion Pursuant to 11 U.S.C. §§ 05, 361, 362, 363, 364 and 507 for an Order Authorizing Debtors to Enter into Second Amendment to Debtor-in-Possession Credit Agreement, Docket No. 1077.*

deal to sell Borders as a going concern in a single transaction, which it believed would maximize value for all parties.<sup>324</sup>

After extensive negotiations between Borders Group, the DIP Lenders, and the Committee, the parties reached an agreement that would eliminate the need to conduct the store closing sales. Accordingly, Borders Group filed a notice on June 15th that the auction scheduled for the following day was cancelled.<sup>325</sup> The deal struck would amend the DIP Credit Agreement to allow Borders Group to delay closing any more stores, but mandated a new schedule of deadlines for the sale of substantially *all* of Borders Group's assets, regardless of lease assumption/rejection deadlines:

- July 1, 2011: Borders Group must file a motion requesting approval of a stalking horse bidder.
- July 15, 2011: The Court must enter an order approving the stalking horse bidder.
- July 19, 2011: An auction must be held.
- July 22, 2011: A sale hearing must be conducted.
- July 29, 2011: The sale must close.<sup>326</sup>

Thus, in order to avoid closing fifty stores prematurely, the DIP Lenders forced Borders Group to go all-in to sell the chain of bookstores as a going concern. In return for the extension of time to finalize a sale, the DIP Lenders required a modest amendment fee -- \$1 million.

Borders Group filed the motion to amend the DIP Credit Agreement on June 6th.<sup>327</sup> The court did not receive the proposed amendment warmly. When Andrew Glenn brought the motion before the court, Judge Glenn was particularly concerned about the \$1 million fee:

**MR. GLENN:** Finally, in exchange for this, we have agreed, and this is the pill that every debtor has to swallow in these cases --

**THE COURT:** It's a pretty big pill.

**MR. GLENN:** -- and that is one million dollar fee.

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<sup>324</sup> *Transcript regarding Hearing Held on 06/22/2011, 11:09 AM RE: Motion for an Order Pursuant to 11 U.S.C. 105, 361, 362, 363, 364, and 507 authorizing Debtors to Enter Into Second Amendment to Debtor in Possession Credit Agreement*, Docket No. 1148, 7:1-2.

<sup>325</sup> *Notice of Cancellation of June 16, 2011 Auction to Select Liquidator to Conduct Store Closing Sales*, Docket No. 1053.

<sup>326</sup> *Debtors' Motion for an Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 Authorizing Debtors to Enter into Second Amendment to Debtor in Possession Credit Agreement*, Docket No. 1077.

<sup>327</sup> *Debtors' Motion for an Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, and 507 Authorizing Debtors to Enter into Second Amendment to Debtor in Possession Credit Agreement*, Docket No. 1077.

**THE COURT:** [My] reluctance [to grant the motion] is because I think you're getting raped -- is the best way I can describe it. . . . I don't doubt that this was viewed as the best deal you could get, but the million dollar fee for the very minimal extension in these dates is an extraordinary fee -- very close to me just saying no.<sup>328</sup>

Despite his concerns with the fee – as well as with the very short amount of time allowed for potential buyers to submit bids – Judge Glenn reluctantly approved the motion and the new timetable on June 22nd.<sup>329</sup>

### **III. *Najafi Gets the Stalking Horse Nod***

Just over a week after the Judge Glenn approved the new timetable, Najafi emerged as the winner for the starting bid. Under the terms of the deal, which was announced on June 30, 2011, Najafi's affiliate, Direct Brands, would acquire substantially all of Borders Group's assets through BB Brands, LLC (a wholly owned subsidiary of Direct Brands) for \$215.1 million in cash plus the assumption of approximately \$220 million of liabilities.<sup>330</sup>

The proposed transaction would be a section 363(b) sale of Borders Group's assets outside of the ordinary course of business, and thus would require court approval. Borders Group filed a motion seeking approval of sale procedures, which included the proposed asset purchase agreement between Borders Group and Najafi. The asset purchase agreement would serve as the "Stalking Horse Bid," or starting point bid, because an auction would still need to be conducted to ensure that the proposed deal was the highest and best offer for the assets to be sold. Thus, the proposed Sale Procedures called for Borders Group to further solicit bids, and if it received other "qualified bids" in addition to the Stalking Horse Bid, an auction would be conducted to select best offer. The Bid Procedures invited bids as either a Going Concern (which, strangely enough, was allowed to also include purchase of substantially all of Borders Group's assets for the purpose of liquidation), a Partial Store Liquidation (bids for liquidation agents to conduct liquidation sales of assets left over from a purchase of less than all of Borders

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<sup>328</sup> Transcript regarding Hearing Held on 06/22/2011, 11:09 AM RE: Motion for an Order Pursuant to 11 U.S.C. 105, 361, 362, 363, 364, and 507 authorizing Debtors to Enter Into Second Amendment to Debtor in Possession Credit Agreement, Docket No. 1148, 17:6-8, 23-25.

<sup>329</sup> Transcript regarding Hearing Held on 06/22/2011, 11:09 AM RE: Motion for an Order Pursuant to 11 U.S.C. 105, 361, 362, 363, 364, and 507 authorizing Debtors to Enter Into Second Amendment to Debtor in Possession Credit Agreement, Docket No. 1148, 17:6-8, 23-25.

<sup>330</sup> Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee, and (III) Granting Related Relief, Docket No. 1130.

Group's assets in a Going Concern Sale), or a Full Store Liquidation (bids from liquidation agents to conduct liquidation sales for all of Borders Group's assets).

The Stalking Horse Bid was not without a catch – Najafi required a \$6.54 million break-up fee, which would be paid to BB Brands, LLC in the event that the parties entered into the purchase agreement (after court approval of the sale and Bid Procedures), but the sale was not subsequently closed.<sup>331</sup> Because of the size of the break-up fee, the proposed Bid Procedures would require any additional bid to exceed the compensation provided to Borders Group under the Stalking Horse Bid by at least \$8.95 million.<sup>332</sup> Further, the asset purchase agreement provided that BB Brands, LLC could decide whether to assume or reject any of Borders Group's unexpired leases of real property at any time prior to the applicable assumption/rejection deadlines (none of which fell before the hearing to approve the sale), and any store locations where BB Brands opted not to assume the leases would be liquidated with the proceeds of the sales going to BB Brands.<sup>333</sup>

In order to comply with the DIP Credit Agreement, Borders Group also solicited a back-up liquidation bid, which was submitted for approval with the Stalking Horse Bid. The back-up bid was an agency agreement (the "Agency Agreement") with Hilco Merchant Resources, LLC, Gordon Brothers Retail Partners, LLC, SB Capital Group, LLC, Tiger Capital Group, LLC and Great American Group, LLC (collectively, the "Liquidators") that would provide for the liquidation of the entire chain of bookstores.<sup>334</sup> The Agency Agreement offer was to be left open until July 29th in case the Stalking Horse Bid (or another winning bidder) fell through.

The Agency Agreement provided that the Liquidators – some of whom also conducted the initial emergency store closings – would conduct store closing sales at all of Borders Group's remaining retail locations, as well as liquidate all of the debtor's other furniture, fixtures and

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<sup>331</sup> *Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee, and (III) Granting Related Relief*, Docket No. 1130.

<sup>332</sup> *Bidding Procedures For Sale of All or Substantially All of the Debtors' Assets*, Docket No. 1130, page 131.

<sup>333</sup> *Asset Purchase Agreement*, Docket No. 1130, Exhibit 1, page 145.

