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

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In re	: Chapter 11
BLOCKBUSTER INC., <i>et al.</i> , <sup>1</sup>	: Case No. 10-____ ( )
	: (Joint Administration Requested)
Debtors.	:
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**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 AND PROGRAMS AND (II) FOR BANKS TO HONOR  
AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS**

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Blockbuster Digital Technologies Inc., its parent Blockbuster Inc., and their  
debtor affiliates, as debtors and debtors in possession (collectively, "***Blockbuster***" or the  
"***Debtors***"), submit this motion (the "***Motion***") and respectfully represent as follows:

<sup>1</sup> The Debtors, together with the last four digits of each Debtor's federal tax identification number, are: Blockbuster Inc. (5102); Blockbuster Canada Inc. (1269); Blockbuster Digital Technologies Inc. (9222); Blockbuster Distribution, Inc. (0610); Blockbuster Gift Card, Inc. (1855); Blockbuster Global Services Inc. (3019); Blockbuster International Spain Inc. (7615); Blockbuster Investments LLC (6313); Blockbuster Procurement LP (2546); Blockbuster Video Italy, Inc (5068); Movielink, LLC (5575); Trading Zone Inc. (8588); and B<sup>2</sup> LLC (5219).

I.

**BACKGROUND**

1. On September 23, 2010 (the “*Commencement Date*”), each of the Debtors commenced a voluntary case under chapter 11 of title 11 of the United States Code (the “*Bankruptcy Code*”). The Debtors are authorized to operate their business and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. Contemporaneously herewith, the Debtors filed a motion seeking joint administration of their chapter 11 cases pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the “*Bankruptcy Rules*”).

II.

**BLOCKBUSTER’S BUSINESS**

2. More than twenty five years ago, Blockbuster became the first national retail chain provider of in-home entertainment, with its blue and gold torn-ticket logo symbolizing the decision by consumers to forego the movie theatre experience and “Make it a Blockbuster Night”® by staying home to watch the latest in new movie title releases from the convenience of their living rooms. Since its incorporation in 1982, Blockbuster has expanded its retail business operations domestically and abroad via a mix of corporate and franchisee-owned stores, with, as of August 29, 2010, over 5,600 stores in the United States and its territories and 16 other countries.

A. **Domestic Operations**

3. Blockbuster operates its domestic media entertainment business through three principal channels of distribution: (i) retail; (ii) by-mail; and (iii) digital. As a result of this multi-channel distribution scheme, Blockbuster offers customers a value-priced entertainment

experience, combining the broad array of products offered by a specialty or online retailer with the convenience of a local neighborhood retailer.

**1. Retail Channel**

4. The convenience offered to customers by having Blockbuster stores located in their cities, towns, and neighborhoods has been instrumental in establishing the BLOCKBUSTER<sup>®</sup> brand. As of August 29, 2010, there were 3,306 stores operating under the BLOCKBUSTER<sup>®</sup> brand in the United States and its territories. Of these stores, 2,924 are owned and operated by Blockbuster Inc. and 382 stores are owned and operated by franchisees. Blockbuster stores offer movies and games (collectively, "**Product**") for rent and purchase (both new and previously-viewed) as well as other entertainment-related consumer electronics and accessories, game consoles, confection, and movie-related merchandise for purchase. Additionally, approximately 240 of these locations include store-in-store game locations operating under the GAME RUSH<sup>®</sup> brand.

5. In step with its continued commitment to be the premier retailer of new release movies, Blockbuster has recently focused on promoting its rapidly emerging availability advantage over certain of its key competitors, who do not have access to key new Product for the initial 28 days of release (the "**28-day Window**"). In 2009, the 28-day Window was imposed by certain movie studios on the rental of newly released titles after the initial distribution date of a title so as to diminish the effect of rental on the retail sale of such titles. Given that a substantial portion of Blockbuster's rental revenues are derived from the rental of such new release Product, Blockbuster's advantage with respect to the 28-day Window is expected to maintain and improve its customer preference and loyalty in comparison to its competitors.

6. To expand its retail reach, in early 2009, Blockbuster entered into an agreement with NCR Corporation ("**NCR**") to launch BLOCKBUSTER Express<sup>®</sup> branded

vending kiosks. Through this partnership, NCR builds and maintains the kiosks and pays royalties to Blockbuster on the revenues generated. This agreement allows Blockbuster to compete in the popular vending kiosk channel without incurring capital expenditures and start-up costs on its own account, while making Product more convenient and less expensive for its customers. As of September 19, 2010, there were approximately 6,630 kiosks operating under the BLOCKBUSTER Express<sup>®</sup> brand throughout the United States and its territories.

**2. By-Mail Channel**

7. Blockbuster offers a by-mail subscription program through its retail chain and through its website, [www.blockbuster.com](http://www.blockbuster.com), whereby customers rent Product that is delivered directly to them by-mail. The by-mail subscription program provides customers access to substantially more Product than is available in its stores, and allows Blockbuster to compete directly with certain of its key competitors. In contrast to its competitors, Blockbuster offers: (i) a wide selection of games; and (ii) Blu-ray Product at no additional charge. Through its BLOCKBUSTER Total Access<sup>™</sup> program (“**Total Access**”), Blockbuster also offers its by-mail subscribers the ability to exchange up to five online movie rentals for in-store movies at its retail locations for only a few dollars more per month. The by-mail subscription program allows Blockbuster to reach customers located in geographic areas where it does not operate store locations.

8. In order to promote the synergies between its retail and by-mail channels of distribution and to profitably grow its by-mail customer base, Blockbuster recently launched a marketing partnership with Comcast Cable Corporation (“**Comcast**”). This partnership includes the launch of *DVDs by Mail*, a co-branded by-mail offer available at [www.DVDsbymail.com](http://www.DVDsbymail.com). As part of the marketing partnership, Comcast customers are now being offered Blockbuster’s by-mail services (both by-mail and Total Access-like products) through the new co-branded web

site as an additional service within their Comcast package. On the site, customers can browse Blockbuster's vast library of more than 95,000 movie and television titles, create a queue of titles they want to rent and then get the DVDs through the mail or at a Blockbuster retail store, where they can also exchange their rentals. In turn, Blockbuster is installing Comcast-dedicated kiosks in select stores that allow customers to quickly and easily learn about, and sign up for, Comcast services.

**3. *Digital Channel***

9. As new distribution channels have emerged and as consumer interest in accessing Product in new ways has grown, Blockbuster has begun to expand its footprint into the digital realm. To that end, Blockbuster's digital business currently offers its customers on-demand access to one of the largest libraries of digital movies for both rental and sale through multiple formats. Blockbuster began its digital initiatives with the purchase of Movielink from a consortium of movie studios in 2007.

10. Through Blockbuster's website, [www.blockbuster.com](http://www.blockbuster.com), Blockbuster customers can download and view movies on their personal computers after downloading Blockbuster's personal computer application. In addition, with the convergence of media entertainment and electronic devices, Blockbuster recently entered into strategic partnerships with certain global third party consumer electronics device developers – including Samsung, Philips, TiVo, and Toshiba – to digitally deliver media entertainment to its customers through consumer electronics such as Internet-connected TVs and Blu-ray players through Blockbuster applications embedded in these devices. In the mobile space, Blockbuster has partnered with device makers such as Motorola and HTC, embedding Blockbuster's digital applications in its popular new models for Verizon and T-Mobile. Blockbuster is also pursuing partnerships with

Cable TV providers to offer Blockbuster-branded video-on-demand services inside an operator's set-top-box infrastructure.

**B. International Operations**

11. Blockbuster's international operations, which serve as ambassadors of the BLOCKBUSTER<sup>®</sup> brand, are comprised of all store operations outside the United States and its territories, including: (i) owned retail operations in Canada, the United Kingdom, Denmark, Italy, Mexico, Argentina, and Uruguay; and (ii) franchised retail operations in Australia, Brazil, Chile, Columbia, Guatemala, Israel, Italy, Mexico, New Zealand, Panama, Portugal, and Taiwan. As of August 29, 2010, Blockbuster had 2,333 stores in 16 markets outside of the United States operating under the BLOCKBUSTER<sup>®</sup> brand, the GAME RUSH<sup>®</sup> brand, and other brand names owned by Blockbuster. During 2008 and 2009, 29% and 30% of Blockbuster's revenues were generated outside of the United States, respectively. Blockbuster's international operations have historically been more dependent than the domestic operations on retail sales and, in particular, sales of games, as opposed to revenue generated from rentals.

**C. Financials**

12. As of July 4, 2010, the Debtors, on a consolidated basis, reported approximately \$1.2 billion in total assets and approximately \$1.6 billion in total liabilities. For 2009, Blockbuster reported consolidated revenues of approximately \$4.1 billion and net cash from operating activities of \$29.3 million.

13. Additional information regarding Blockbuster's business, capital structure, and the circumstances leading to these chapter 11 cases is contained in the *Affidavit of Jeffery J. Stegenga Pursuant to Local Bankruptcy Rule 1007-2 in Support of First Day Motions* (the "**First Day Affidavit**") filed contemporaneously herewith.

**III.**

**JURISDICTION**

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

**IV.**

**RELIEF REQUESTED**

15. The Debtors request, pursuant to sections 105(a), 363(b), and 507 of the Bankruptcy Code and Bankruptcy Rules 6003 and 6004, (i) for authorization to (a) pay, in their sole discretion, all obligations incurred under or related to Compensation Obligations, Payroll Tax Obligations, Garnishment Obligations, Supplemental Workforce Obligations, Independent Contractor Obligations, Reimbursement Obligations, Incentive Obligations, the Retention Plan, the Severance Plan, and Employee Benefit Obligations (each as defined below, and collectively, the “*Employee Obligations*”) and all fees and costs incident to the foregoing, including amounts owed to third-party administrators, and (b) maintain and continue to honor and pay all amounts with respect to their practices, programs, and policies for their employees as they were in effect as of the Commencement Date, and as such may be modified, amended, or supplemented from time to time in the ordinary course of business; and (ii) authorizing and directing applicable banks and financial institutions (the “*Banks*”) at which the Debtors maintain disbursement and other accounts (the “*Bank Accounts*”), at the Debtors’ instruction, to receive, honor, process, and pay, to the extent of funds on deposit, any and all checks or electronic funds transfers to the extent that such checks or transfers relate to any of the Employee Obligations.<sup>2</sup> The Debtors

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<sup>2</sup> Concurrently herewith, the Debtors have filed a motion for authority to, among other things, continue their cash management system (the “*Cash Management Motion*”).

seek this authority to minimize the personal hardship that their employees would suffer if the Employee Obligations are not paid when due and to maintain the stability of the Debtors' work force, which is critical to the success of these reorganization cases. A proposed form of order approving the relief requested herein on an interim basis is annexed hereto as *Exhibit "A"* (the "*Interim Order*") and, pending a final hearing (the "*Final Hearing*") on the Motion, on a final basis as *Exhibit "B"* (the "*Final Order*").

V.

**BLOCKBUSTER'S WORKFORCE  
AND RELATED EMPLOYEE OBLIGATIONS**

16. As described above and in the First Day Affidavit, Blockbuster is a leading provider of rental and retail movie and game entertainment. As of the Commencement Date, Blockbuster operated approximately 3,000 domestic retail stores, 39 distribution centers, and 2 corporate offices located throughout the United States, and approximately 1,600 stores in markets outside the United States.<sup>3</sup>

17. In connection with its operations, Blockbuster currently employs approximately 25,500 employees (the "*Employees*"), of whom approximately 7,500 are full-time employees (the "*Full-Time Employees*") and approximately 18,000 are part-time employees (the "*Part-Time Employees*"). Approximately 22,500 Employees (88%) are paid on an hourly basis and approximately 3,000 Employees (12%) are paid a fixed salary.

