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Blockbuster and the Pushback by Unsecured Creditors

BY STEPHEN J. LUBBEN

Blockbuster's fight to stay in Chapter 11 may represent another round in the pushback against aggressive secured lenders and the increasing use of quick 363 sale in place of



Zvi Lowenthal/The New York Times

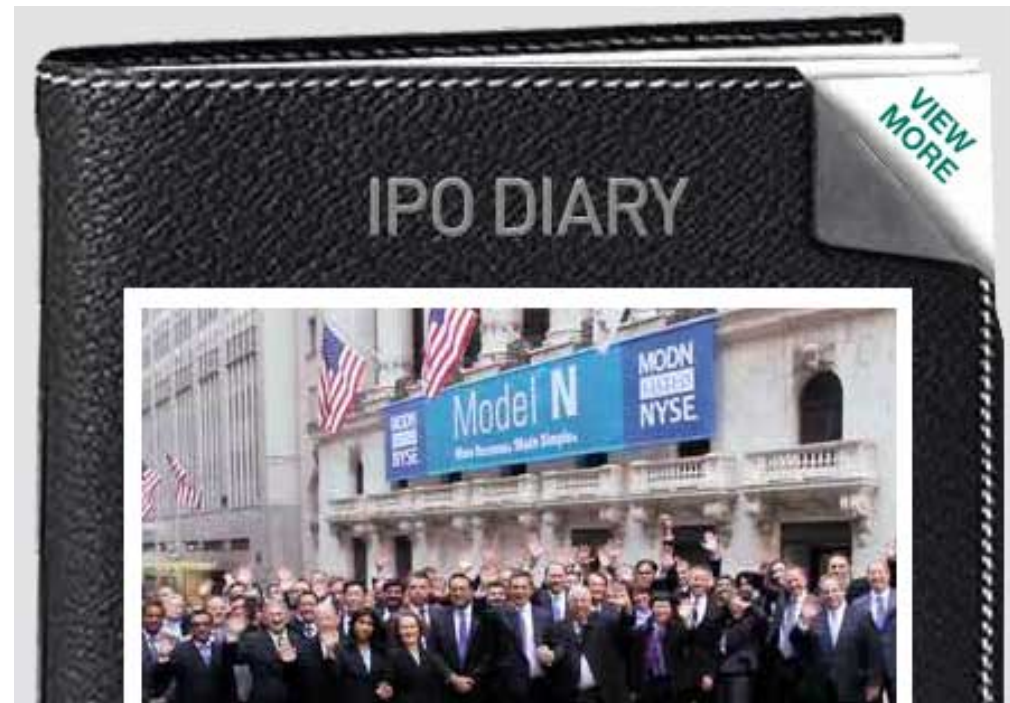
A Blockbuster store in East Meadow, N.Y., that is scheduled to close

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traditional on April 1.

Chapter 11 plans.

A while ago I noted some signs that the bankruptcy courts were pushing back against the senior lenders, and today we see the efforts of unsecured creditors to do the same. And they managed to get the United States Trustee – the government watchdog for bankruptcy – on their side.

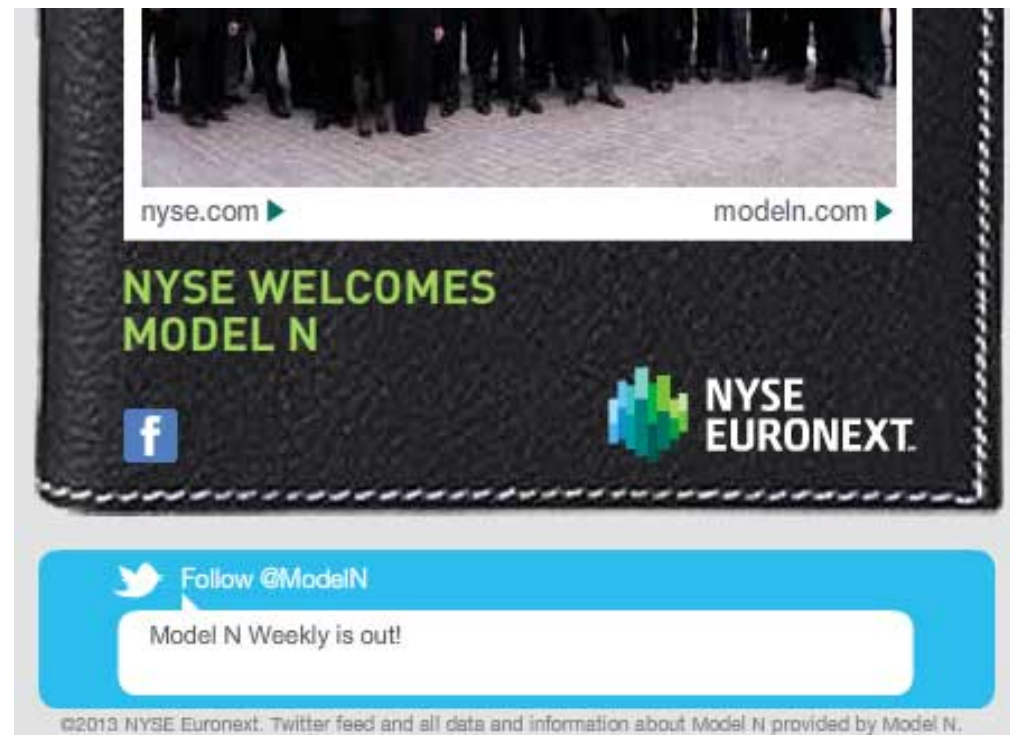
The current plan outline in Blockbuster calls for the senior noteholders to finance operations until a sale, after which the lenders will become owners and the pre-bankruptcy unsecured creditors will get bupkis. (That’s the technical bankruptcy term, of course.)

And there is a substantial amount of pre-bankruptcy unsecured debt outstanding: almost \$300 million in subordinated bonds and more than \$57 million owed to trade creditors.

But the present dispute involves something more: Blockbuster’s obligations to trade creditors who have continued to supply the debtor’s operations pending a sale. The creditors’ committee sees many of its constituents taking a further hit if these post-bankruptcy claims are left unpaid, and, perhaps more worryingly, the creation of a large group of priority creditors who will have first claim on the few scraps left after the sale.

The senior note holders respond that it is their cash that has kept Blockbuster alive to date. That may be so, but there is a real question of whether trade creditors are being asked to make an involuntary contribution to Blockbuster’s survival. The note holders are in this for the risk and return, the trade creditors are unlikely to want to go along for that ride.

The larger issue looming here is



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when is it appropriate for bankruptcy courts to facilitate a sale that benefits nobody except the senior lenders.

More broadly, there are important policy considerations embedded in the decision to allow a corporate reorganization scheme to

transform into a kind of supercharged foreclosure mechanism, particularly if secured lenders are able to avoid incurring costs that they would normally absorb in a state debt collection action. That question becomes especially problematic when the bankruptcy code allows the debtor to run up further exposure to trade creditors, while limiting the ability of those creditors to terminate their relationship with the debtor.

As the automotive cases showed, [quick 363 sales](#) are the current status quo in Chapter 11. To date, the senior lenders have largely [run this show](#). We are just seeing the beginnings of a response.

Blockbuster stays in Chapter 11 for now, and the senior lenders still get to try to do their thing, but maybe, just maybe, they have awakened the unsecured creditors.

Stephen J. Lubben is the Harvey Washington Wiley Chair in corporate governance and business ethics at Seton Hall Law School and an expert on bankruptcy.

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