<sup>334</sup> *Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee, and (III) Granting Related Relief*, Docket No. 1130.

equipment.<sup>335</sup> The Liquidators would guarantee a certain amount to Borders Group based on percentage of the cost value of the merchandise, and any additional proceeds beyond the guaranteed amount and the Liquidators' expenses would be split evenly between the Liquidators and the Borders Group.<sup>336</sup>

Regardless of who ended up winning the auction, as soon as a deal closed, Borders Group would be required to seek approval of the court to use all of the sale proceeds to pay back the DIP Lenders.<sup>337</sup>

#### **IV. *The Creditors' Committee Shoots Down Najafi***

Edwards and Borders heralded the Stalking Horse Bid from Najafi as a triumph for the reorganization, indicating that they perceived the deal – or at least hoped the public would perceive the deal – as a successful sale of Borders as a going concern. In a statement released by Borders on June 30, 2011, Edwards said:

We are pleased to take another important step forward as we position Borders for a vibrant future and sustainable earnings growth. Since the filing, we have made significant progress in reducing our cost structure, refocusing our merchandise offering, and building our eBook business. We look forward to working with a supportive partner as we continue to execute on our turnaround strategy.<sup>338</sup>

Considering the bonus Edwards stood to receive if the deal went through, it is easy to understand his enthusiasm. Not everyone was enthralled the Stalking Horse Bid, however. The Creditors' Committee was particularly concerned with purchaser's option to assume or reject whichever unexpired leases it wished, liquidating any retail locations that were not assumed.<sup>339</sup>

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<sup>335</sup> *Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee, and (III) Granting Related Relief*, Docket No. 1130.

<sup>336</sup> *Modified Agency Agreement*, Docket No. 1235, page 41.

<sup>337</sup> *Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee, and (III) Granting Related Relief*, Docket No. 1130.

<sup>338</sup> *Borders Group Enters Into Preliminary Agreement With Direct Brands, A Portfolio Company of Najafi Companies*, Borders Group, June 30, 2011.

<sup>339</sup> *Transcript regarding Hearing Held on 07/14/2011 10:03AM RE: Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made*



The Committee feared that BB Brands would purchase substantially all of Borders Group's assets and subsequently choose to liquidate all of the chain's retail locations (by opting not to assume any of the unexpired leases) while retaining the intellectual property and other assets (which would be particularly valuable for Najafi's book clubs) – all while paying less consideration than the projected proceeds of the liquidation sales contemplated under the backup liquidation bid.<sup>340</sup> If the purchaser were not going to actually continue to operate the Borders retail locations as a going concern, the Committee believed the value of the estate would be maximized by the back-up liquidation bid, especially considering that the proposed Bid Procedures entitled BB Brands to a \$6.45 million Break-Up Fee, while the backup liquidation bid did not entail any such protections.<sup>341</sup>

Borders Group worked “around the clock” to negotiate a compromise between Najafi, the Committee, and other creditors to ease the Committee's concerns.<sup>342</sup> Unfortunately, the Committee would not budge, and Najafi likewise could not be persuaded to eliminate the liquidation option from the asset purchase agreement. Accordingly, the Committee filed a formal objection to the proposed Bid Procedures on July 13th, in which it outlined its aforementioned concerns with the Najafi bid and requested that the court deny the motion to

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*by Acorn Media Group, Inc; Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Broad One L.P. Filed by Broad One, L.P; Sale Procedures Hearing Re: Bidding Procedures Motion, Docket No. 1332, 9:18-25.*

<sup>340</sup> *Objection to Motion/Objection of the Official Committee of Unsecured Creditors to Bid Procedures and Break-Up Fee Contained in the Debtors' Motion for an Order Pursuant to Sections 105, 363 And 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving the Sale Procedures and Break-Up Fee, and (III) Granting Related Relief, Docket No. 1216.*

<sup>341</sup> *Objection to Motion/Objection of the Official Committee of Unsecured Creditors to Bid Procedures and Break-Up Fee Contained in the Debtors' Motion for an Order Pursuant to Sections 105, 363 And 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving the Sale Procedures and Break-Up Fee, and (III) Granting Related Relief, Docket No. 1216.*

<sup>342</sup> *Transcript regarding Hearing Held on 07/14/2011 10:03AM RE: Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Acorn Media Group, Inc; Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Broad One L.P. Filed by Broad One, L.P; Sale Procedures Hearing Re: Bidding Procedures Motion, Docket No. 1332, 9:4-8, 18-25.*

approve the Bid Procedures and accompanying requests.<sup>343</sup> This formal objection effectively doomed any chance of the Najafi bid, as laid out in the proposed asset purchase agreement, being approved by Judge Martin Glenn for the section 363(b) sale.<sup>344</sup>

## V. *Liquidation Begins to Appear Imminent*

Realizing that the Bid Procedures were unlikely to be approved in the face of the Committee's objection, and being obligated by the DIP Credit Agreement to have a stalking horse bidder approved by July 15th in order to avoid default, Borders Group filed a series of documents on the eve of the July 14th hearing on its Motion to Approve the Sale Procedures. The documents included a modified Sales Procedures Order, modified Bid Procedures, and a modified Agency Agreement with Hilco et al.<sup>345</sup>

The modified Bid Procedures made the Agency Agreement the new stalking horse bid and cut out the Najafi deal completely.<sup>346</sup> The Bid Procedures still invited bids to purchase the assets as a Going Concern, to conduct a Partial Store Liquidation of any assets left over from a

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<sup>343</sup> *Objection to Motion/Objection of the Official Committee of Unsecured Creditors to Bid Procedures and Break-Up Fee Contained in the Debtors' Motion for an Order Pursuant to Sections 105, 363 And 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving the Sale Procedures and Break-Up Fee, and (III) Granting Related Relief*, Docket No. 1216.

<sup>344</sup> For the court to approve a sale under section 363(b) of the Bankruptcy Code, the debtor must justify to the court that the sale is supported by sound business reasons and is in the best interest of the reorganization. *See In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174 (Bankr. S.D.N.Y. 1989). Thus, Borders Group had the burden of convincing Judge Martin Glenn that the proposed deal with Najafi was justified with sound business reasons and would satisfy Borders Group's fiduciary obligations to its creditors. Because the Committee's objection clearly established that the Najafi bid could likely be followed by a full liquidation and that the backup liquidation bid would bring more money into the estate, thus compelling the court to rule against the motion to approve the bid procedures using the Najafi bid as the stalking horse.

<sup>345</sup> *Statement/Notice of Filing of Modified Sale Procedures Order, Bid Procedures and Agency Agreement filed by Andrew K. Glenn on behalf of Borders Group, Inc.*, Docket No. 1235.

<sup>346</sup> The Najafi bid for BB Brands to acquire substantially all of Borders Group's assets was withdrawn; the debtors and the Committee still encouraged Najafi to place a modified bid, however. could still place another bid to be considered in the auction, however. *Transcript regarding Hearing Held on 07/14/2011 10:03AM RE: Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Acorn Media Group, Inc; Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Broad One L.P. Filed by Broad One, L.P; Sale Procedures Hearing Re: Bidding Procedures Motion*, Docket No. 1332, 20:4-7, 17-18.

Going Concern sale, and to conduct a Full Chain Liquidation.<sup>347</sup> The new Bid Procedures also required that any bid exceed the consideration in the Agency Agreement by \$1 million and include a minimum of \$215.1 million in cash, but still did not provide the Liquidators a break-up fee.<sup>348</sup>

One significant change in the new Bid Procedures was that Borders Group's intellectual property, certain leases, and certain other specific assets would be excluded from any Full Chain Liquidation.<sup>349</sup> The Committee and Borders Group believed that these assets should be separately marketed and sold, which they contended would maximize value for the estate and allow for the possibility that other buyers – such as Barnes & Noble – would opt to buy the rights to assume certain store leases and work out a deal with the liquidators to essentially purchase a small number of specific stores.<sup>350</sup>

The hearing to approve the modified Sale Procedures, Bid Procedures, and Agency Agreement was held on July 14, 2011 – less than 24 hours after the modified documents were filed. After talking through all of the issues and making several changes to the Bid Procedures overcome objections from landlords, Judge Glenn approved Borders Group's motion and the modified Bid Procedures.<sup>351</sup> The deadline for any interested purchaser to submit a bid to compete with the Agency Agreement was officially set for July 17th at 5:00 P.M., and a hearing to approve the Sale Procedures and the winning bidder was set for July 21st.<sup>352</sup>

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<sup>347</sup> *Bid Procedures for the Sale of All or Substantially All of the Debtors' Assets*, Docket No. 1235.

<sup>348</sup> *Bid Procedures for the Sale of All or Substantially All of the Debtors' Assets*, Docket No. 1235.

<sup>349</sup> *Bid Procedures for the Sale of All or Substantially All of the Debtors' Assets*, Docket No. 1235.

<sup>350</sup> The Najafi bid for BB Brands to acquire substantially all of Borders Group's assets was withdrawn; the debtors and the Committee still encouraged Najafi to place a modified bid, however. could still place another bid to be considered in the auction, however. *Transcript regarding Hearing Held on 07/14/2011 10:03AM RE: Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Acorn Media Group, Inc; Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Broad One L.P. Filed by Broad One, L.P; Sale Procedures Hearing Re: Bidding Procedures Motion*, Docket No. 1332, 23:2-7, 16-25.