18. Blockbuster's retail store Employees are the public "face" of its business – they are responsible for ensuring that customers receive the Product and service they have come to expect from the Blockbuster brand. Indeed, a positive in-store experience is a vital part of

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<sup>3</sup> Pursuant to this Motion, Blockbuster does not seek any relief with respect to any employees of its foreign non-debtor affiliates.



ensuring customer loyalty, especially in the face of competition from Blockbuster's non-retail competitors. Blockbuster's business also crucially depends on its Employees who assist with product distribution to its stores and online customers, development and maintenance of the Blockbuster website and digital delivery services, and corporate management<sup>4</sup> of its operations. Collectively, the Employees' dedication to customer satisfaction has helped Blockbuster develop the customer loyalty that serves as a basis for its worldwide brand and its status as a leader in the retail and rental movie market. Accordingly, the Employees perform a variety of critical functions, including customer service, inventory control, management, leasing, accounting, marketing, purchasing and sales, shipping, tax, technical services, and legal services. The Employees' skills and their knowledge and understanding of Blockbuster's operations, customer and supplier relationships, and infrastructure are essential to maintaining Blockbuster's business franchise and the success of its chapter 11 reorganization efforts. Without the Employees' continued commitment to Blockbuster's business operations, Blockbuster's ability to achieve a successful reorganization would be severely compromised.

19. In the ordinary course of its business, Blockbuster incurs payroll and various other obligations for its Employees and provides other benefits to its Employees for the performance of services. These benefits and obligations are described in more detail below.

**A. Payroll and Related Obligations**

***1. Compensation Obligations***

20. In the ordinary course of business, the Debtors incur payroll obligations to their Employees, comprised generally of wages and salaries. The Debtors pay their Employees,

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<sup>4</sup> Blockbuster's corporate level Employees include certain non-executive managers at the director level. These director-level Employees are not "directors" or "officers" within the meaning of section 101(31) of the Bankruptcy Code.

in most cases, on a biweekly basis, on Friday, in arrears.<sup>5</sup> The Debtors' average monthly gross payroll based on the last 12 months (*i.e.*, gross salaries and wages paid to Employees before Employee taxes, garnishments, or other deductions are withheld) for all Employees is approximately \$41.5 million per month. The last date Employees were compensated prior to the Commencement Date was September 10, 2010, which primarily included all salaries and wages earned through September 5, 2010.<sup>6</sup>

21. Approximately forty-eight percent (48%) of the Debtors' payroll is made by direct deposit, with the remainder issued via checks. The Debtors utilize Automatic Data Processing, Inc. ("**ADP**") to process their payroll and coordinate the payment of Payroll Tax Obligations and Garnishment Obligations (each as defined below). Employees are paid from one of two Blockbuster disbursement accounts maintained at Wachovia Bank (each, a "**Payroll Account**"). In the case of Employees paid through direct deposit, ADP transfers the appropriate amounts from the applicable Payroll Account to the Employee's designated account. For Employees receiving individual checks, ADP issues individual checks against the applicable Payroll Account, and the Debtors then distribute those checks.

22. The ongoing services of ADP are crucial to the smooth functioning of the Debtors' payroll system. For its payroll services, the Debtors pay ADP approximately \$82,000

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<sup>5</sup> The Debtors pay approximately 30 Employees on a weekly basis, including their Employees in Rhode Island and certain corporate senior management Employees. In addition, on occasion, the Debtors may issue off-cycle checks to correct discrepancies between the amounts paid to Employees and the amounts that should have been paid.

<sup>6</sup> The last date that Employees in Rhode Island were compensated was September 17, 2010, which primarily included all salaries and wages earned through September 12, 2010. The last date that certain other senior management Employees who are paid on a weekly basis were compensated was September 17, 2010, which primarily included all salaries and wages earned through September 17, 2010.

per month. As of the Commencement Date, the Debtors estimate they owe ADP approximately \$150,000 in outstanding fees in connection with its payroll services.

23. Because Employees are paid in arrears, as of the Commencement Date, some of the Employees will not have been paid all of their prepetition wages. Additionally, some Employees may be entitled to compensation because, among other things, (a) potential discrepancies may exist between the amounts paid and amounts Employees believe should have been paid, which, upon resolution, may reveal that additional amounts are owed to such Employees, and (b) some payroll checks issued to Employees prior to the Commencement Date may not have been presented for payment or may not have cleared the banking system and, accordingly, have not been honored and paid as of the Commencement Date.

24. The Debtors estimate that, as of the Commencement Date, the accrued and unpaid prepetition salaries and wages (the “*Compensation Obligations*”) total approximately \$15.4 million, all of which will be due and payable in the period of time prior to the Final Hearing (the “*Interim Period*”),<sup>7</sup> and approximately \$900,000 in payroll checks from previous pay periods are outstanding and have not been cashed by Employees and former Employees. As of the Commencement Date, to the best of the Debtors’ understanding, no Employee is owed more than \$11,725 in accrued and unpaid prepetition wages or salaries, excluding outstanding and uncashed payroll checks.

25. By this Motion, the Debtors seek authority, but not direction, to pay any unpaid Compensation Obligations, any prepetition amounts owed to ADP in connection with payroll services, and outstanding payroll checks not yet presented for payment, and to continue

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<sup>7</sup> This amount excludes earned and unpaid PTO Obligations and Reimbursement Obligations (each as defined below).

their employee compensation practices in the ordinary course<sup>8</sup> during the administration of these chapter 11 cases.

2. *Amounts Withheld on Behalf of Third Parties*

a. Payroll Tax Obligations

26. In connection with the salaries and wages paid to Employees, the Debtors are required by law to withhold from their Employees' wages amounts related to federal, state, and local income taxes, as well as social security and Medicare taxes (collectively, the "*Employee Withholding Taxes*") and to remit the same to the applicable taxing authorities (the "*Taxing Authorities*"). In addition, the Debtors are required to make matching payments from their own funds for, among other things, social security and Medicare taxes and to pay, based on a percentage of gross payroll, state and federal unemployment insurance, employment training taxes, and state disability insurance contributions (the "*Employer Payroll Tax Obligations*," and together with Employee Withholding Taxes, the "*Payroll Tax Obligations*").

27. Each pay cycle Blockbuster withholds any applicable Employee Withholding Taxes from the Employees' wages, and ADP remits the same to the applicable Taxing Authorities. Historically, on average, Blockbuster has withheld approximately \$7.2 million per month in Employee Withholding Taxes. At the same time, ADP also remits any Employer Payroll Tax Obligations. The Debtors' average monthly payment for Employer Payroll Tax Obligations has been approximately \$3.8 million per month.

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<sup>8</sup> In the ordinary course of business, the Debtors compensate their outside directors semi-annually on January 1 and July 1 of each year for services rendered or to be rendered in that calendar year. Directors are compensated in arrears with respect to the cash portion of their retainer, and in advance with respect to the equity portion of their retainer. In addition, each outside director is paid a fee for board of directors meetings and committee meetings, and is reimbursed reasonable out-of-pocket expenses incurred in connection with such meetings. Consistent with the Debtors' prepetition practice, the Debtors intend to continue to pay fees to outside directors in the ordinary course of business; *provided, however*, that the Debtors are not seeking authority at this time to pay the portion of the semi-annual cash retainer that pertains to services rendered prior to the Commencement Date.

28. As of the Commencement Date, the Debtors estimate that they owe approximately \$5.4 million in accrued Payroll Tax Obligations, most of which will become due and payable during the Interim Period.

b. Garnishment Obligations

29. In the ordinary course of processing the Employees' payroll, the Debtors may be required by law, in certain circumstances, to withhold certain amounts for garnishments such as tax levies, child support, and other court-ordered garnishments (the "**Garnishments**"). Blockbuster withholds, on average, \$290,000 per month from Employee wages and salaries on account of Garnishments, and ADP remits the same to the appropriate authorities or entities. As of the Commencement Date, Blockbuster has withheld from Employees' wages, and ADP has not yet remitted, approximately \$115,000 on account of Garnishments (the "**Garnishment Obligations**").

30. By this Motion, the Debtors seek authority, but not direction, to (i) pay, any accrued and unpaid Payroll Tax Obligations and Garnishment Obligations, and (ii) continue to remit amounts withheld on behalf of third parties postpetition in the ordinary course of business throughout the administration of these chapter 11 cases.

3. ***The Supplemental Workforce***

31. In the ordinary course of business, the Debtors utilize the services of certain employment agencies (the "**Agencies**") to engage a supplemental workforce (collectively, the "**Supplemental Workforce**" and each member thereof, a "**Supplemental Worker**") to work for the Debtors, primarily in their distribution centers and in various information technology and administrative support functions. Because the Supplemental Workforce is in constant flux to meet the ebb and flow of the Debtors' business needs, the Debtors do not have a firm estimate of the number of Supplemental Workers currently working for the Debtors. The Debtors do not pay

wages, withhold taxes, or provide benefits for the Supplemental Workforce. Rather, the Debtors make payments to the Agencies based upon the number of hours worked by the Supplemental Workers and, in turn, the Agencies pay the Supplemental Workers' wages and other amounts to which they are entitled. As of the Commencement Date, the Debtors estimate that approximately \$1.3 million has accrued in respect of the prepetition services of the Supplemental Workforce (the "**Supplemental Workforce Obligations**"), of which \$900,000 will become due and payable to the Agencies in the Interim Period.

32. Similar to their regular Employees, any delay in payments to the Agencies, and, in turn, the Supplemental Workers, would likely cause the Debtors to lose the benefit of the Supplemental Workforce's services, which would significantly disrupt certain aspects of the Debtors' operations. Because the Debtors would be irreparably harmed without the services of the Supplemental Workforce, the Debtors request authority to honor and pay such obligations, whether pre- or postpetition, as and when such amounts become due and payable.

#### **4. Independent Contractors**

33. From time to time, the Debtors also employ a small number of independent contractors (the "**Independent Contractors**"). Like the Supplemental Workforce, the number of Independent Contractors is in constant flux to meet the Debtors' business needs. As of the Commencement Date, the Debtors estimate that the amount owing to Independent Contractors for services performed prior to the Commencement Date (the "**Independent Contractor Obligations**") does not exceed \$10,000.

34. Because the Independent Contractors are skilled persons who provide services that are critical to the Debtors' business, the Debtors request authority to honor and pay Independent Contractor Obligations with respect to prepetition work performed and to continue payments to Independent Contractors postpetition in the ordinary course of business.

5. ***Reimbursement Obligations***

35. The Debtors customarily reimburse Employees for a variety of business-related expenses incurred in performing their employment obligations (the “***Reimbursement Obligations***”). The Reimbursement Obligations consist of, among other things, certain expenses for (a) professional development, (b) office supplies, (c) cellular telephones and personal data assistants, and (d) reasonable and documented travel expenses for meals, hotels, and rental cars. All such expenses are incurred with the understanding that they will be reimbursed by the Debtors in accordance with the Debtors’ reimbursement policy. In most cases, Employees pay for such expenses directly from their own funds and are reimbursed upon the submission of a claim itemizing the business expenses.

36. The Debtors also maintain a corporate card program with American Express (the “***American Express Corporate Cards***”). Approximately 100 Employees have been issued American Express Corporate Cards and incur reimbursable expenses for goods and services purchased for, or incidental to, the Debtors’ business on such cards. Statements are forwarded directly to Employees, who are personally liable to American Express for such business-related charges. It is essential to the sustained operation of the Debtors’ business that they be permitted to continue reimbursing Employees for expenses incurred on American Express Corporate Cards. A substantial amount of the reimbursable American Express Corporate Card charges are related to business travel, and use of the American Express Corporate Cards is an efficient way for the Debtors to manage the costs incurred by their Employees.

37. The Debtors process expense and reimbursement claims on a rolling basis through their accounts payable three times a week. Typically, no more than two months elapse between when Employees incur reimbursable expenses and submit a request for reimbursement.

In addition, there may be a lag of approximately one week between submission and reimbursement of such claims. Depending on the Employee's payroll preference, the Debtors pay Reimbursement Obligations by either individual check or direct deposit.

38. Historically, Reimbursement Obligations aggregate approximately \$200,000 per month. It is difficult for the Debtors to determine the precise amount of Reimbursement Obligations outstanding as of the Commencement Date because Employees may have expenses that have yet to be submitted to the Debtors for reimbursement. The Debtors estimate, however, the total unpaid prepetition Reimbursement Obligations owed directly to Employees to be approximately \$200,000 as of the Commencement Date.<sup>9</sup> The Debtors seek authorization to satisfy all prepetition Reimbursement Obligations, including those incurred through the use of American Express Corporate Cards, as and when they arise; *provided, however*, that the Debtors have agreed that prior to the Final Hearing, reimbursement will be limited to \$1,000 for each eligible Employee. The Debtors intend to continue their policies relating to the Reimbursement Obligations, including the American Express Corporate Card program, in the ordinary course during the administration of these chapter 11 cases.

**B. Incentive, Retention, and Severance Programs**

**1. *Incentive Programs***

39. Blockbuster has customarily maintained discretionary bonus and incentive programs for its Employees (collectively, the "*Incentive Programs*") designed to encourage exceptional Employee performance for the benefit of Blockbuster's business. These programs and the payment of the obligations owed thereunder (the "*Incentive Obligations*") have, in the past, been critical to Blockbuster's financial performance because they provide Employees with

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<sup>9</sup> This amount includes Reimbursement Obligations estimated to be owed to Employees in respect of charges to American Express Corporate Cards.



financial incentives to operate the business as efficiently and profitably as possible. These Incentive Programs are as follows:

a. Annual Performance Bonus

40. The Debtors offer an annual performance bonus plan (the “*Annual Performance Bonus Plan*”) to Employees, ranging from professional and administrative staff to senior management.<sup>10</sup> The plan does not include individual goals for Employee participants, but instead links bonuses to the overall performance of the Debtors’ operations. Annual Performance Bonus Plan award targets are reflected as a percentage of the relevant Employee’s annual salary. Although, in the past, bonuses under the Annual Performance Bonus Plan were payable at fiscal year end, in February 2010, the Compensation Committee of the Board of Directors of Blockbuster approved an amendment to the 2010 Annual Performance Bonus Plan to pay incrementally at mid-year and year-end, subject to Blockbuster’s achievement of performance requirements under this plan.

41. Due to Blockbuster’s declining financial performance, current expectations are that Blockbuster will not meet target earnings for the 2010 Annual Performance Bonus Plan. As a result, in July 2010, Blockbuster determined that accruals for the 2010 program should be suspended and reversed, and no payouts should be made with respect to the 2010 performance period. Accordingly, no prepetition amounts are owed on account of the Annual Performance Bonus Plan.

b. Field Bonus Plan

42. Historically, the Debtors have maintained an incentive program for retail store managers and field executives (the “*Field Bonus Plan*”). Approximately 2,800 store and

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<sup>10</sup> Employees covered by another annual bonus plan are ineligible to participate in the Annual Performance Bonus Plan.

multi-store managers and 200 district and market managers are eligible to receive a bonus when (i) Blockbuster achieves certain fiscal goals tied to overall company performance, and (ii) the Employee achieves certain personal goals related to revenue and profit margin targets for the stores within the Employee's mandate. Under the Field Bonus Plan, if company and individual performance metrics are met, eligible Employees may receive annual target bonus amounts ranging from 15%-30% of their annual salary. The maximum bonus opportunity for all Field Bonus Plan participants is up to 200% of their annual target bonus amount. As currently in effect, the performance targets under the Field Bonus Plan are determined and announced in the first fiscal quarter, and payments earned under the Field Bonus Plan are paid annually in February or March of the following year.

43. The Debtors currently are reviewing the metrics of performance established for the Field Bonus Plan for 2010, but based on current performance and expectations of profitability, it is not anticipated that Blockbuster will pay bonuses under the Field Bonus Plan for 2010.

c. Long Term Incentive Plan

44. Since 1999, Blockbuster has maintained a bonus program to reward certain key management Employees for their contributions to the financial success of Blockbuster and thereby motivate them to continue to make such contributions in the future (the "*Long Term Incentive Plan*"). Specifically, to motivate achievement of pre-established operating income and net cash flow targets, the Debtors have awarded certain Employees in positions of vice president and above shares, options, and/or cash performance units in the Debtors. For fiscal year 2010, the Board of Directors approved a bonus of a combination of restricted stock and performance units payable in cash for approximately 20 participating Employees that will vest in equal parts over three years, provided performance goals for each

year are met.<sup>11</sup> The aggregate value of the 2010 Long Term Incentive Plan for active Employees at the time of issuance was \$3.5 million. In addition, certain options awarded to various Employees participating in the Long Term Incentive Plan will vest in upcoming years.<sup>12</sup>

45. Due to Blockbuster's declining financial performance, current expectations are that Blockbuster will not meet operating income and net cash flow targets for fiscal year 2010. As a result, accruals for fiscal year 2010 have been suspended and reversed, and no bonus obligations will be incurred for fiscal year 2010. Accordingly, there are no prepetition amounts owed in respect of the Long Term Incentive Plan.

d. Real Estate Incentive Plan

46. To incentivize members of the real estate management team to reduce lease costs and control various real estate-related expenditures, Blockbuster adopted a bonus program for real estate managers, program managers, and directors, commencing in January 2010 (the "*Real Estate Incentive Plan*"). If earned, bonuses under the Real Estate Incentive Plan are paid annually out of a bonus pool based on total approved lease savings or net sale proceeds generated by the entire real estate team as a result of, but not limited to, negotiating or renegotiating lease renewals, tenant improvement allowances, rent, lease terminations, square footage changes, subleases on dark stores, and sales of owned stores. No bonuses are paid unless

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<sup>11</sup> No payments under the Long Term Incentive Plan would be made until the third anniversary of the plan in 2012. Vesting of restricted stock is dependent on Blockbuster achieving pre-established operating income and net cash flow targets. In addition, no cash will be distributed to eligible Employees if, by the third anniversary of the plan, the Debtors do not achieve at least 80% of both the net cash flow and operating income targets under the Long Term Incentive Plan.

<sup>12</sup> Outstanding stock options granted prior to July 1, 2007 generally vest over a three-year to five-year period from the date of grant and generally expire ten years after the date of grant. Generally, outstanding stock options granted subsequent to July 1, 2007 vest over a one-year to three-year period from the date of grant and expire five years after the date of grant. Restricted shares and restricted share units generally vest over a one-year to three-year period from the date of grant and are payable in shares of Class A common stock.

a threshold of total savings or proceeds is achieved. Any payments from the bonus pool, which would not be made until the first quarter of 2011, are to be divided among each of the eligible Employees, with five percent (5%) reserved for discretionary allocation by senior management.

47. Eleven Employees are eligible for bonuses under the Real Estate Incentive Plan. To date, the applicable performance target under the plan has not yet been achieved. The Debtors seek authority, if the applicable performance target is achieved for 2010, to pay bonus amounts as and when they become due in the ordinary course business.

e. Other Cash Awards

48. The Debtors offer nominal cash incentive awards to rank and file Employees in order to, for example, motivate Employees to sell certain products and services, or complete an internal project. Although it is difficult to ascertain the exact amount of outstanding cash award obligations incurred with respect to the prepetition period, the Debtors believe any cash awards that may be owed to their rank and file employees are not material in amount. Accordingly, the Debtors seek authority to pay such amounts as and when they become due in the ordinary course business.

49. The Debtors intend to maintain the Incentive Programs in the ordinary course of business, subject to the requirements of section 503(c) of the Bankruptcy Code.

**2. *Retention Plan***

50. In February 2010, Blockbuster instituted a retention program designed to retain key corporate level employees who are critical to the success of the business and who achieved recognition for their strong individual performance (the “*Retention Plan*”). Approximately 50 Employees at the director and vice president levels are currently eligible to participate in the Retention Plan. An eligible Employee’s payment under the program is equal to 100% of the individual’s target bonus under the Annual Performance Bonus Plan for 2010 (the

“**Retention Bonus**”). The Retention Plan provides that payments to eligible Employees are to be made in three equal installments. Two remaining installments in the aggregate amount of approximately \$500,000 each are scheduled for December 31, 2010 and June 30, 2011 for participating Employees that remain with the Debtors through those payment dates. Under the Retention Plan, the mean amount of remaining payments an Employee will receive is approximately \$20,000.

51. Pursuant to this Motion, the Debtors seek authority to make all payments under the Retention Plan as and when they come due. The Debtors believe that payment of these amounts is consistent with the provisions of Section 503(c)(1) of the Bankruptcy Code.

### **3. Severance Plan**

52. The Debtors maintain a discretionary severance pay plan (the “**Severance Plan**”) for all Full-Time Employees who are not a party to (i) a separate severance agreement with Blockbuster, or (ii) an individual employment agreement with Blockbuster that provides for severance benefits. The Severance Plan provides continuation of the Employee’s base salary, at the Debtors’ sole discretion, to eligible Employees whose employment with the Debtors is involuntarily terminated without cause as a result of a reduction in workforce, elimination of the Employee’s position, closure or sale of the facility where the Employee is employed, or other permanent separation, and provided that the Employee signs a release of claims against Blockbuster.

53. The amount of severance benefits payable under the Severance Plan (the “**Severance Payments**”) depends on an Employee’s tenure and position. Store hourly Employees with six months to one year of service are eligible to receive one week of severance, while store hourly Employees with one or more years of service accrue two weeks of severance for every year of service. Salaried Employees accrue two weeks of severance for every year of

service with a minimum of four to eight weeks of salary continuation, depending on the Employee's position. The maximum Severance Payment to any eligible Employee under the Severance Plan is 26 weeks' pay, irrespective of length of service. Coverage under applicable Health Plans (as defined below) ends as of the last day of the month in which the covered Employee's employment termination date occurs, while benefits under applicable Welfare Plans (as defined below) end as of the last date of employment, unless otherwise provided for in the relevant benefit plan or as required by law.<sup>13</sup> The Debtors also offer outplacement services to all terminated Employees, provided such services are initiated within thirty days of such Employee's termination date.

54. As of the Commencement Date, approximately 140 Employees are receiving Severance Payments. None of these severed Employees is a former insider of any of the Debtors. The Debtors estimate that the aggregate amount of outstanding Severance Payments with respect to such Employees (which amount is payable over a period of time), including Payroll Tax Obligations in connection with such Severance Payments, is approximately \$1.2 million.<sup>14</sup> In addition, the Debtors estimate that they owe approximately \$30,000 on account of prepetition outplacement services provided to terminated Employees.

55. By this Motion, the Debtors request authority, in their sole discretion, on both an interim and final basis, to continue to make Severance Payments and provide related benefits under the Severance Plan to former Employees terminated prior to the Commencement

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<sup>13</sup> Terminated Employees have the opportunity to elect continued health benefits coverage for a period of at least eighteen months in accordance with the Consolidated Omnibus Budget Reconciliation Act of 1986 ("**COBRA**"). COBRA benefits are administered by the Debtors through their payroll and benefits center in Spartanburg, South Carolina.

<sup>14</sup> In addition, pursuant to separate agreements, approximately \$1 million of severance pay is owed to 6 executive officers of the Debtors. At this time, the Debtors are not seeking authority to make severance payments pursuant to such agreements.

Date. In addition, the Debtors intend to continue the Severance Plan in the ordinary course of business and provide any eligible Employees thereunder with a Severance Payment and outplacement services in the event such Employee is terminated postpetition, subject to the requirements of section 503(c)(2) of the Bankruptcy Code. Further, to the extent that checks, wire transfers, and direct deposit transfers with respect to prepetition Severance Payments have not cleared the Debtors' Banks, the Debtors request that the Court direct the Banks to honor such transfers, and authorize the Debtors to reissue payment in the event payment is nevertheless stopped.