<sup>351</sup> *Transcript regarding Hearing Held on 07/14/2011 10:03AM RE: Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Acorn Media Group, Inc; Motion for Payment of Administrative Expenses/Administrative Claim and Request for Payment of Administrative Expense Made by Broad One L.P. Filed by Broad One, L.P; Sale Procedures Hearing Re: Bidding Procedures Motion*, Docket No. 1332, 44:9-19.

<sup>352</sup> *Order Signed on 7/14/2011 Approving Sale Procedures in Connection With the Sale of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests*, Docket No. 1253.

## **E. The Liquidation**

### **I. *The End of Borders Bookstores – But a Possible Silver Lining***

On January 18, 2011, Borders Group filed a notice with the court that the scheduled auction was cancelled.<sup>353</sup> Borders Group did not receive any additional qualified bids, and thus the modified Sale Procedures to authorize the liquidation of all of Borders Group's assets via the Agency Agreement were set to be approved at a hearing on July 21st.<sup>354</sup> At the hearing, Andrew Glenn spoke on behalf of Borders Group with a tone of defeat:

MR. GLENN: Your Honor, this is a very bittersweet day in the history of this company. While we are here as fiduciaries of this estate, with what we believe to be a transaction that maximizes value under the circumstances, we obviously didn't get to where we wanted to be, which was a full going concern transaction along the lines of what we had proposed with Najafi. There are a lot of sad people around the country, a lot of sadness at the corporate office and a lot of people are very scared about the prospect of losing a major bookseller. Let's just hope that people keep reading books even if this company is not surviving.<sup>355</sup>

Borders Group did find a silver lining during the bid solicitation period, however. Books-A-Million had expressed interest in purchasing the inventory, furniture, fixtures, and leases at 30 stores.<sup>356</sup> Although negotiations had not progressed far enough for Books-A-Million

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<sup>353</sup> *Notice of Cancellation of Auction*, Docket No. 1337.

<sup>354</sup> *Notice of Cancellation of Auction*, Docket No. 1337; *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 11:22-24.

<sup>355</sup> *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 11:22-24.

<sup>356</sup> *Notice of Cancellation of Auction*, Docket No. 1337; *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 11:22-24.

to submit a bid before the deadline, Borders Group remained hopeful that they could find a way to consummate the deal with Books-A-Million in order to save between 1,000 and 1,500 jobs at those stores, even in the face of DIP Credit Agreement's mandate that a hearing to approve the sale be conducted on July 21st.<sup>357</sup>

At the July 21st hearing, it was clear that the Agency Agreement, as the only bid, had to be approved, but Borders Group was determined to convince Judge Glenn to approve a Sale Order that left the door open to the Books-A-Million deal. At that time, the negotiations with Books-A-Million had not progressed beyond a series of letters of intent, but Borders Group knew which stores Books-A-Million was interested in and the substance of the proposed deal.<sup>358</sup> Borders Group proposed that, in accordance with the Agency Agreement, Books-A-Million would purchase all of the merchandise, furniture, fixtures, and equipment in each store it wanted from the Liquidators in a bulk sale.<sup>359</sup> Simultaneously, Borders Group would assume and assign each store lease to Books-A-Million.<sup>360</sup> It was the latter part of the deal that would be troublesome – Borders Group would have to ask Judge Glenn at the hearing to put a mechanism

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<sup>357</sup> Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief, Docket No. 1392, 12:20-24.

<sup>358</sup> Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief, Docket No. 1392, 12:10-19.

<sup>359</sup> Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief, Docket No. 1392, 13:1-7.

<sup>360</sup> Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief, Docket No. 1392, 14:4-10.

in the Sale Order that would allow Borders to assume and assign the leases that Books-A-Million wanted.<sup>361</sup>

At the hearing, Buechler, representing the Committee, expressed skepticism of the Books-A-Million deal. The Committee was primarily concerned because the terms of the deal were not yet solidified and they were unsure whether Books-A-Million would be providing adequate consideration for the assumption and assignment of the leases.<sup>362</sup> Further, the Committee seemed wary to even entertain the idea because the economic value to the estate would only be “incremental.”<sup>363</sup>

At the end of the day, the prospect of being able to save 1,000-plus jobs seemed to win Judge Glenn over, and he entered a Sale Order approving the Agency Agreement to liquidate all of Borders Group’s stores with a carve out provision aimed at facilitating a deal with Books-A-Million.<sup>364</sup> The carve out did two primary things:

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<sup>361</sup> *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 14:11-17.

<sup>362</sup> Mr. Buechler stated that by assuming and assigning the leases, Borders Group “would be foregoing its right to chop those leases during the pendency of the store closing process,” and was concerned that the estate might be better off marketing those leases individually during the store closing sales, rather than selling them in bulk. *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 20:21-25, 21:1-3; 47:19-23.

<sup>363</sup> For the merchandise, furniture, fixtures, and equipment, Borders Group estimated that the amount of money it would receive from the Liquidators’ bulk sale to Books-A-Million would be substantially the same as it would receive at the end of a store closing process for each store. *Transcript regarding Hearing Held on 07/21/2011 11:36 AM RE: Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving Sale Procedures and Break-Up Fee and (III) Granting Related Relief*, Docket No. 1392, 15:17-25, 20:8.

<sup>364</sup> *Order Approving Agency Agreement, Store Closing Sales, and Related Relief*, Docket No. 1377.

- (1) Authorized the Liquidators to enter into a bulk sale of inventory, furniture, fixtures, and equipment to Books-A-Million if Borders Group, the Liquidators, and the Committee all consented to the transaction; and
- (2) Authorized Borders Group to assume and assign the specific leases that Books-A-Million was interested in, but only with consent of the Committee and each landlord, which the order provided could be withheld for any reason.<sup>365</sup>

Thus, as of July 21st, all of Borders Group's stores were officially in the hands of the Liquidators, but there still some hope that a few of the stores would remain open.

## **II. *Reactions to the Liquidation News***

When it became apparent that Borders Group would liquidate, Edwards said the following in a statement issued by Borders Group:

All of us have been working hard towards a different outcome, and I wish I had better news to report to you today. The truth is that Borders has been facing headwinds for quite some time, including a rapidly changing book industry, eReader revolution, and turbulent economy. We put in a valiant fight, but regrettably in the end we weren't able to overcome these external forces.<sup>366</sup>

Edwards's grief was understandable: despite his best efforts to reorganize the company and sell it as a going concern, all 399 of its remaining stores (less any that Books-A-Million decided to acquire) would be closed, and all 10,700 of its employees would be terminated. Edwards himself was terminated less than two weeks later, along with Scott Henry, who was the company's then-serving Vice President and Chief Financial Officer.<sup>367</sup> Needless to say, Edwards did not receive his bonus under the KEIP.

Borders Group's employees and executives were not the only parties adversely affected by the liquidation news. Landlords across the country were faced with filling big-box retail spaces that would be left vacant by former Borders stores. At a time when demand for large retail space was declining, this burden fell especially hard on some landlords -- at least one real estate investment trust predicted that it would be forced to give up five of its retail spaces formerly occupied by Borders to lenders.<sup>368</sup>

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<sup>365</sup> Order Approving Agency Agreement, Store Closing Sales, and Related Relief, Docket No. 1377.

<sup>366</sup> Shira Ovide, Borders President Explains Liquidation, *THE WALL STREET JOURNAL*, July 18, 2011.

<sup>367</sup> Borders Group, Inc. Form 8-K, July 29, 2011.

<sup>368</sup> A. D. Pruitt, Landlords Go Plan B on Borders, *THE WALL STREET JOURNAL*, July 20, 2011.

### **III. Auctioning off the Rest of Borders Group's Assets**

After the store closing liquidations were approved, Borders Group was still faced with the challenge of selling its remaining unexpired leases, intellectual property, and executory contracts, along with hopefully finalizing a deal with Books-A-Million. These leftover assets would be auctioned off, generally on a piece-meal basis, in the weeks following July 2011.