**C. Employee Benefit Plans**

56. In the ordinary course of business, the Debtors have established various benefit plans and policies for their Employees that can be divided into the following categories: (i) medical and prescription drug benefits, dental care, vision care, mental health and substance abuse assistance, and confidential counseling assistance (collectively, the "**Health Plans**"); (ii) basic life and accidental death and dismemberment insurance, supplemental life insurance, short- and long-term disability insurance, business travel accident insurance, and other voluntary insurance plans (collectively, the "**Welfare Plans**" and together with the Health Plans, the "**Health and Welfare Plans**"); (iii) paid time off and parental and adoption leave (collectively, the "**PTO Plans**"); (iv) 401(k) plan and deferred compensation plan (the "**Employee Savings and Retirement Plans**"); and (v) certain other benefits programs (the "**Other Benefits Programs**" and together with the Health and Welfare Plans, PTO Plans, the Employee Savings and Retirement Plans, the "**Employee Benefit Plans**"). In certain instances, the Debtors deduct specified amounts from the Employees' wages in connection with the Employee Benefit Plans, such as, among others, certain of the Health and Welfare Plans and the 401(k) plan.

57. All obligations with respect to the Employee Benefit Plans (including insurance policies and coverage) are hereinafter referred to as the “**Employee Benefit Obligations**,” which include, without limitation, the obligations arising under the various plans described below. As of the Commencement Date, the Debtors believe that the accrued and unpaid prepetition Employee Benefit Obligations, inclusive of Employee contributions to such plans, total approximately \$5 million, as described in further detail below.<sup>15</sup>

**1. Health and Welfare Plans**

58. The Debtors provide their Employees with a standard range of Health and Welfare Plans. Participants include the Debtors’ Employees and their eligible dependants. Benefit options differ for Full-Time Employees and Part-Time Employees. The Health and Welfare Plans are administered or insured by several vendors, including United HealthCare Insurance Company (“**United Health**”), United Behavioral Health, CVS Caremark (“**Caremark**”), Alere Health Improvement Company<sup>16</sup> (“**Alere**”), Blue Cross and Blue Shield of Hawaii (“**Blue Cross**”), Aetna Affordable Health Choices (“**Aetna**”), Vision Service Plan Insurance Company (“**VSP**”), Metropolitan Life Insurance Company (“**Met Life**”), The Life Insurance Company of North America<sup>17</sup> (“**LINA**”), Unitrin, Inc. (“**Unitrin**”), Prudential Insurance Company of America (“**Prudential**”), Veterinary Pet Insurance Company (“**Veterinary Pet**”), Paylogix, LLC (“**Paylogix**”), and American Insurance Group (“**AIG**”).

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<sup>15</sup> This amount excludes the value of earned and unpaid paid time off. Employee contributions constitute approximately \$670,000 of the Debtors’ accrued, and unpaid prepetition Employee Benefit Obligations.

<sup>16</sup> Formerly Matria Health Enhancement Company.

<sup>17</sup> LINA is a subsidiary of CIGNA.



a. Full-Time Employees

(1) Medical Benefits

59. The Debtors provide the majority of their Full-Time Employees and eligible dependents medical and prescription drug benefits through a self-funded insurance program, the Blockbuster Group Health Care Plan (the “**Group Health Plan**”), administered by United Health, United Behavioral Health, Caremark, and Alere. Approximately 5,600 Full-Time Employees and 5,000 dependents are enrolled in the Group Health Plan.

60. Under the Group Health Plan, the Debtors deduct premiums from each participating Employee’s paycheck based upon the level of coverage the Employee elects. The Employee contributions, together with additional funding provided by the Debtors, are used to pay claims under the Group Health Plan. The Group Health Plan costs the Debtors approximately \$3.4 million per month in gross claims (\$2.4 million per month net cost after employee contributions), and approximately \$220,000 per month in administrative services fees to United Health.<sup>18</sup>

61. As part of the Group Health Plan, Full-Time Employees have the ability to enroll in a program for disease management (the “**Disease Management Program**”), whereby participants are provided access to resources to learn better ways to manage certain chronic conditions. Alere administers the Disease Management Program, which costs the Debtors approximately \$24,000 per month. Full-Time Employees and their dependents enrolled in the

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<sup>18</sup> The Debtors believe that they have accrued obligations under the Group Health Plan for medical claims that have been incurred but not yet reported. In addition, United Health pays Employee claims under the Group Health Plan from a controlled disbursement account maintained in Blockbuster’s name, for the benefit of United Health, at Bank of America (the “**Group Health Plan Claims Account**”). This account requires daily transfers to maintain an imprest balance of approximately \$425,000 at all times. Cash is remitted on a daily basis from Blockbuster’s electronic payments disbursement account maintained at Wachovia Bank to regularly replenish the balance in the Group Health Plan Claims Account.

Group Health Plan are also eligible for mental health or substance abuse treatment coordinated through United Behavioral Health.

62. The Debtors also offer a fully-insured plan, HMSA Blue Cross (the “*Hawaii Plan*”), which covers approximately 85 Employees and 25 dependents located in Hawaii. Coverage for employees enrolled in the Hawaii Plan costs the Debtors approximately \$24,000 in premiums per month.

63. In addition, pursuant to local San Francisco County law, Blockbuster is required to contribute an amount for health care for each Full-Time Employee that works in San Francisco County during each calendar quarter. Blockbuster is not required to make payments for Employees who have been employed for less than 90 days as of the quarter end, Employees who have not worked an average minimum of eight hours weekly during the quarter, Employees whose annual base salary is greater than \$80,397, Employees who are enrolled in Medicare, and Employees who sign a waiver form. The payment is calculated by multiplying the number of hours (up to 516) worked during the 13-week period by the health care expenditure rate (\$1.96 for 2010), and subtracting Blockbuster’s cost for medical and dental coverage based on the Employee’s election. In compliance with this law, for the last two quarters, Blockbuster has remitted on average approximately \$34,500 per quarter directly to San Francisco County for all Full-Time Employees who worked in the county during the quarter.

(2) Dental Plan Coverage

64. The Debtors also offer dental benefits to Full-Time Employees through a self-funded insurance program, the Blockbuster Group Dental Plan (the “*Dental Plan*”), administered by Met Life. Approximately 5,200 Full-Time Employees and 4,500 dependents are enrolled in the Dental Plan. The Debtors pay approximately \$290,000 per month in gross claims and approximately \$12,000 per month in administrative services fees to Met Life. The Debtors

deduct approximately \$200,000 per month from enrolled Full-Time Employees' wages in respect of this cost. As of the Commencement Date, approximately \$200,000 of accrued unpaid amounts, inclusive of Employee contributions, are owed in respect of the Dental Plan.

(3) Vision Plan Coverage

65. The Debtors' primary vision plan for Full-Time Employees is the Blockbuster Vision Plan (the "***Vision Plan***"). The Vision Plan is insured through VSP and is fully funded by Full-Time Employees' contributions. Approximately 4,400 Full-Time Employees and 3,600 dependants participate in the Vision Plan. Deductions from participating Employees' paychecks in respect of the Vision plan total approximately \$50,000 per month. As of the Commencement Date, the Debtors estimate that there are no outstanding amounts on account of the Vision Plan that have not yet been transferred to VSP.

(4) Employee Assistance Program

66. The Debtors offer Full-Time Employees and their dependents a confidential counseling and referral service for a broad range of personal topics, including, but not limited to, child care or elder care, legal issues, financial concerns, and dealing with various personal problems (the "***Employee Assistance Program***"), at no cost to the eligible Employee. Benefits are limited to up to three counseling sessions per problem annually.<sup>19</sup> The Employee Assistance Program is insured and is administered by United Behavioral Health. The Debtors pay approximately \$80,000 per month on account of the Employee Assistance Plan. As of the Commencement Date, the Debtors estimate there are no prepetition amounts owing to United Behavioral Health on account of the Employee Assistance Plan.

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<sup>19</sup> Eligible Employees do not have to elect medical coverage under one of Blockbuster's Health Plans to participate in the Employee Assistance Program. However, if an Employee's situation requires more than three sessions and is covered under one of Blockbuster's Health Plans, treatment may continue under the mental health provision of such medical coverage.

(5) Life and AD&D Insurance

67. The Debtors maintain primary life and accidental death and dismemberment coverage for all Full-Time Employees through Met Life (the “*Life and AD&D Insurance*”). The Life and AD&D Insurance coverage costs the Debtors approximately \$44,000 per month. As of the Commencement Date, the Debtors estimate that there are no outstanding prepetition amounts due on account of the Life and AD&D Insurance.

68. Full-Time Employees are also offered the opportunity to purchase supplemental life insurance through the Met Life Group Supplemental Life and Accidental Death and Dismemberment Insurance Programs (the “*Supplemental Life and AD&D Insurance*”), the premiums for which are paid entirely by the electing Full-Time Employee. The Debtors estimate that approximately 1,100 Full-Time Employees have elected to purchase Supplemental Life and AD&D Insurance. The Debtors also estimate that, prior to the Commencement Date, they deducted on average approximately \$30,000 per month in Employee contributions for Supplemental Life and AD&D Insurance. As of the Commencement Date, approximately \$12,000 of such accrued Employee contributions have not yet been transferred to Met Life.

(6) Short- and Long-Term Disability Benefits

69. The Debtors provide Full-Time Employees with short- and long-term disability benefits (the “*STD Plan*” and the “*LTD Plan*,” respectively) through LINA. The STD Plan is a self-funded plan administered by LINA, and costs the Debtors approximately \$26,000 per month in administrative services fees. The average company payout for STD Plan benefits is approximately \$113,000 per month, which includes parental leave benefits (discussed below). The Debtors offer to fund the entirety of the LTD Plan premiums for all Full-Time Employees, and pay approximately \$75,000 per month to maintain this coverage on behalf of 6,700 Full-Time Employees. On the other hand, Full-Time Employees may purchase LTD Plan benefits at

their own cost.<sup>20</sup> The Debtors estimate that 1,000 Employees have opted to pay for LTD Plan benefits, and, prior to the Commencement Date, the Debtors withheld approximately \$5,000 in Full-Time Employee contributions for such disability benefits, which amount has not yet been transferred to LINA. In addition, as of the Commencement Date, the Debtors believe that approximately \$100,000 has accrued in the prepetition period on account of STD Plan and LTD Plan benefits funded by the Debtors.

(7) Accident Insurance

70. The Debtors maintain business travel accident insurance for all Full-Time Employees through AIG (the “*Accident Insurance*”). If a Full-Time Employee dies, suffers a disability or loss of limbs, hearing or sight while traveling on company business, the eligible Employee is entitled to seven times annual earnings up to a maximum of \$3 million. The Debtors pay approximately \$3,000 per month in premiums for Accident Insurance. The Debtors estimate that, as of the Commencement Date, they do not owe any amounts in outstanding Accident Insurance premiums.

(8) Voluntary Insurance Benefits

71. The Debtors also offer Full-Time Employees the opportunity to enroll in home, automotive, boat, pet, and long term care insurance (collectively, the “*Voluntary Insurance Benefits Plans*”) through Met Life,<sup>21</sup> Unitrin, Veterinary Pet, and Prudential, the premiums for which are paid entirely by the electing Employee. Except in the case of Prudential, if an Employee elects to receive any of the foregoing insurance, the Debtors withhold the appropriate premiums from the Employee’s paycheck and remit the amount collected to Paylogix, a third party billing aggregator, which administers payment to Met Life on the

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<sup>20</sup> If an Employee elects to pay for long-term disability benefits themselves, in the event the Employee becomes disabled, benefit payments are not taxable income.

Employee's behalf.<sup>22</sup> The Debtors do not incur any expenses in connection with the Voluntary Insurance Benefits Plans.

72. Approximately 300 Employees have enrolled in the Voluntary Insurance Benefits Plans. The Debtors estimate that they deducted approximately \$18,000 in Employee contributions for Voluntary Insurance Benefits Plans prior to the Commencement Date, which amount has not yet been transferred to Paylogix.

b. Part-Time Employees

73. The Debtors provide a separate welfare plan, the Aetna Affordable Health Choices Insurance Plan (the "*Aetna Plan*"),<sup>23</sup> to their Part-Time Employees, which includes medical, dental, vision, term life, hospital indemnity insurance, and accidental death insurance coverage. The costs associated with the Aetna Plan are fully funded by the enrolled Part-Time Employees. On average, approximately \$250,000 is deducted each month from Part-Time Employee wages for contributions to the Aetna Plan. Prior to the Commencement Date, the Debtors estimate that they deducted approximately \$110,000 in Part-Time Employee contributions for the Aetna Plan, which amount has not yet been transferred to Aetna.

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74. Approximately \$1.4 million is deducted from Employees' wages each month on account of the Health and Welfare Plans, as described above. During calendar year

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<sup>21</sup> The Voluntary Benefits Plans were historically provided through three different insurance carriers: Unitrin (home, automotive, and boat insurance), Veterinary Pet (pet insurance) and Prudential (long term care insurance). As of July 1, 2010, the Debtors added Met Life as administrator of the Voluntary Benefits Plans. Employees select and enroll in insurance plans through Met Life, including plans provided by Unitrin, Veterinary Pet, and Prudential.

<sup>22</sup> Prudential collects premiums directly from electing Employees.

<sup>23</sup> The Aetna Plan is underwritten by Aetna Life Insurance Company and administered by Strategic Resource Company.

2009, the Debtors paid approximately \$8 million per month to provide the Health and Welfare Plans to their Employees, inclusive of Employee payroll contributions. Because of the manner in which expenses are incurred and claims are processed under the Health and Welfare Plans, it is difficult for the Debtors to accurately determine the accrued obligations under the Health and Welfare Plans outstanding at any particular time. Nevertheless, the Debtors estimate that, as of the Commencement Date, their incurred prepetition obligations that have not been paid to or on behalf of the Employees under the Health and Welfare Plans (including premiums, employee contributions, claims, and administrative fees to benefit providers) aggregate approximately \$4.1 million.

75. By this Motion, the Debtors seek authority, but not direction, to (a) pay all prepetition amounts under the Health and Welfare Plans as and when they come due, and (b) continue to offer such plans and honor their obligations thereunder in the ordinary course during the administration of these chapter 11 cases.

**2. *PTO Plans and Leaves of Absence***

76. As described in greater detail below, the Debtors offer their Employees certain paid time off benefits, and also allow their Employees to take certain other leaves of absence for personal reasons that include (a) jury duty, (b) bereavement, (c) pregnancy and adoption, (d) family medical leaves, (e) voting leaves, and (f) military leave. Many of these leave policies are required by law.

a. Paid Time Off

77. All Employees are eligible for certain amounts of paid time off per year (“*PTO*”). Full-Time Employees are eligible to receive their full wages for PTO (“*Full-Time PTO*”) after 90 days of full-time employment. The rate at which Full-Time Employees earn Full-Time PTO varies depending upon the eligible Employee’s position and length of continuous

service with Blockbuster. As of the Commencement Date, the amount of accrued Full-Time PTO ranged from 10.67 hours to 17.33 hours per month per Full-Time Employee. Full-Time Employees are permitted to carry over a maximum of 40 hours of Full-Time PTO earned, but not taken, in the previous year. Part-Time Employees who have one year of uninterrupted service with Blockbuster are eligible to accrue 1.67 hours of PTO per month up to a maximum of 20 hours of PTO annually (“**Part-Time PTO**,” and together with Full-Time PTO, the “**PTO Obligations**”). Part-Time PTO must be taken in the year in which it is earned.<sup>24</sup> Employees cash out their unused PTO upon termination.

78. As of the Commencement Date, the Debtors estimate that the value of accrued and unused or unpaid PTO Obligations does not exceed approximately \$7 million. This amount is not an obligation that must be satisfied at one time. Rather, it is satisfied as and when Employees take their PTO, or in the event they are terminated.

b. Parental Leave and Adoption Benefits

79. The Debtors offer their Full-Time Employees that have children or adopt children the ability to collect 60% of their salary for up to four weeks based on their length of service with the Debtors (the “**Parental Leave and Adoption Benefits**”). Although the number of Employees receiving Parental Leave and Adoption Benefits varies from month to month, historically, the Debtors have paid approximately \$3,700 per month for such benefits. In addition, the Debtors provide a maximum benefit of \$5,000 per child to Full-Time Employees for eligible adoption related expenses (*i.e.*, agency fees, legal fees, and temporary foster care).

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<sup>24</sup> Due to applicable California law, the above described limits on the amount of PTO that may be carried over from the previous year do not apply to those Employees working in California. All Employees working in California retain their accrued but unused PTO up to a maximum of 1.75 times the number of hours earned annually.



80. The Debtors believe that the PTO Plans are essential features of the employment package provided to Employees, and failure to provide these benefits would harm Employee morale and encourage the premature departure of valuable Employees. By this Motion, the Debtors request authority to continue the PTO Plans and pay and provide all benefits thereunder, whether arising pre- or postpetition.

**3. *Employee Savings and Retirement Plans***

a. 401(k) Plan

81. The Debtors maintain a retirement savings plan pursuant to section 401 of the Internal Revenue Code (the “**401(k) Plan**”) for the benefit of all Full-Time and Part-Time Employees. Mercer Retirement Services (“**Mercer**”) is the Trustee and record keeper of the 401(k) Plan. Full-Time Employees who are over the age of 21 and who have completed 90 days of employment are eligible to participate in the 401(k) Plan. The 401(k) Plan allows for automatic pre-tax salary deductions of eligible compensation up to the statutorily prescribed dollar amounts. Approximately 1,300 Full-Time Employees, and 200 Part-Time Employees currently participate in the 401(k) Plan,<sup>25</sup> and the approximate monthly amount withheld from the participating Employees’ paychecks for 401(k) contributions (the “**Employee Contributions**”) is \$500,000.<sup>26</sup>

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<sup>25</sup> In addition, there are approximately 1,300 terminated or suspended participants in the 401(k) Plan. Suspended participants cannot make contributions (typically due to having taken a distribution that is not yet fully repaid). Terminated participants are no longer Blockbuster Employees but have not yet rolled over their 401(k) account into another qualified retirement plan or individual retirement account.

<sup>26</sup> For non-highly compensated Employees, the Debtors historically matched 100% on the first 3% contributed and 50% on the next 2% contributed by the Employee. For highly compensated Employees, the Debtors historically matched 50% on the first 5% contributed by the Employee. However, for payroll periods occurring on or after June 1, 2009, the Debtors suspended the matching program for all Employees. At this time, the Debtors do not seek relief with respect to matching contributions.

82. In addition, the Debtors spend an additional \$45,000 to \$175,000 per year in record-keeping and advisory fees for the 401(k) Plan, depending on fund performance. The Debtors pay on a quarterly basis \$11,250 to 401(k) Advisors, Inc. for its investment advisory services, and up to approximately \$80,000 per quarter to Mercer for record-keeping and related fees (together, the “**401(k) Administrative Fees**” and with the Employee Contributions, the “**401(k) Plan Obligations**”). However, the Debtors receive revenue sharing credits to offset the administrative fees paid to Mercer, which at times have funded such fees almost entirely. As of the Commencement Date, the accrued and unpaid portion of the Debtors’ 401(k) Plan Obligations total approximately \$265,000. By this Motion, the Debtors seek authority, but not direction, to continue the 401(k) Plan in the ordinary course of business and pay all accrued 401(k) Plan Obligations.

b. Deferred Compensation Plan

83. The Debtors provide a non-qualified deferred compensation plan (the “**Excess Plan**”) for certain Employees whose participation in the 401(k) Plan was limited by applicable treasury regulations. Under the Excess Plan, Employees who earn annual compensation of at least \$245,000 in 2010 are permitted to defer payment of up to 15% of their compensation. Each participating Employee’s deferred compensation was placed into a memorandum account and invested in certain funds selected by the Debtors. Disbursements from this account are made to the participating Employee either in one lump sum or over a period of two to five years on January 31 beginning in the calendar year immediately following such Employee’s separation from the Debtors. As of the Commencement Date, nine participants have memorandum accounts under the Excess Plan aggregating approximately \$415,000. The Debtors pay Mercer approximately \$3,000 per quarter for its administrative services in connection with the Excess Plan. As of the Commencement Date, the accrued and unpaid

prepetition fees owed to Mercer in connection with the administration of the Excess Plan are approximately \$3,000. At this time, the Debtors do not seek any relief with respect to the Excess Plan.

**4. Other Benefit Programs**

a. Commuter Benefits

84. The Debtors also offer a commuter benefits program (the “**Commuter Benefits Program**”) that allows Employees to use pre-tax earnings to pay, on a monthly basis, public transportation and parking costs. As of the Commencement Date, the Debtors estimate that no outstanding amounts are owed on account of the Commuter Benefits Program.

b. Automobile Program

85. The Debtors currently lease approximately 200 automobiles for Employees who require transportation as part of their employment (the “**Automobile Costs**”).<sup>27</sup> A nominal amount is deducted from employee payroll, in accordance with applicable Treasury regulations, on account of Employees’ personal use of the leased automobiles. In 2009, the Debtors paid approximately \$2.9 million in Automobile Costs, net of approximately \$500,000 in Employee deductions, for an average of 294 vehicles in service. As of the Commencement Date, the Debtors estimate that no outstanding amounts are owed on account of Automobile Costs.

c. Relocation Program

86. The Debtors offer a relocation reimbursement program (the “**Relocation Program**”) to certain Employees who transfer to a different geographical location to fulfill their job responsibilities. The scope of benefits under the Relocation Program varies depending on the

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<sup>27</sup> The Automobile Costs include lease payments, title and license fees, maintenance fees, repair costs, excess mileage charges, fuel costs, insurance premiums and related costs.

category of Employee.<sup>28</sup> In general, affected Employees are provided, among other things, relocation allowances between \$2,000 and \$5,000 (depending on their position), transportation services for household goods, renters' assistance, temporary housing, home marketing and home sale assistance, reimbursement for residence-finding trips, and reimbursement for other moving expenses, all in accordance with Internal Revenue Service guidelines.

87. The Debtors have entered into an agreement with a relocation services provider, Altair Global Relocation<sup>29</sup> ("*Altair*"), to administer the Relocation Program. With respect to certain types of reimbursable expenses paid directly to those entities that facilitate the Employee's relocation, such as movers of household goods, Altair funds payment and invoices the Debtors at the end of each week. In addition, the Debtors pay Altair an administrative fee of up to \$500 for each relocation it facilitates, which amount is included in its weekly bill. Other types of reimbursable expenses are paid directly by the Employee, who then submits his or her reimbursement requests to Altair. Altair processes Employee reimbursement requests and, with respect to those allowable expenses, forwards the requests to the Debtors for payment. The Employee's taxable reimbursements are included in his or her pay as compensation.

88. As of the Commencement Date, the Debtors estimate that accrued and unpaid obligations related to the Relocation Program with respect to current Employees total approximately \$220,000.<sup>30</sup>

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<sup>28</sup> There are five tiers of Employees who are eligible for reimbursement benefits under the Relocation Program comprised of full-time exempt salaried Employees, including executive Employees.

<sup>29</sup> Formerly AmeriCorp., Inc.

<sup>30</sup> This amount excludes any tax payments that are estimated to be owed to the applicable Taxing Authorities on account of taxable relocation benefits, which tax payments the Debtors are not seeking authority to pay on behalf of Employees to Taxing Authorities at the end of the calendar year.

d. Flexible Benefit Plan

89. The Debtors offer their Full-Time Employees the ability to contribute a portion of their pre-tax compensation to flexible spending accounts to pay for eligible out-of-pocket health care and dependent care premiums and expenses (the “*Flexible Benefit Plan*”). Approximately 420 Employees participate in the health care portion of the Flexible Benefit Plan and approximately 25 Employees participate in the dependent care portion of the Flexible Benefit Plan. The Debtors pay fees of approximately \$5,000 per month to United Health to administer the Flexible Benefit Plan.