#### **a. Leases**

To dispose of the remaining leases, Borders Group proposed bid procedures pursuant to which the leases would be sold in two rounds of auctions.<sup>369</sup> The first round leases, which comprised of those leases with assumption/rejection deadlines of September 30, 2011 or sooner, called for a bid deadline of August 26th, an auction on August 31st, and a sale hearing on September 8th.<sup>370</sup> The second round leases, comprised of the rest of the leases, called for a bid deadline, auction, and sale hearing on September 7th, September 13th, and September 20th, respectively.<sup>371</sup>

At the hearing to approve the bid procedures on the leases, there was extensive debate over what information the landlords would be entitled to during the bidding process, particularly regarding adequate assurances. Because the landlords themselves would be potential bidders, and because the landlords might be tempted to manipulate the bidding process in order to secure certain tenants, Borders Group wanted to withhold all bidder information from the landlords until

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<sup>369</sup> *Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Bidding and Auction Procedures for Sale of Unexpired Nonresidential Real Property Leases, (II) Setting Lease Sale Hearing Dates and (III) Authorizing and Approving (A) Sale of Certain Unexpired Nonresidential Real Property Leases Free and Clear of All Interests, and (B) Assumption and Assignment of Certain Unexpired Nonresidential Real Property Leases*, Docket No. 1399.

<sup>370</sup> *Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Bidding and Auction Procedures for Sale of Unexpired Nonresidential Real Property Leases, (II) Setting Lease Sale Hearing Dates and (III) Authorizing and Approving (A) Sale of Certain Unexpired Nonresidential Real Property Leases Free and Clear of All Interests, and (B) Assumption and Assignment of Certain Unexpired Nonresidential Real Property Leases*, Docket No. 1399.

<sup>371</sup> *Motion to Approve/Debtors' Motion for Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Bidding and Auction Procedures for Sale of Unexpired Nonresidential Real Property Leases, (II) Setting Lease Sale Hearing Dates and (III) Authorizing and Approving (A) Sale of Certain Unexpired Nonresidential Real Property Leases Free and Clear of All Interests, and (B) Assumption and Assignment of Certain Unexpired Nonresidential Real Property Leases*, Docket No. 1399.



a winning bidder was selected.<sup>372</sup> The landlords objected, however, on the grounds that they would need more time to conduct their own due diligence of the bidders, and if they did not receive bidder information early, the short period of time between the auctions and sale hearings would lead to a large number of objections that could needlessly delay the confirmation of the sales.<sup>373</sup> In the end, the bid procedures that Judge Glenn approved were somewhat of a compromise – immediately following the selection of a winning bidder, Borders Group would be required to e-mail the winning bidder’s adequate assurance information to the counsel of record for each lease.<sup>374</sup>

150 leases went out for bid in the first round, but only eight of them received bids.<sup>375</sup> Seven of those eight were simply landlords bidding to terminate the leases by paying termination fees.<sup>376</sup> One lease did receive a bid from a third party, but the landlord won the right to terminate the lease at auction for \$150,000 plus the waiver of its claims against the bankruptcy estate.<sup>377</sup> The Bankruptcy Court eventually entered multiple orders approving the sale or termination of first round leases for a total of \$220,000 plus the waiver of certain claims against the debtors.<sup>378</sup>

In the second round, Borders Group received bids on ten leases, only one of which was subject to a competitive bidding process.<sup>379</sup> Most of these bids were termination agreements with the respective landlords, although three were assumption and assignment agreements, including one to a third party.<sup>380</sup> These sales brought in a total of \$550,000 into the bankruptcy

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<sup>372</sup> *Transcript regarding Hearing Held on August 10, 2011 10:10 AM RE: Motion for Payment of Administrative Expenses filed by 2121 Borders, LLC; Motion for Payment of Administrative Expenses filed by 49 Waukegan Road Limited Partnership, etc.*, Docket No. 1401, 59:1-14.

<sup>373</sup> *Transcript regarding Hearing Held on August 10, 2011 10:10 AM RE: Motion for Payment of Administrative Expenses filed by 2121 Borders, LLC; Motion for Payment of Administrative Expenses filed by 49 Waukegan Road Limited Partnership, etc.*, Docket No. 1401, 68:12-17.

<sup>374</sup> *Lease Sale Bidding Procedures*, Docket No. 1519.

<sup>375</sup> *Transcript regarding Hearing Held on 09/08/2011 11:05 AM RE: First Lease Sale of Motion . . .*, Docket No. 1741, 6:1-14.

<sup>376</sup> *Transcript regarding Hearing Held on 09/08/2011 11:05 AM RE: First Lease Sale of Motion . . .*, Docket No. 1741, 6:1-14.

<sup>377</sup> *Transcript regarding Hearing Held on 09/08/2011 11:05 AM RE: First Lease Sale of Motion . . .*, Docket No. 1741, 6:1-14.

<sup>378</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code*, Docket No. 2090, page 20.

<sup>379</sup> *Transcript regarding Hearing Held on 09/22/2011 2:11PM*, Docket No. 1911, 17:16-23.

<sup>380</sup> *Transcript regarding Hearing Held on 09/22/2011 2:11PM*, Docket No. 1911, 17:16-23.

estate, \$425,000 of what was attributed to a lease in Puerto Rico that was the subject of a competitive auction.<sup>381</sup>

**b. The Books-A-Million Deal**

Unfortunately, the Books-A-Million transaction did not pan out as flawlessly as Borders Group had hoped. Books-A-Million only ended up purchasing the leases for fourteen stores -- rather than the thirty to thirty-five that it originally expressed interest in -- and the transactions did not include any bulk purchases of inventory.<sup>382</sup> The sale of these leases did, however, bring \$750,000 into the estate, and Books-A-Million paid an additional \$184,209 to cover the cure costs associated with Borders Group assuming and assigning each lease.<sup>383</sup>

**c. Intellectual Property**

As for the intellectual property, which included Borders Group's website, trademarks, and customer information (collectively, the "IP Assets"), Borders Group sought to conduct an auction with the assistance of Streambank, LLC, a company that specialized in marketing and selling intangible assets for distressed companies.<sup>384</sup> The sale of the IP Assets would be, like the other sales, a sale the debtor's assets outside of the ordinary course of business pursuant to section 363(b)(1) of the Bankruptcy Code. However, because Borders Group wanted to sell its customer lists, which contained personally identifiable information ("PII") about persons not affiliated with the debtor, section 363(b)(1) required that Borders Group take additional steps

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<sup>381</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code, Docket No. 2090, page 20; Order Signed on 12/14/2011 Authorizing Debtors To Terminate Unexpired Lease of Non-Residential Real Property, Store No.: 356 (San Juan, Puerto Rico), Docket No. 2338.*

<sup>382</sup> *Order signed on 8/30/2011 Granting Debtors' Motion for Order Pursuant to Sections 363(b) and 365(a) of the Bankruptcy Code and Fed. R. Bankr. P. 6004, 6006 and 9014 Authorizing Debtors to Assume and Assign Certain Unexpired Non-Residential Real Property Leases to Books-A-Million, Inc., Docket No. 1676.*

<sup>383</sup> *Order signed on 8/30/2011 Granting Debtors' Motion for Order Pursuant to Sections 363(b) and 365(a) of the Bankruptcy Code and Fed. R. Bankr. P. 6004, 6006 and 9014 Authorizing Debtors to Assume and Assign Certain Unexpired Non-Residential Real Property Leases to Books-A-Million, Inc., Docket No. 1676.*

<sup>384</sup> Streambank had assisted debtors in disposing of intellectual property in several high-dollar bankruptcy cases prior to 2011. *See Transcript regarding Hearing Held on August 10, 2011 10:10 AM RE: Motion for Payment of Administrative Expenses filed by 2121 Borders, LLC; Motion for Payment of Administrative Expenses filed by 49 Waukegan Road Limited Partnership, etc., Docket No. 1531, 43:1-10.* Hilco's parent company actually acquired Streambank during the Borders reorganization. Press Release, *Hilco Joins Forces with Streambank to Strengthen Intellectual Property Valuation and Disposition Services*, BUSINESS WIRE, September 6, 2011.