90. On average, Employees participating in the Flexible Benefit Plan designate approximately \$75,000 in the aggregate each month to be withheld through payroll deductions.<sup>31</sup> Regardless of an Employee’s contributions for the health care portion of the Flexible Benefit Plan, an Employee may seek reimbursement or payment directly to a health care provider for all amounts up to the designated annual contribution at any point during the year.<sup>32</sup> However, an Employee may only seek reimbursement or direct payments to a provider for dependent care expenses up to the actual amount in his or her dependent care spending account. Any unspent amounts in health care or dependent care accounts at the end of the calendar year do not roll over to the following year, although Employees may submit reimbursement or payment requests for the preceding year until March 31 of the following year. As of the

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<sup>31</sup> United Health pays eligible Flexible Benefit Plan expenses and requests reimbursement from Blockbuster. A balance of approximately \$36,000 is maintained in a restricted account in the name of United Health at all times in connection with eligible expense reimbursements, which balance is replenished daily by Blockbuster from its Wachovia electronic payments disbursement account.

<sup>32</sup> As a result, the Debtors’ payments under the Flexible Benefit Plan could exceed Employee contributions for health care or dependent care accounts. For 2009, payments under the Flexible Benefits Plan exceeded Employee contributions to spending accounts by approximately \$100,000.

Commencement Date, the Debtors estimate that they hold approximately \$270,000 on account of designated Flexible Benefit Plan contributions.

91. By this Motion, the Debtors seek authority, but not direction, to continue to honor their obligations under the Other Benefit Programs and pay all prepetition amounts due under the Other Benefit Programs as and when such amounts come due in the ordinary course of business.

## VI.

### **BASIS FOR RELIEF REQUESTED**

#### **A. Cause Exists to Authorize the Payment Of the Debtors' Employee Obligations**

92. Pursuant to section 507(a)(4)(A) of the Bankruptcy Code, employee claims for “wages, salaries, or commissions, including vacation, severance, and sick leave pay” earned within 180 days before the Commencement Date are afforded priority unsecured status to the extent of \$11,725 per employee. Similarly, section 507(a)(5) of the Bankruptcy Code provides that employees’ claims for contributions to certain employee benefit plans also are afforded priority unsecured status to the extent of \$11,725 per Employee covered by such plan, less any amount paid pursuant to section 507(a)(4) of the Bankruptcy Code.

93. Furthermore, section 363(b)(1) of the Bankruptcy Code provides, in pertinent part, 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)(1). Section 105(a) of the Bankruptcy Code further provides:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

94. The Debtors believe that the substantial portion of the Employee Obligations relating to the period prior to the Commencement Date constitute priority claims under sections 507(a)(4) and (5) of the Bankruptcy Code. As priority claims, the Employee Obligations must be paid in full before any general unsecured obligations of the Debtors may be satisfied. Accordingly, the relief requested herein likely may affect only the timing of the payment of these priority obligations and should not prejudice the rights of general unsecured creditors or other parties in interest. The Debtors submit that, to the extent any Employee is owed in excess of \$11,725 or a requested payment is on account of a Supplemental Worker or Independent Contractor, satisfaction and payment of such amount is necessary and appropriate, and may be authorized under sections 105(a) and 363(b) of the Bankruptcy Code pursuant to the “doctrine of necessity.”

95. A Bankruptcy Court’s use of its equitable powers to “authorize the payment of pre-petition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept.” *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989); *see In re Just for Feet, Inc.*, 242 B.R. 821 (D. Del. 1999) (holding that the court is authorized under section 105(a) to allow immediate payment of prepetition claims of vendors found to be critical to the debtor’s reorganization (citing *In re Penn Cent. Transp. Co.*, 467 F.2d 100 (3d Cir. 1972))); *In re Columbia Gas Sys. Inc.*, 171 B.R. 189 (Bankr. D. Del. 1994) (noting that the debtor may pay prepetition claims that are essential to the continued operation of its business).

96. The “necessity of payment” doctrine “recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay pre-petition claims where

such payment is essential to the continued operation of the debtor.” *Ionosphere Clubs*, 98 B.R. at 176 (authorizing the payment of prepetition employee wages and benefits); *see also Mich. Bureau of Workers’ Disability Comp. v. Chateaugay Corp. (In re Chateaugay Corp.)*, 80 B.R. 279, 285-86, 287 (S.D.N.Y. 1987) (approving bankruptcy court order authorizing payment of prepetition wages, salaries, expenses, and benefits and recognizing that the fundamental purpose of reorganization and equity powers of bankruptcy courts “is to create a flexible mechanism that will permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately”). This doctrine is consistent with the paramount goal of chapter 11 of “facilitating the continued operation and rehabilitation of the debtor. . . .” *Ionosphere Clubs*, 98 B.R. at 176.

97. The relief requested in this Motion is necessary for Blockbuster’s business to continue to operate in the ordinary course of business and, most importantly, to maximize value for all stakeholders. The Employees are vital to the continuing operations of Blockbuster’s business and the Debtors’ successful reorganization. The relief sought herein is entirely consistent with the intent of section 105(a) of the Bankruptcy Code and the rehabilitative purpose of chapter 11, and represents the exercise of sound business judgment. In these cases, any delay or failure to pay wages, salaries, benefits, and other similar items would irreparably impair the Employees’ morale, dedication, confidence, and cooperation, and would adversely impact Blockbuster’s relationship with its Employees at a time when the Employees’ support is critical to these chapter 11 cases and to Blockbuster’s reorganization efforts. At this early stage, Blockbuster simply cannot risk the substantial damage to its business enterprise that would inevitably result from a rapid decline in Employee morale.



98. Further, absent the relief requested herein, the Employees will suffer undue hardship and, in many instances, serious financial difficulties, as the amounts in question are needed to enable the Employees to meet their own personal financial obligations. Likewise, any interruption to the Employee benefits provided by the Debtors could have a material, negative effect on the physical well-being and morale of the Debtors' employees and their families. Without the requested relief, the stability of the Debtors' business will be undermined, perhaps irreparably, by the distinct possibility that otherwise loyal Employees will seek other employment alternatives. In addition, to the extent the Debtors owe Employees for business expenses incurred prepetition, it would be inequitable to require the Debtors' Employees to bear personally the cost of any business expenses they incurred prepetition, for the benefit of the Debtors, with the understanding that they would be reimbursed. Further, Employees could become concerned about personal liability for business charges, which could distract them from devoting attention to their responsibilities.

99. The Debtors further believe it is critical that they be authorized to honor severance obligations to former Employees terminated prior to the Commencement Date and to continue providing benefits under their Severance Plan in the ordinary course of business, subject, of course, to the requirements of section 503(c)(2) of the Bankruptcy Code.<sup>33</sup> The financial well-being of the Debtors' former Employees who received severance prior to the Commencement Date depends on the receipt of such payments. Moreover, the continuation of the Severance Plan as requested herein is necessary to preserve the goodwill and morale of current Employees during the Debtors' reorganization efforts.

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<sup>33</sup> Section 503(c)(2) permits severance payments to insiders (as defined in section 101(31) of the Bankruptcy Code) only if they are part of a program applicable to all employees, and are less than ten times the mean of severance payments made to non-management employees during that calendar year. 11 U.S.C. § 503(c)(2).

100. The Debtors also believe that continuation of the Retention Plan (even if any of the Retention Plan were considered to be outside the ordinary course of the Debtors' business) is warranted under section 503(c) of the Bankruptcy Code. The Retention Plan is aimed at retaining critical employees by providing them with a degree of job security and preventing attrition that will hinder the reorganization effort. The Debtors believe that the benefits under the Retention Plan will create a meaningful level of stability, morale, and motivation in the workplace and allow the Debtors' critical employees to not only continue to effectively manage the Debtors' business, but also maximize the value of the Debtors' estates. Furthermore, as the Debtors are not seeking authority to pay Retention Bonuses to any insiders of the Debtors, the restrictions of 503(c)(1) are inapplicable. Rather, to the extent outside the ordinary course of the Debtors' business, payments under the Retention Plan are allowed under section 503(c)(3) of the Bankruptcy Code because, as set forth above, they are appropriate under the facts and circumstances and in the best business interest of the Debtors' estates.

101. With respect to Payroll Tax Obligations, the payment of such taxes will not prejudice other creditors of the Debtors' estates, as the relevant Taxing Authorities generally would hold priority claims under section 507(a)(8) of the Bankruptcy Code in respect of such obligations. Moreover, the portion of the payroll taxes withheld from an Employee's wages on behalf of the applicable Taxing Authority is held in trust by the Debtors. As such, these Employee Withholding Taxes are not property of the Debtors' estates under section 541 of the Bankruptcy Code. *See, e.g., Begier v. IRS*, 496 U.S. 53 (1990) (withholding taxes are property held by a debtor in trust for another and, as such, are not property of the debtor's estate).

102. In addition, the Debtors believe it is necessary to continue payment of administrative fees to the various vendors that administer the Debtors' Employee Obligations

and Employee Benefit Plans. Without the continued services of these administrators, including, but not limited to, ADP, United Health, Caremark, Alere, Blue Cross, Aetna, VSP, Met Life, Paylogix, LINA, AIG, and 401(k) Advisers, the Debtors will be unable to continue to honor their Employee Obligations and related Employee Benefit Plans in an efficient and cost-effective manner.

103. The Debtors do not seek to alter their compensation, vacation, or other benefit policies at this time. This Motion is intended only to permit the Debtors, in their discretion, to make payments consistent with the Debtors' existing policies to the extent that, without the benefit of an order approving this Motion, such payments may be inconsistent with the relevant provisions of the Bankruptcy Code, and to permit the Debtors, in their discretion, to continue to honor their practices, programs, and policies with respect to their Employees, as such practices, programs, and policies were in effect as of the Commencement Date.<sup>34</sup> Payment of Employee Obligations as requested herein and in accordance with the Debtors' prepetition business practices is in the best interests of the Debtors' estates, their creditors, and all parties in interest and will enable the Debtors to continue to operate their businesses in an economic and efficient manner, without disruption. Moreover, the total amount sought to be paid herein is relatively modest compared with the size of the Debtors' overall businesses and the importance of the Employees to the Debtors' chapter 11 cases and rehabilitation effort.

104. In other chapter 11 cases, courts in this district have approved payment of prepetition claims similar to those described herein.<sup>35</sup> *See, e.g., In re Uno Restaurant Holdings Corp.*, Ch. 11 Case No. 10-10209 (MG) (Bankr. S.D.N.Y. Feb. 17, 2010) [Docket No. 150]; *In*

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<sup>34</sup> The Debtors believe that continuation of the Employee Benefit Obligations consistent with their prepetition practices and policies is within the ordinary course of their business.

<sup>35</sup> Because of the voluminous nature of the unreported orders cited herein, such orders are not annexed to the Motion. Copies of these orders are available upon request of Debtors' counsel.

*re Finlay Enterprises, Inc.*, Ch. 11 Case No. 09-14873 (JMP) (Bankr. S.D.N.Y. Sept. 3, 2009) [Docket No. 190]; *In re General Motors Corp.*, Ch. 11 Case No. 09-50026 (REG) (Bankr. S.D.N.Y. June 1, 2009) [Docket No. 164]; *In re U.S. Shipping Partners L.P.*, Ch. 11 Case No. 09-12711 (RDD) (Bankr. S.D.N.Y. Apr. 30, 2009) [Docket No. 37]; *In re General Growth Properties, Inc.*, Ch. 11 Case No. 09-11977 (ALG) (Bankr. S.D.N.Y. May 11, 2009) [Docket No. 461]; *In re Bearing Point, Inc.*, Ch. 11 Case No. 09-10691 (REG) (Bankr. S.D.N.Y. March 13, 2009) [Docket No. 28]; *In re Tronox Inc., et al.*, Case No. 09-10156 (ALG) (Bankr. S.D.N.Y. Jan. 13 and Feb. 6, 2009) [Docket No. 45 and 143]; *In re Lyondell Chemical Co., et al.*, Case No. 09-10023 (REG) (Bankr. S.D.N.Y. Jan. 9 and 26, 2009) [Docket Nos. 90 and 408]; *In re Lenox Sales, Inc.*, Ch. 11 Case No. 08-14679 (ALG) (Bankr. S.D.N.Y. Dec. 15, 2008) [Docket No. 25]; *In re Steve & Barry's Manhattan, LLC*, Ch. 11 Case No. 08-12579 (ALG) (Bankr. S.D.N.Y. July 29, 2008) [Docket No. 49]; *In re Lexington Precision Corp.*, Ch. 11 Case No. 08-11153 (MG) (Bankr. S.D.N.Y. Apr. 22, 2008) [Docket Nos. 27, 77]; *In re PRC, LLC*, Ch. 11 Case No. 08-10239 (MG) (Bankr. S.D.N.Y. Jan. 24, 2008) [Docket No. 27]; *In re Silicon Graphics, Inc.*, Ch. 11 Case No. 06-10977 (BRL) (Bankr. S.D.N.Y. May 31, 2006) [Docket No. 146], (Bankr. S.D.N.Y. May 10, 2006) [Docket No. 51]; *In re Atkins Nutritionals, Inc.*, Ch. 11 Case No. 05-15913 (ALG) (Bankr. S.D.N.Y. Aug. 1, 2005) [Docket No. 31].

**B. Cause Exists to Authorize the Payment of the Debtors' Supplemental Workforce and Independent Contractors**

105. The Debtors also seek authority to pay pre- and postpetition amounts payable with respect to the Supplemental Workers and Independent Contractors as they become due and owing. The Debtors believe that payment of this compensation is consistent with the underlying policy in the Bankruptcy Code and will promote a successful reorganization for the

benefit of all parties in interest. *See In re Wang Labs., Inc.*, 164 B.R. 404, 405-08 (Bankr. D. Mass. 1994).

106. Moreover, as described above, the “necessity of payment doctrine” provides a mechanism by which this Court can exercise its equitable power to allow payment of critical prepetition claims not explicitly authorized by the Bankruptcy Code. Here, the Debtors require the services of their Supplemental Workforce and Independent Contractors to the same extent as they do their Employees. Without such services, the Debtors’ operations would be significantly impaired, and, pursuant to section 105(a) of the Bankruptcy Code, this Court is empowered to grant the relief requested herein.

**C. Applicable Banks Should be Authorized to Honor and Pay Checks Issued and Make Other Transfers to Pay the Employee Obligations**

107. In furtherance of the relief requested herein, the Debtors request that the Court authorize and direct the Banks, including, but not limited to, those identified on *Exhibit “I”* to the proposed Interim Order and Final Order, to receive, honor, process, and pay, to the extent of funds on deposit, any and all checks or electronic transfers requested or to be requested by the Debtors relating to the Employee Obligations and all amounts incident thereto, including those checks or electronic transfers that have not cleared the Banks as of the Commencement Date, without the need for further Court approval.

108. The Debtors also seek authority to replace any prepetition checks or electronic transfers relating to the Employee Obligations and all amounts incident thereto that may be dishonored or rejected. Each of the checks or electronic transfers can be readily identified as relating directly to the authorized payment of the Employee Obligations. The Debtors believe that prepetition checks and electronic transfers, other than those for Employee Obligations, or those authorized by another order of the Court, will not be honored inadvertently.

The Debtors also request that the Banks be authorized and directed to rely on the representations of the Debtors as to which checks and electronic transfers are in payment of the Employee Obligations

109. Authorization to pay all amounts on account of prepetition Employee Obligations shall not be deemed to constitute postpetition assumption or adoption of any contract, program, or policy pursuant to section 365 of the Bankruptcy Code. The Debtors are in the process of reviewing these matters and reserve all of their rights under the Bankruptcy Code with respect thereto. Moreover, authorization to pay all amounts in respect of prepetition Employee Obligations shall not affect the Debtors' right to contest the amount or validity of any Employee Obligation, including without limitation, the Payroll Tax Obligations that may be due to any Taxing Authority.

**D. Waiver and/or Compliance With  
Applicable Bankruptcy Rules**

***1. Compliance With Bankruptcy Rule 6003(b)***

110. Bankruptcy Rule 6003(b) provides that to the extent "relief is necessary to avoid immediate and irreparable harm," a Bankruptcy Court may approve a motion to "pay all or part of a claim that arose before the filing of the petition" prior to 21 days after the Commencement Date. Fed. R. Bankr. P. 6003(b). As described herein and in the First Day Affidavit, the continuity and viability of the Debtors' business operations relies heavily on its Employees. The failure of the Debtors to honor their Employee Obligations would have immediate and detrimental consequences to the Debtors' business operations and would decrease value to the detriment and prejudice of all stakeholders. Accordingly, the Debtors submit that the relief requested in the Motion is necessary to avoid immediate and irreparable harm to the Debtors and, therefore, Bankruptcy Rule 6003(b) is satisfied.

**2. Waiver of Bankruptcy Rules 6004(a) and (h)**

111. Bankruptcy Rule 6004(a) provides that “[n]otice of a proposed use, sale, or lease of property, other than cash collateral, not in the ordinary course of business shall be given pursuant to Rule 2002(a)(2), (c)(1), (i), and (j).” Fed. R. Bankr. P. 6004(a). Bankruptcy Rule 2002(a) provides that at least 21 days’ notice by mail shall be given to all creditors and indenture trustees of “a proposed use, sale, or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice.” Fed. R. Bankr. P. 2002(a). Bankruptcy Rule 6004(h) provides that an “order authorizing the use, sale, or lease of property ... is stayed until the expiration of 14 days after entry of the order, unless the court orders otherwise.” Fed. R. Bankr. P. 6004(h).

112. To implement the foregoing immediately, the Debtors seek a waiver of the notice requirements, to the extent applicable, under Bankruptcy Rule 6004(a) and the fourteen-day stay of an order authorizing the use, sale, or lease of property under Bankruptcy Rule 6004(h).

**VII.**

**NOTICE**

113. No trustee or examiner has been appointed in these chapter 11 cases. The Debtors have served notice of this Motion on: (i) the Office of the United States Trustee for the Southern District of New York (Attn: Brian Masumoto, Esq.); (ii) those creditors holding the fifty largest unsecured claims against the Debtors’ estates; (iii) Sheppard, Mullin, Richter & Hampton LLP, the attorneys for U.S. Bank National Association, as trustee under that certain indenture agreement, dated as of October 1, 2009, with respect to the 11.75% Senior Secured Notes due 2014 issued by Blockbuster Inc. (Attn: Kyle J. Mathews, Esq.); (iv) The Bank of New York Trust Company, N.A., as trustee under that certain indenture agreement, dated as of August

20, 2004, with respect to the 9% Senior Subordinated Notes due 2012 issued by Blockbuster Inc. (Attn: Corporate Trust); (v) Sidley Austin LLP, attorneys for the lenders under the proposed Debtor in Possession Revolving Credit Agreement (the “**DIP Facility**”) (Attn: James Seery, Esq.); (vi) Wilmington Trust FSB as Agent under the DIP Facility (the “**Agent**”) (Attn: Joshua G. James); (vii) Skadden, Arps, Slate, Meagher & Flom LLP, the attorneys for the Agent (Attn: Peter J. Neckles, Esq.); and (viii) the Internal Revenue Service (collectively, the “**Notice Parties**”). The Debtors submit that no other or further notice need be provided.

114. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE the Debtors respectfully request that the Court grant the relief requested herein and such other and further relief as it deems just and proper.

Dated: September 23, 2010  
New York, New York

/s/ Stephen Karotkin  
Stephen Karotkin  
WEIL, GOTSHAL & MANGES LLP  
767 Fifth Avenue  
New York, New York 10153  
Telephone: (212) 310-8000  
Facsimile: (212) 310-8007

and

Martin A. Sosland (*pro hac vice pending*)  
WEIL, GOTSHAL & MANGES LLP  
200 Crescent Court, Suite 300  
Dallas, Texas 75201  
Telephone: (214) 746-7700  
Facsimile: (214) 746-7700



**Exhibit A**

**Proposed Interim Order**

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

-----X  
: **Chapter 11**  
: **Case No. 10-\_\_\_\_ (\_\_\_\_)**  
: **(Jointly Administered)**  
: **Debtors.**  
-----X

**INTERIM ORDER PURSUANT TO 11 U.S.C §§ 105(a), 363(b), AND 507 AND FED. R. BANKR. P. 6003 AND 6004 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) DIRECTING BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS**

Upon the Motion<sup>2</sup>, dated September 23, 2010, of Blockbuster Digital Technologies Inc., its parent Blockbuster Inc., and their debtor affiliates, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, “*Blockbuster*” or the “*Debtors*”), for an order, pursuant to sections 105(a), 363(b), and 507 of the Bankruptcy Code and Bankruptcy Rules 6003 and 6004 (a) authorizing, but not directing the Debtors to (i) pay, in their sole discretion, all Employee Obligations and all costs and expenses incident to the foregoing, and (ii) maintain and continue to honor and pay all amounts with respect to their practices, programs, and policies for their employees as they were in effect as of the Commencement Date, and as such may be modified, amended, or supplemented from time to

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<sup>1</sup> The Debtors, together with the last four digits of each Debtor’s federal tax identification number, are: Blockbuster Inc. (5102); Blockbuster Canada Inc. (1269); Blockbuster Digital Technologies Inc. (9222); Blockbuster Distribution, Inc. (0610); Blockbuster Gift Card, Inc. (1855); Blockbuster Global Services Inc. (3019); Blockbuster International Spain Inc. (7615); Blockbuster Investments LLC (6313); Blockbuster Procurement LP (2546); Blockbuster Video Italy, Inc (5068); Movielink, LLC (5575); Trading Zone Inc. (8588); and B<sup>2</sup> LLC (5219).

<sup>2</sup> Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the Motion.

time in the ordinary course, (b) directing the Banks to receive, honor, process, and pay any and all checks and transfers drawn on the Debtors' disbursement Bank Accounts, to the extent that such checks or transfers relate to any of the foregoing, and (c) schedule a final hearing (the "*Final Hearing*") to consider the relief requested on a permanent basis, all as more fully described in the Motion; and the Court having jurisdiction to consider the Motion and the relief requested therein in accordance with 28 U.S.C. §§ 157 and 1334 and the Standing Order M-61 Referring to Bankruptcy Judges for the Southern District of New York Any and All Proceedings Under Title 11, dated July 10, 1984 (Ward, Acting C.J.); and consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the Notice Parties, and it appearing that no other or further notice need be provided; and a hearing having been held to consider the relief requested in the Motion (the "*Interim Hearing*"); and upon the record of the Interim Hearing and all of the proceedings had before the Court; and upon the First Day Affidavit; and the Court having found and determined that the relief sought in the Motion is in the best interests of the Debtors, their estates, and creditors, and that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, **IT IS HEREBY ORDERED AND ADJUDGED THAT:**

1. The Motion is granted as provided herein on an interim basis.
2. The Debtors are authorized, but not directed, to pay or otherwise

honor all Employee Obligations, the most significant of which are described in the Motion, including, but not limited to, all obligations incurred under or related to Compensation Obligations, Payroll Tax Obligations, Garnishment Obligations,

Supplemental Workforce Obligations, Independent Contractor Obligations, Reimbursement Obligations, Incentive Obligations, the Retention Plan, the Severance Plan, and Employee Benefit Obligations, and all costs and expenses incident to the foregoing and all programs related thereto that come due prior to the Final Hearing, including those Employee Obligations that (i) were or are due and payable and relate to the period prior to the Commencement Date and (ii) are or become due and payable or relate to the period after the Commencement Date; *provided, however*, that prior to the Final Hearing, the Debtors' payment of prepetition Reimbursement Obligations shall be limited to \$1,000 for each eligible Employee.