before the court could allow the sale.<sup>385</sup> Specifically, because the Borders Group's privacy policy did not allow Borders Group to sell the information outside of a going concern sale, Borders Group had to request that the court order the U.S. Trustee to appoint a consumer privacy ombudsman who would investigate the facts surrounding the proposed sale and make recommendations to the court.<sup>386</sup> On August 10th, Judge Glenn considered and approved Borders Group's motion to approve the bid procedures to sell the IP assets and ordered the U.S. Trustee to appoint a consumer privacy ombudsman.<sup>387</sup> The deadline to submit bids was set for September 8th, with an auction to be conducted, if necessary, on September 14th, and a sale hearing to follow on September 20th.<sup>388</sup>

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<sup>385</sup> Section 363(b)(1) provides that:

The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

- (A) such sale or such lease is consistent with such policy; or
- (B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—
  - (i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
  - (ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

11 U.S.C. § 363.

<sup>386</sup> *Motion to Approve/Debtors' Motion for Orders Pursuant to Sections 332, 363, 365 and 105 of the Bankruptcy Code and Rules 2002, 6004 and 6006 of the Federal Rules of Bankruptcy Procedure: (I) Approving Bidding Procedures with Respect to Sale of Certain IP Assets, Including Expense Reimbursement for a Stalking Horse Bidder, Setting the Sale Hearing Date, and Appointing a Consumer Privacy Ombudsman; and (II) Approving and Authorizing the Sale of IP Assets to the Highest and Best Bidder Free and Clear of all Liens, Interests, Claims and Encumbrances and the Assumption and Assignment of Certain Related Executory Contracts and Waiving the Requirements of Bankruptcy Rules 6004(H) and 6006(D)*, Docket No. 1401. Section 332 of the Bankruptcy Code provides that if a hearing is required in order to approve the sale of personal information pursuant to section 363(b)(1)(B), the court must order the United States Trustee to appoint a consumer privacy ombudsman who is tasked with analyzing and testifying as to the debtors's privacy policy, the potential gains or losses of consumer privacy if the sale is allowed, the potential costs or benefits to consumers if the sale is allowed, and any alternative that might be available to mitigate consumer costs and losses of consumers' privacy. 11 U.S.C. § 332.

<sup>387</sup> *Transcript regarding Hearing Held on August 10, 2011 10:10 AM RE: Motion for Payment of Administrative Expenses filed by 2121 Borders, LLC; Motion for Payment of Administrative Expenses filed by 49 Waukegan Road Limited Partnership, etc.*, Docket No. 1531, 42:14-18.

<sup>388</sup> *Order Signed on 8/10/2011 Approving Bidding Procedures in Connection With Sale of the Debtors' IP Assets Free and Clear of All Liens, Interests, Claims and Encumbrances*, Docket No. 1513.

Mr. St. Patrick Baxter of Covington & Burlington was named the consumer privacy ombudsman.<sup>389</sup> The primary question presented to him was whether, pursuant to section 363(b)(1)(B) of the Bankruptcy Code, the sale would be consistent with Border's privacy policy to which its customers had consented, and if not, whether the sale could be consummated without running afoul of federal and state consumer protection laws and regulations.<sup>390</sup>

Prior to May 2008, Borders's privacy policy provided that it could not share any consumer information with third parties without the customer's express consent, but it changed its policy on May 28, 2008 to allow it to share such information in some cases without obtaining such consent.<sup>391</sup> This presented concerns that the pre-May 2008 customers would be covered under a policy that would not permit the transfer of their PII to a third-party buyer, which could cause the sale of the information to violate numerous consumer protection laws. These concerns were reflected in a letters that Mr. St. Patrick Baxter received from the Federal Trade Commission and from the Attorney General of New York on behalf of twenty-four state attorneys general.<sup>392</sup> Specifically, Mr. St. Patrick Baxter stated in his report that Borders could only transfer post-May 28, 2008 PII about its customers subject to the following four conditions:

- (1) The buyer adheres to all material terms in Borders's 2008 privacy policy;
- (2) The buyer honors any customer's request to opt-out of having his or her information transferred;
- (3) The buyer safeguards all conveyed PII in a manner consistent with industry standard data security protections and applicable information security laws; and
- (4) The buyer destroys all personally identifiable information for which it determines it has no reasonable business need.<sup>393</sup>

As to the pre-May 28, 2008 customer data, the report recommended that such information only be transferred if either (i) each customer affirmatively consented to the transfer; or (ii) the buyer agreed to treat the information consistently with Border's privacy policy that was in place at the time the information was collected.<sup>394</sup>

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<sup>389</sup> *Notice of Appointment of Consumer Privacy Ombudsman*, Docket No. 1523.

<sup>390</sup> *See Report of Michael St. Patrick Baxter Consumer Privacy Ombudsman*, Docket No. 1830.

<sup>391</sup> *Report of Michael St. Patrick Baxter Consumer Privacy Ombudsman*, Docket No. 1830.

<sup>392</sup> *Report of Michael St. Patrick Baxter Consumer Privacy Ombudsman*, Docket No. 1830, Exhibits E and F.

<sup>393</sup> *Report of Michael St. Patrick Baxter Consumer Privacy Ombudsman*, Docket No. 1830.

<sup>394</sup> *Report of Michael St. Patrick Baxter Consumer Privacy Ombudsman*, Docket No. 1830.

Despite the privacy concerns, the auction itself was very successful, resulting in winning bids totaling \$15,775,000. The winning bids were:

- Barnes & Noble -- IP Assets for \$13.9 million;
- Pearson Australia Group Pty Ltd -- License to Trademarks in Australia and New Zealand for \$450,000;
- Popular Holdings Limited -- License to Trademarks in Singapore for \$100,000;
- Berjaya Books SDN BHD -- License to Trademarks in Malaysia for \$825,000; and
- Al Maya International, Ltd. -- License to Trademarks for certain Persian Gulf countries for \$500,000.

Convincing Judge Glenn to confirm the sales in light of the consumer protection ombudsman's concerns, however, was not as easy as obtaining bids.

At the July 22, 2011 hearing to approve the intellectual property sales, there was extensive discussion over whether the terms contained in the Barnes & Noble asset purchase agreement for Borders Group's customer information would comport with consumer protection laws.<sup>395</sup> In Particular, there was confusion over how, and to what extent, Borders Group's customers would be able to opt-in or opt-out of the transfer of the information, especially regarding the pre-May 2008 PII.<sup>396</sup> Because there was not a clear consensus that the state attorneys general and the Federal Trade Commission approved of the proposed deal, Mr. St. Patrick Baxter, upon pressure by Judge Glenn, reluctantly agreed to help Borders Group and Barnes & Noble develop a solution that would appease all of the governmental authorities.<sup>397</sup>

The parties reconvened in court a few days later on September 26th. Andrew Glenn brought forward the final proposed terms of the Barnes & Noble transaction, which featured significant customer protections. The new terms of the transaction included:

- Within one day of closing, an e-mail would be sent to all affected Borders customers describing the transfer of the information and informing the customers of their rights to opt-out;
- Notices of the transaction would be posted on both Borders's and Barnes & Noble's websites; and
- A full-page notice would be published in USA Today containing substantially the same information as the e-mail.<sup>398</sup>

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<sup>395</sup> See generally, *Transcript regarding Hearing Held on 09/22/2011 2:11PM*, Docket No. 1911.

<sup>396</sup> *Transcript regarding Hearing Held on 09/22/2011 2:11PM*, Docket No. 1911, 41:2-8.

<sup>397</sup> *Transcript regarding Hearing Held on 09/22/2011 2:11PM*, Docket No. 1911, 55:1-24.

<sup>398</sup> *Transcript regarding Hearing Held 09/26/2011 4:09PM*, Docket No. 1910, 8:9-25, 9:1-9.

Prior to the hearing, Borders Group sent the revised terms to the FTC and all of the concerned state attorneys general for their review, and did not receive any objections.<sup>399</sup> Now satisfied that all of Borders Group's customers' privacy concerns were adequately addressed, Judge Glenn approved the sale of the IP to Barnes & Noble,<sup>400</sup> along with three of the four sales of foreign trademark licenses.<sup>401</sup>

### **III. *The Plan is Filed and Confirmed***

Although Borders was in the process of liquidation, a Chapter 11 plan defining the rights of all parties was still required. Borders Group filed the first joint plan on October 3, 2011.<sup>402</sup> The general structure of the plan was to transfer all of Borders Group's remaining assets into a Liquidating Trust, which would liquidate the assets and eventually distribute the net proceeds to unsecured creditors.<sup>403</sup> There would be six classes of creditors, but only the following classes would be impaired: Class 3 – General Unsecured Claims, who would also be the only class entitled to vote; Class 4 – Equity Interest Holders, who would not be entitled to vote; and Class 5 – Intercompany Claims, who likewise would not be entitled to vote.<sup>404</sup> All claims other than those in Classes 3, 4, and 5 would be repaid in full.<sup>405</sup> The unsecured creditors in Class 3 were projected to recover between \$812 and \$850 million, which would equate to four to ten percent of each creditor's claim.<sup>406</sup> Classes 4 and 5 would not receive anything under the plan.<sup>407</sup> The disclosure statement provided the following breakdown of classes:

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<sup>399</sup> *Transcript regarding Hearing Held 09/26/2011 4:09PM*, Docket No. 1910, 12:2-8.

<sup>400</sup> *Transcript regarding Hearing Held 09/26/2011 4:09PM*, Docket No. 1910, 21:23-24.

<sup>401</sup> *Transcript regarding Hearing Held 09/26/2011 4:09PM*, Docket No. 1910, 22:10-14. The bid from Popular Holdings Limited for the trademark rights in Singapore fell through, although Judge Glenn was not able to hear any of the issues involving that deal because the bidder's counsel was an attorney from Judge Glenn's prior law firm. *Transcript regarding Hearing Held 09/26/2011 4:09PM*, Docket No. 1910, 16:2-8.

<sup>402</sup> *Chapter 11 Plan/Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 1897.

<sup>403</sup> *Disclosure Statement for Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 1896.

<sup>404</sup> *Statement/Notice of Blacklines of Proposed Disclosure Statement in Support of First Amended Joint Plan of Liquidation*. Docket No. 2112.

<sup>405</sup> *Statement/Notice of Blacklines of Proposed Disclosure Statement in Support of First Amended Joint Plan of Liquidation*. Docket No. 2112.

<sup>406</sup> *Statement/Notice of Blacklines of Proposed Disclosure Statement in Support of First Amended Joint Plan of Liquidation*. Docket No. 2112.

CLASS	DESCRIPTION	TREATMENT	ENTITLED TO VOTE	ESTIMATED ALLOWED AMOUNTS (\$)	ESTIMATED RECOVERY (%)
Not classified	Administrative Claims (including fees for Professionals)	Unimpaired; payment in full, in Cash, of the allowed amount of such Claim (or as otherwise agreed).	No.	N/A <sup>3</sup>	100%
Not classified	Priority Tax Claims	Unimpaired; payment in full, in Cash, to the extent and in the manners allowed by §1129 of the Bankruptcy Code (or as otherwise agreed).	No.	\$7.4 to \$13.9 million	100%
1	Priority Non-Tax Claims	Unimpaired; payment in full, in Cash, of the allowed amount of such Claim (or as otherwise agreed).	No.	\$0.3 to \$0.4 million	100%
2	Secured Claims	Unimpaired; payment in full, in Cash, of the allowed amount of such Claim (or as otherwise agreed), or return of the collateral.	No.	\$0.0 to \$2.0 million	100%
3	General Unsecured Claims	Impaired; shall receive Pro Rata Share of proceeds remaining after payment of administrative, priority and secured claims.	Yes.	\$812.0 to \$850.0 million <sup>4</sup>	4% to 10%
4	Equity Interests	Impaired; shall receive no Distribution	No.	N/A	0%
5	Intercompany Claims	Impaired; shall receive no Distribution	No.	N/A	0%

On the Confirmation Date provided in the plan, all assets that were not to be retained by the surviving debtor entity – the “Liquidating Debtor” – would vest in the Liquidating Trust.<sup>408</sup> Further, the Liquidating Trust would succeed to all causes of action that Borders Group still had.<sup>409</sup> The Liquidating Trust’s primary purposes would be to: (i) investigate and pursue any

<sup>407</sup> *Statement/Notice of Blacklines of Proposed Disclosure Statement in Support of First Amended Joint Plan of Liquidation*. Docket No. 2112.

<sup>408</sup> The Trustee would be the sole member and director of the Liquidating Debtor and he would have the right to either merge the Liquidating Debtor into the Liquidating Trust or he could dissolve the Liquidating Debtor. *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>409</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

causes of action; (ii) pursue and administer all transferred assets; (iii) resolve any disputed claims; and (iv) make distributions in accordance with the Trust Agreement.<sup>410</sup>

Before any distributions were to be made from the Liquidating Trust, the trustee was required to create a Disputed Claims reserve in the amount equal to the aggregate of all of the disputed claims.<sup>411</sup> Next, the Liquidating Trustee would make an initial distribution from the Liquidating Trust to holders of all allowed claims, and thereafter would be required to make distributions in accordance with the Trust Agreement at least once per year.<sup>412</sup> The Liquidating Trust would continue to exist until the earlier of five years from the confirmation date or the time at which the Trustee determined that all of the Liquidating Trust assets had been liquidated and there were no more substantial potential sources of income for distribution.<sup>413</sup> At that time, the Trustee would make its final distributions in accordance with the plan, and finally request that the Bankruptcy Court order a closing of the case.<sup>414</sup>

Judge Glenn held a hearing to confirm the voting procedures disclosure statement on November 11th.<sup>415</sup> There were only four objections – three from taxing authorities, and one from an individual stockholder. The taxing authorities were concerned with whether the amount to be distributed in satisfaction of their claims would include interest and penalties, but Borders Group

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<sup>410</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>411</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>412</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>413</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>414</sup> *Disclosure Statement for First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2110.

<sup>415</sup> *Transcript regarding Hearing Held on 11/10/2011 10:12AM RE: Doc# 1898 Disclosure Statement Hearing/Motion for an Order Approving Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2185.



intended to settle these disputes at the hearing in order to moot the objections.<sup>416</sup> The individual stockholder, Amanda Trippe, was apparently requesting that the court adjourn the proceedings to allow her to seek all kinds of relief.<sup>417</sup> While Judge Glenn expressed sympathy for her plight, he summarily denied Ms. Trippe's objection.<sup>418</sup> After all of the objections were out of the way and the documents were tweaked slightly, Judge Glenn agreed to approve the corrected disclosure statement and vote solicitation procedures as soon as they were filed, and entered the accompanying order on November 14th.<sup>419</sup> The deadline to submit votes was set for December 9th, and the plan confirmation hearing was set for December 20th.<sup>420</sup>

All unsecured creditors voted to approve the plan, and all requirements of section 1129(a) of the Bankruptcy Code, which lays out the requirements a plan must meet in order for it to be confirmed, were met, except for 1129(a)(8), which requires that each impaired class of creditors accept the plan. This subsection was not satisfied because Classes 5 and 6 were not entitled to vote on the plan, and thus did not accept it.<sup>421</sup> Nevertheless, Borders Group was able to demonstrate that the plan could be still be confirmed pursuant to section 1129(b), which allows a plan to be confirmed even when an impaired class does not approve it, as long as the plan does not unfairly discriminate against the class and it is "fair and equitable," which, in the case of unsecured claims and interests, means holders of junior claims or interests will not receive or retain anything under the plan.<sup>422</sup> Thus, the plan met all of the requirements under section 1129 and could be approved, and Judge Glenn confirmed the plan in an order entered on December 20,

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<sup>416</sup> *Transcript regarding Hearing Held on 11/10/2011 10:12AM RE: Doc# 1898 Disclosure Statement Hearing/Motion for an Order Approving Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2185, 6:13-16, 7:8-17.

<sup>417</sup> *Transcript regarding Hearing Held on 11/10/2011 10:12AM RE: Doc# 1898 Disclosure Statement Hearing/Motion for an Order Approving Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2185, 27:3-9, 28:13-15.

<sup>418</sup> *Transcript regarding Hearing Held on 11/10/2011 10:12AM RE: Doc# 1898 Disclosure Statement Hearing/Motion for an Order Approving Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2185, 27:3-9, 28:13-15.

<sup>419</sup> *Order signed on 11/14/2011 Approving Disclosure Statement; Approving the Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2122.

<sup>420</sup> *Order signed on 11/14/2011 Approving Disclosure Statement; Approving the Solicitation and Voting Procedures; Scheduling the Plan Confirmation Process; and Granting Related Relief*, Docket No. 2122.

<sup>421</sup> 11 U.S.C. § 1129; *Order Confirming First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2384.

<sup>422</sup> 11 U.S.C. § 1129.