3. The Debtors are authorized to maintain and continue to honor their practices, programs, and policies (as more fully described in the Motion) for their Employees with respect to the Employee Obligations as they were in effect as of the Commencement Date, and as such may be modified, amended, or supplemented from time to time in the ordinary course of business.

4. The Debtors are authorized to pay, in their sole discretion, compensation owed to the Supplemental Workforce through the Agencies.

5. The Debtors are authorized to pay, in their sole discretion, compensation owed to Independent Contractors.

6. Notwithstanding anything to the contrary herein, Severance Payments to any Employee pursuant to this Order shall be subject in all respects to the provisions of section 503(c)(2) of the Bankruptcy Code.

7. The banks set forth on *Exhibit "I"* annexed hereto and any other bank authorized to administer the Debtors' bank accounts under the Cash Management Motion (the

“*Banks*”) are authorized and directed to receive, honor, process, and pay, to the extent of funds on deposit, any and all checks or electronic transfers drawn on the Debtors’ Bank Accounts relating to the Employee Obligations, including those checks or electronic transfers that have not cleared the Banks as of the Commencement Date.

8. The Debtors are authorized to replace any prepetition checks or electronic transfers relating to the Employee Obligations that may be dishonored or rejected.

9. The Banks may rely on the representations of the Debtors as to which checks or electronic transfers are in payment of the Employee Obligations.

10. The Debtors are authorized, but not directed, to pay any and all costs and other obligations in connection with maintaining or paying third parties to maintain, administer, and provide record-keeping relating to the Employee Obligations that they may have outstanding as of the Commencement Date in the ordinary course of business.

11. Neither this Order, nor any payments made by the Debtors pursuant to the Motion or this Order, shall be deemed to change the classification of any claim or to in any way change the rights or create new rights of any Employee or other person, including without limitation, the creation of any right to payment entitled to administrative expense priority pursuant to sections 503 and 507 of the Bankruptcy Code.

12. Nothing contained in this Order shall be deemed to constitute the assumption or rejection of any employee benefit plan, employment agreement, or any other contract, program, or agreement under section 365 of the Bankruptcy Code and all the Debtors’ rights are reserved with respect thereto.

13. Notwithstanding any provision in the Bankruptcy Code or Bankruptcy Rules to the contrary, the Debtors are not subject to any stay in the implementation, enforcement, or realization of the relief granted in this Order, and the Debtors may, in their discretion and without further delay, take any action and perform any act authorized under or contemplated by this Order.

14. The requirements of Bankruptcy Rule 6003(b) are satisfied.

15. The requirements of Bankruptcy Rule 6004(a) are waived.

16. Notwithstanding the possible applicability of Bankruptcy Rule 6004(h), the terms and provisions of this Order shall be immediately effective and enforceable upon its entry.

17. The Final Hearing to consider entry of an order granting the relief requested in the Motion on a final basis shall be held on \_\_\_\_\_, 2010 at \_\_\_\_ [ ]m. (Eastern Time); and any objections to entry of such order shall be in writing, filed with the Court in accordance with General Order M-242 and served upon the attorneys for the Debtors, the Notice Parties, and any official committee of unsecured creditors appointed in these chapter 11 cases, in each case so as to be received no later than 4:00 p.m. (Prevailing Eastern Time) on \_\_\_\_\_, 2010.

18. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation or interpretation of this Order.

Dated: \_\_\_\_\_, 2010  
New York, New York

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UNITED STATES BANKRUPTCY JUDGE

**Exhibit 1**

**Banks**

BANK	BANK MAILING ADDRESS	LAST FOUR DIGITS OF ACCOUNT #	ACCOUNT TYPE
Wachovia	301 South College Street Charlotte, NC 28202	6983	Payroll Controlled Disbursement
		8800	Procurement Controlled Disbursement
		6996	Electronic Payment Disbursement
		6970	Accounts Payable Controlled Disbursement
JPMorgan Chase	300 S. Riverside Plaza, 5th Floor Mail Code: IL-0196 Chicago, IL 60606	9070	Controlled Disbursement
Bank of America	100 N. Tryon Street Charlotte, NC 28255	7108	Controlled Disbursement

**Exhibit B**

**Proposed Final Order**



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

-----X  
: **Chapter 11**  
: **Case No. 10-\_\_\_\_ (\_\_\_\_)**  
: **(Jointly Administered)**  
: **Debtors.**  
-----X

**FINAL ORDER PURSUANT TO 11 U.S.C §§ 105(a), 363(b), AND 507 AND FED. R. BANKR. P. 6003 AND 6004 (I) AUTHORIZING THE DEBTORS TO PAY CERTAIN EMPLOYEE OBLIGATIONS AND MAINTAIN AND CONTINUE EMPLOYEE BENEFITS AND PROGRAMS AND (II) DIRECTING BANKS TO HONOR AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH OBLIGATIONS**

Upon the Motion<sup>2</sup>, dated September 23, 2010, of Blockbuster Digital Technologies Inc., its parent Blockbuster Inc., and their debtor affiliates, as debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, “*Blockbuster*” or the “*Debtors*”), for an order, pursuant to sections 105(a), 363(b) and 507 of the Bankruptcy Code and Bankruptcy Rules 6003 and 6004 (a) authorizing, but not directing the Debtors to (i) pay, in their sole discretion, all Employee Obligations and all costs and expenses incident to the foregoing, and (ii) maintain and continue to honor their practices, programs, and policies for their employees as they were in effect as of the Commencement Date, and as such may be modified, amended, or supplemented from time to time in the ordinary course, (b) directing the

<sup>1</sup> The Debtors, together with the last four digits of each Debtor’s federal tax identification number, are: Blockbuster Inc. (5102); Blockbuster Canada Inc. (1269); Blockbuster Digital Technologies Inc. (9222); Blockbuster Distribution, Inc. (0610); Blockbuster Gift Card, Inc. (1855); Blockbuster Global Services Inc. (3019); Blockbuster International Spain Inc. (7615); Blockbuster Investments LLC (6313); Blockbuster Procurement LP (2546); Blockbuster Video Italy, Inc (5068); Movielink, LLC (5575); Trading Zone Inc. (8588); and B<sup>2</sup> LLC (5219).

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

Banks to receive, honor, process, and pay any and all checks and transfers drawn on the Debtors' disbursement Bank Accounts, to the extent that such checks or transfers relate to any of the foregoing, and (c) schedule a final hearing (the "***Final Hearing***") to consider the relief requested on a final basis, all as more fully described in the Motion; and the Court having jurisdiction to consider the Motion and grant the requested relief in accordance with 28 U.S.C. §§ 157 and 1334 and the Standing Order M-61 Referring to Bankruptcy Judges for the Southern District of New York Any and All Proceedings Under Title 11, dated July 10, 1984 (Ward, Acting C.J.); and consideration of the Motion being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the Notice Parties, and it appearing that no further notice need be provided; and the Court having held a hearing to consider the requested relief; and a hearing to consider approval of the Motion on an interim basis having been held (the "***Interim Hearing***"); and the Court having entered an interim order (the "***Interim Order***") granting the relief requested in the Motion, pending the Final Hearing; and it appearing that due and proper notice of the Final Hearing having been given and that no other or further notice need be provided; and upon the record of the Interim Hearing and the Final Hearing and all of the proceedings had before the Court; and upon the First Day Affidavit; and the Court having found and determined that the relief sought in the Motion is in the best interests of the Debtors, their estates and creditors, and all parties in interest, and that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, **IT IS HEREBY ORDERED THAT:**

1. The Motion is granted on a final basis as provided herein.

2. The Debtors are authorized, but not directed, to pay or otherwise honor all Employee Obligations, the most significant of which are described in the Motion, including, but not limited to, all obligations incurred under or related to Compensation Obligations, Garnishment Obligations, Supplemental Workforce Obligations, Independent Contractor Obligations, Reimbursement Obligations, Payroll Tax Obligations, Incentive Programs, the Retention Plan, Severance Payments, and Employee Benefit Obligations, and all costs and expenses incident to the foregoing, including those Employee Obligations that (i) were or are due and payable and relate to the period prior to the Commencement Date and (ii) are or become due and payable or relate to the period after the Commencement Date, in all cases, without further order of the Court.

3. The Debtors are authorized to maintain and continue to honor their practices, programs, and policies (as more fully described in the Motion) for their Employees with respect to the Employee Obligations as they were in effect as of the Commencement Date, and as such may be modified, amended, or supplemented from time to time in the ordinary course of business.

4. The Debtors are authorized to pay, in their sole discretion, compensation owed to the Supplemental Workforce through the Agencies.

5. The Debtors are authorized to pay, in their sole discretion, compensation owed to Independent Contractors.

6. Notwithstanding anything to the contrary herein, Severance Payments to any Employee pursuant to this Order shall be subject in all respects to the provisions of section 503(c)(2) of the Bankruptcy Code.

7. The banks set forth on *Exhibit "I"* annexed hereto and any other bank authorized to administer the Debtors' bank accounts under the Cash Management Motion (the "*Banks*") are authorized and directed, when the Debtors request in their sole discretion, to receive, honor, process, and pay, to the extent of funds on deposit, any and all checks or electronic transfers drawn on the Debtors' Bank Accounts relating to the Employee Obligations, including those checks or electronic transfers that have not cleared the Banks as of the Commencement Date.

8. The Debtors are authorized to replace any prepetition checks or electronic transfers relating to the Employee Obligations that may be dishonored or rejected.

9. The Banks may rely on the representations of the Debtors as to which checks or electronic transfers are in payment of the Employee Obligations.

10. The Debtors are authorized, but not directed, to pay any and all costs and other obligations in connection with maintaining or paying third parties to maintain, administer, and provide record-keeping relating to the Employee Obligations that they may have outstanding as of the Commencement Date in the ordinary course of business.

11. Neither this Order, nor any payments made by the Debtors pursuant to the Motion or this Order, shall be deemed to change the classification of any claim or to in any way change the rights or create new rights of any Employee or other person, including without limitation, the creation of any right to payment entitled to administrative expense priority pursuant to sections 503 and 507 of the Bankruptcy Code.

12. Nothing contained in this Order shall be deemed to constitute the assumption or rejection of any employee benefit plan, employment agreement, or any

other contract, program, or agreement under section 365 of the Bankruptcy Code and all the Debtors' rights are reserved.

13. Notwithstanding any provision in the Bankruptcy Code or Bankruptcy Rules to the contrary, the Debtors are not subject to any stay in the implementation, enforcement, or realization of the relief granted in this Order, and the Debtors may, in their discretion and without further delay, take any action and perform any act authorized under or contemplated by this Order.

14. The requirements of Bankruptcy Rule 6004(a) are waived.

15. Notwithstanding the possible applicability of Bankruptcy Rule 6004(h), the terms and provisions of this Order shall be immediately effective and enforceable upon its entry.

16. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation or interpretation of this Order.

Dated: \_\_\_\_\_, 2010  
New York, New York

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UNITED STATES BANKRUPTCY JUDGE

**Exhibit 1**

**Banks**

BANK	BANK MAILING ADDRESS	LAST FOUR DIGITS OF ACCOUNT #	ACCOUNT TYPE
Wachovia	301 South College Street Charlotte, NC 28202	6983	Payroll Controlled Disbursement
		8800	Procurement Controlled Disbursement
		6996	Electronic Payments Disbursement
		6970	Accounts Payable Controlled Disbursement
JPMorgan Chase	300 S. Riverside Plaza, 5th Floor Mail Code: IL-0196 Chicago, IL 60606	9070	Controlled Disbursement
Bank of America	100 N. Tryon Street Charlotte, NC 28255	7108	Controlled Disbursement

## General Information

<b>Case Name</b>	BB Liquidating Inc.
<b>Docket Number</b>	1:10-bk-14997
<b>Court</b>	United States Bankruptcy Court for the Southern District of New York
<b>Primary Date</b>	2010-09-23 00:00:00
<b>Related Opinion(s)</b>	441 B.R. 239; 2011 BL 78536