2011.<sup>423</sup> The Effective Date of the plan occurred on January 12, 2012, and the Liquidating Trust, controlled by trustee Curtis R. Smith, went to work.<sup>424</sup>

## **F. Tying Up Loose Ends**

### **I. The Party Isn't Over Yet: The Gift Card Fiasco**

Shortly after the plan was confirmed, yet another class of creditors showed up to the party hoping to get a piece of the pie: Borders Group's gift card holders.

In the fiscal year ending January 29, 2011 – just before Borders Group entered bankruptcy – Borders Group had approximately \$275,045,213 of gift cards outstanding, of which it would normally expect \$113,141,505 to be redeemed.<sup>425</sup> In its first day motions, Borders Group requested permission to honor these gift cards, primarily because doing so seemed critical to maintaining its customer base and restructuring the company.<sup>426</sup> Legally, Borders Group justified the motion to respect the gift cards on the grounds that the gift card would be classified as unsecured claims held by consumers for the purchase of property for a personal, family, or household use that had not been delivered, and thus the claims would be entitled to priority over other unsecured claims pursuant to section 507(a)(7) of the Bankruptcy Code.<sup>427</sup> The court approved the motion, and Borders continued to honor its gift cards while its stores were still open.<sup>428</sup>

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<sup>423</sup> *Order Confirming First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors*, Docket No. 2384.

<sup>424</sup> *Statement/Notice of Entry of: (I) Order Confirming First Amended Joint Plan of Liquidation Pursuant to Chapter 11 of the Bankruptcy Code Proposed by the Debtors and the Official Committee of Unsecured Creditors; (II) Occurrence of Effective Date; and (III) Deadline for Filing Administrative Claims and Claims Arising from Rejection of Executory Contracts or Unexpired Leases*, Docket No. 2465.

<sup>425</sup> *Debtor's Motion Pursuant to 11 U.S.C. §§ 105(a) and 503(b)(1) for Authorization to Honor Certain Prepetition Customer Programs*, Docket No. 18.

<sup>426</sup> *Debtor's Motion Pursuant to 11 U.S.C. §§ 105(a) and 503(b)(1) for Authorization to Honor Certain Prepetition Customer Programs*, Docket No. 18; 11 U.S.C § 507.

<sup>427</sup> *Debtor's Motion Pursuant to 11 U.S.C. §§ 105(a) and 503(b)(1) for Authorization to Honor Certain Prepetition Customer Programs*, Docket No. 18; 11 U.S.C § 507.

<sup>428</sup> *Order signed on 2/16/2011 Authorizing Debtors to Honor Certain Prepetition Customer Programs*, Docket No. 63.

On April 8, 2011, the bankruptcy court set a Bar Date on the filing of all claims against the estate – June 1, 2011 at 5:00 P.M.<sup>429</sup> Pursuant to the order, Borders Group was to notify all known creditors of the bar date, and was additionally required to notify all unknown creditors – including the gift card holders, whose identities could not be ascertained due to the nature of gift cards – by publication in the *New York Times*.<sup>430</sup> Accordingly, Borders Group published the bar date notice in the *New York Times* on April 25, 2011, and also provided a link to claim filing instructions on the Borders Reorganization website.<sup>431</sup>

All of Borders Group’s retail store liquidations were completed and Borders Group had ceased taking online orders by the end of September 2011.<sup>432</sup> Thus, by the end of September, all outstanding Borders gift cards were essentially worthless – unless, of course, the gift card holders had filed a claim by the bar date.

On January 4, 2012, two gift card holders emerged and requested Judge Glenn to approve a motion to allow claims from late-filing gift card holders.<sup>433</sup> The cardholders essentially contended that they never received actual notice of the June 1, 2011 Bar Date, and that it was “much to their surprise” that they were unable to use their gift cards – which were in the amounts of \$100 and \$25 – in the 2011 holiday season.<sup>434</sup> In particular, the cardholders asserted that Borders Group’s assurances that it would honor all outstanding gift cards during the sale process led to confusion as to whether the Bar Date applied to them.<sup>435</sup> Further, the card holders argued that the publication notice of the Bar Date was inadequate because it was in the *New York Times*, which they claimed the average customer does not subscribe to.<sup>436</sup> They also argued that publication notice was inadequate regardless, because “the Debtors could have simply

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<sup>429</sup> *Order Signed on 4/7/2011 Establishing the Deadline for Filing Proofs of Claim and Approving the Form and Manner of Notice Thereof - Deadline For Filing Proofs of Claim (General Bar Date)*, Docket No. 580.

<sup>430</sup> *Order Signed on 4/7/2011 Establishing the Deadline for Filing Proofs of Claim and Approving the Form and Manner of Notice Thereof - Deadline For Filing Proofs of Claim (General Bar Date)*, Docket No. 580.

<sup>431</sup> *Memorandum Opinion Denying Gift Card Claimants’ Motion to File Late Claims and Class Certification*, Docket No. 2806.

<sup>432</sup> *Memorandum Opinion Denying Gift Card Claimants’ Motion to File Late Claims and Class Certification*, Docket No. 2806.

<sup>433</sup> *Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2415.

<sup>434</sup> *Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2415.

<sup>435</sup> *Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2415.

<sup>436</sup> *Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2415.

downloaded their database of Gift Card purchasers and mailed each a summary of the Bar Date Notice on a post card.”<sup>437</sup>

Shortly after filing the motion requesting the court to allow the late-filed gift card claims, the gift card holders filed another motion requesting the court to certify a class of all gift card holders, which would allow them to pursue priority unsecured claim status and collect the amounts outstanding on the gift cards.<sup>438</sup> The initial hearing on both motions was set for February 23, 2012, but was delayed for months while the Liquidating Trust and the gift card holders engaged in unfruitful negotiations.<sup>439</sup> The Liquidating Trust filed its official objection to the motion on May 25, 2011, along with declarations from two individuals explaining why the gift card holders were unknown creditors and that Borders Group had no way of ascertaining who the initial purchasers of the gift cards were, let alone who ultimately received them.<sup>440</sup> With a hearing then scheduled for May 31, 2011, counsel for the gift card holders again sought an adjournment of the hearing, and served discovery requests on the Liquidating Trustee to depose the Liquidating Trustee’s declarants.<sup>441</sup> Both parties still showed up for a status hearing on May 31, 2011, where Judge Glenn clearly was not amused:

**THE COURT:** Gift card late claimants.

**MR. CARROLL:** Absolutely, Your Honor. I’ll start, Your Honor, if it pleases the Court with the mediation request.

**THE COURT:** No. Actually what game were you playing when you asked to adjourn the motions from today and then serve discovery, including a deposition notice for tomorrow and wouldn’t agree to adjournment?

**MR. CARROLL:** Your Honor, we were not playing any games, and that is not what happened.

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<sup>437</sup> *Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2415.

<sup>438</sup> *Motion to Allow Motion for the Entry of an Order (I) Pursuant to Rule 9014(c) Making Rule 7023 Applicable to the Allowance and Priority of the Class Proof of Claim, (II) Certifying the Class of All Holders and Purchasers of Gift Cards, (III) Allowing the Class Claim, and (IV) Granting the Class Claim Priority Status*, Docket No. 2450.

<sup>439</sup> *Transcript regarding hearing Held on May 31, 2012*, Docket No. 2724, 25:5-17.

<sup>440</sup> *Objection of the BGI Creditors' Liquidating Trust and Liquidating Trustee to the Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2699; *Objection of the BGI Creditors' Liquidating Trust And Liquidating Trustee to the Motion for Entry of an Order (i) Pursuant to Rule 9014(c) Making Rule 7023 Applicable to the Allowance and Priority of the Class Proof Of Claim, (ii) Certifying the Class of all Holders and Purchasers of Gift Cards, (iii) Allowing the Class Claim, and (iv) Granting the Class Claim Priority Status*, Docket No. 2698; *Declaration of James Toner in Support of the Objection of the BGI Creditors' Liquidating Trust and Liquidating Trustee*, Docket No. 2700; *Declaration of Kate Matson in Support of the Objection of the BGI Creditors' Liquidating Trust and Liquidating Trustee*, Docket No. 2701.

<sup>441</sup> *Transcript regarding hearing Held on May 31, 2012*, Docket No. 2724, 26:11-17.

**THE COURT:** Well, it sure seems to me like that.<sup>442</sup>  
As no surprise, Judge Glenn refused the gift card holder's requests for mediation on the issue.<sup>443</sup>  
Shortly thereafter, however, he approved the discovery requests by order dated June 12, 2012.<sup>444</sup>

Following the depositions of the Liquidating Trust's two declarants, both parties filed supplemental briefs, and Judge Glenn was set to rule on the gift card claim issues.<sup>445</sup> In a memorandum opinion dated August 14, 2011, Judge Glenn focused on whether the gift card holders were "known" creditors to Borders Group, which would render the published notice of the Bar Date insufficient to the gift card holders.<sup>446</sup> This issue would hinge on whether Borders Group had a way to identify who purchased and ultimately received gift cards.<sup>447</sup> In his memorandum opinion on the issues, Judge Glenn quickly dismissed the gift cardholder's arguments:

Gift Card Holders' status as possible creditors was not known or reasonably ascertainable to the Debtors. As an initial matter, gift cards, as their name illustrates, are not intended to be used by the purchaser but are instead intended as gifts, so even if the Debtors were able to identify the purchasers of the Gift Cards, they would have no way of tracing the ultimate recipients. And, in fact, the Gift Card Holders, by their own admission, received their Gift Cards as gifts.<sup>448</sup>

Thus, Judge Glenn held that the gift card holders were *not* known creditors. Further, he held that the notice provided to the gift card holders in the *New York Times* and on the Borders Reorganization website complied with the Bar Date Order and the Federal Rules of Bankruptcy

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<sup>442</sup> *Transcript regarding hearing Held on May 31, 2012*, Docket No. 2724, 27:4-14.

<sup>443</sup> *Transcript regarding hearing Held on May 31, 2012*, Docket No. 2724, 39:2-4.

<sup>444</sup> *Order signed on 6/12/2012 Permitting Gift Card Holders to Depose Trust's Declarants on Limited Issues*, Docket No. 2734.

<sup>445</sup> *Order signed on 6/12/2012 Permitting Gift Card Holders to Depose Trust's Declarants on Limited Issues*, Docket No. 2734.

<sup>446</sup> *Memorandum Opinion Denying Gift Card Claimants' Motion to File Late Claims and Class Certification*, Docket No. 2806.

<sup>447</sup> *Memorandum Opinion Denying Gift Card Claimants' Motion to File Late Claims and Class Certification*, Docket No. 2806.

<sup>448</sup> *Memorandum Opinion Denying Gift Card Claimants' Motion to File Late Claims and Class Certification*, Docket No. 2806.

procedure, and therefore was adequate.<sup>449</sup> Accordingly, he entered orders denying both of the gift card holder's motions.<sup>450</sup>

Despite Judge Glenn's rulings, the gift card claimants (or, probably more accurately, their counsel) refused to go away. Less than two weeks after the rulings were entered, the gift card claimants filed notices of appeal.<sup>451</sup> They additionally filed a motion to stay the required interim distribution for 2012, on the grounds that making any such distributions would decrease the amount of money available to satisfy their priority claims and make their appeals equitably moot.<sup>452</sup> Judge Glenn was not receptive: he denied the motion to stay the interim distributions on November 2, 2012.<sup>453</sup>

The gift card holders were right about something, however: when Andrew Carter, Jr., District Court Judge for the United States District Court for the Southern District of New York, ruled on their appeals, he held that the appeals were entirely equitably moot.<sup>454</sup> Thus, on May 22, 2013, the gift card holders claims were officially dead, and the outstanding gift cards were reduced to mere bookmarks (that is, if anyone still even reads paper books).

## **II. *The Borders Bankruptcy Today***

As of April 2014, the Borders case is still open. The most recent action in the case began on January 3, 2013, when the trustee of the Liquidating Trust began filing preference actions

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<sup>449</sup> *Memorandum Opinion Denying Gift Card Claimants' Motion to File Late Claims and Class Certification*, Docket No. 2806.

<sup>450</sup> *Order signed on 8/16/2012 Denying the Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2814; *Order signed on 8/16/2012 Denying the Motion for Entry of an Order (I) Pursuant to Rule 9014(c) Making Rule 7023 Applicable to the Allowance and Priority of the Class Proof of Claim (II) Certifying the Class of All Holders and Purchasers of Gift Cards (III) Allowing the Class Claim and (IV) Granting the Class Claim Priority Status*, Docket No. 2815.

<sup>451</sup> *Notice of Appeal From the Order Denying Motion for Entry of an Order (I) Pursuant to Rule 9014(c) Making Rule 7023 Applicable to the Allowance and Priority of the Class Proof of Claim, (II) Certifying the Class of All Holders and Purchasers of Gift Cards, (III) Allowing the Class Claim, and (IV) Granting the Class Claim Priority Status*, Docket No. 2829; *Notice of Appeal From the Order Denying the Motion to Allow and Deem Timely Filed Gift Card Claims*, Docket No. 2828.

<sup>452</sup> *Motion of Gift Card Claimants for a Stay of Interim Distributions Pending Appeal*, Docket No. 2896.

<sup>453</sup> *Memorandum Opinion and Order signed on 11/2/2012 Denying Motion of Gift-Card Claimants for a Stay of Interim Distributions Pending Appeal of Denial of Leave to File Late Claims*, Docket No. 2934.

<sup>454</sup> *In re BGI, Inc*, No. 12 Civ. 7714 (ALC), 12 Civ. 7715 (ALC), 13 Civ. 0080 (ALC), 2013 BL 165932 (Bankr. S.D.N.Y. 2013).

pursuant section 547 of the Bankruptcy Code, primarily against vendors and suppliers who received payments in the 90 days prior to Borders filing bankruptcy.<sup>455</sup> The Liquidating Trustee ended up filing a total of 192 such actions.<sup>456</sup> Few details can be ascertained about these actions from the case docket, since the Avoidance Action Procedures were tailored to facilitate resolving the disputes with as little court involvement as possible.<sup>457</sup> However, as of the latest status report, filed on January 17, 2014, it appears that most of the preference actions have been resolved, either through settlement or dismissal.<sup>458</sup>

## **G. Conclusion**

### *The End of an Era*

By the end of September 2011, all that remained of what used to be a bookstore giant were hundreds of empty stores throughout the nation covered with “NOTHING HELD BACK!” signs and yellow tape – oh, and tons of worthless gift cards. While Borders Group portrayed itself as having fallen prey to the industry’s digital revolution, its ultimate collapse reflected a culmination of countless poor decisions. Because Borders Group entered bankruptcy in such a devastated condition and strapped with debt, it found itself at the will of the DIP Lenders, whose tight deadlines pulled the trigger to end the bookstore chain. But Borders Group’s bankruptcy represents more than just the end of the bookstore chain – it signifies the obsolescence of the American bookstore. Long gone are the days when books were cherished - renowned books can now be found in gas stations, Wal-Marts, grocery stores, and of course on the Internet. Also long gone are the days when people turned to bookstores as safe havens from reality – places where readers could escape from their busy lives and get lost in a book. Now, most people get lost in a Kindle. Thus, when America said goodbye to Borders, it was also saying goodbye to an era.

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<sup>455</sup> *Status Report Regarding BDI, Inc., f/k/a Borders Group, Inc. Preference Actions (April 2013)*, Docket No. 3328. The court had previously entered an order allowing the trustee of the Liquidating Trust to commence avoidance actions on October 23, 2012. *Order signed on 10/23/2012 Granting Motion of BGI Creditors' Liquidating Trust and the Liquidating Trustee to Establish Procedures Governing Adversary Proceedings Commenced Pursuant to Sections 547 and 550 of the Bankruptcy Code*, Docket No. 2922.

<sup>456</sup> *Status Report Regarding BDI, Inc., f/k/a Borders Group, Inc. Preference Actions (April 2013)*, Docket No. 3328.

<sup>457</sup> *See Motion to Approve/Establish Procedures Governing Adversary Proceedings Commenced Pursuant to Sections 547 and 550 of the Bankruptcy Code*, Docket No. 2876. [http://bordersreorganization.com/pdflib/2876\\_10614.pdf](http://bordersreorganization.com/pdflib/2876_10614.pdf)

<sup>458</sup> *Status Report Regarding BDI, Inc., f/k/a Borders Group, Inc. Preference Actions (January 2014)*, Docket No. 3422.

