

# Circuit City's Chapter 11 Bankruptcy

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## Cast of Characters

**Wards Company** – Original name of Circuit City when it was founded in 1949.

**Samuel S. Wurtzel** – Original founder of Wards Company.

**Abraham Hecht** – Co-founder of Wards Company with Samuel Wurtzel; retired when Sam Wurtzel stepped down as president.

**Alan Wurtzel** – Sam Wurtzel’s son; took over as president of Wards when his father stepped down.

**The Wards Loading Dock** – An expansion project conceptualized by Alan Wurtzel when instituting the superstore concept.

**Lafayette Radio Electronics Corporation** – Corporation that merged with Wards when Wards began to expand.

**Circuit City Stores Inc.** – The new name of Wards Company in 1984.

**Richard Sharp** – Succeeded Alan Wurtzel as Chairman of the Board in 1984. Instituted CarMax.

**Best Buy Inc.** – Circuit City’s main competitor which eventually overtook Circuit City as the number one consumer electronics retailer in the mid-1990’s.

**Wal-Mart Stores Inc.** – Another competitor with Circuit City. Attacked Circuit City’s most profitable line of business.

**Alan McCollough** – Promoted to president and CEO in 2000. Tried to revitalize Circuit City.

**Philip Schoonover** – Executive Vice President of Circuit City in 2004.

**McGuire Woods LLP** – Circuit City’s bankruptcy counsel.

**Judge Kevin Huennkens** – Bankruptcy Judge.

**Ricardo Salinas Pliego** – Hopeful purchaser of Circuit City during bankruptcy.

**Systemax** – Stalking horse purchaser of Circuit City.

## INTRODUCTION

Circuit City Stores, Inc. sold consumer electronics, personal computers, entertainment software, and appliances in the growing consumer electronics market.<sup>1</sup> Circuit City was founded by Samuel S. Wurtzel in 1949 under the name Wards Company. The store named “Wards” was an acronym of Wurtzel’s family name’s: “W” for Wurtzel, “A” for his son Alan, “R” for his wife Ruth, “D” for his son David, and “S” for his own name.<sup>2</sup> Circuit City was the first electronics superstore and was the nation’s second largest retailer of consumer electronics as recently as 2004.<sup>3</sup> Circuit City began the superstore concept for consumer sales, showing that the concept was highly efficient and lucrative. Instead, Circuit City will be remembered as a cautionary tale of bad management and complacency in the fast-evolving retail-electronics industry.<sup>4</sup>

### A. Circuit City’s New Business Style

To understand Circuit City’s business strategy and success, an understanding of (1) the quick expansion of Circuit City and (2) the concept behind superstores is necessary.

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<sup>1</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/](http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/) (Last visited May 23, 2013).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> [Why Circuit City Busted, While Best Buy Boomed, TIME BUSINESS AND MONEY, Nov. 11, 2008, available at http://www.time.com/time/business/article/0,8599,1858079,00.html](http://www.time.com/time/business/article/0,8599,1858079,00.html) (Last visited March 25, 2013).

## 1. The Quick Expansion of Circuit City

Wards Company opened its doors to the public in 1949.<sup>5</sup> Within 10 years, Wards became a chain of four stores with total sales of \$1 million per year.<sup>6</sup> In 1962 Wards implemented a new service plan to show the company's commitment to customer service. The plan included a free loan of a television set if a customer's television could not be repaired in the home.<sup>7</sup> In 1965, the company began its expansion. Wards began to acquire several television and home appliance stores throughout the United States.<sup>8</sup> Samuel Wurtzel, Ward's founder, stepped down as president, and Abraham Hecht, his partner, retired. Alan Wurtzel was then named president of the company.<sup>9</sup> In 1974, Wards closed all of its unprofitable stores and invested the revenues generated into a \$2 million electronics superstore.<sup>10</sup> In an effort to cut its losses, the company began to move out of its leased audio and television operations in department stores and into its own buildings, leading to the birth of the Superstore.

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<sup>5</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The rise and fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS. (Last visited March 25, 2013), available at <http://www.aabri.com/manuscripts/121101.pdf>.

<sup>6</sup> *Id.*

<sup>7</sup> *Circuit City Stores, Inc. History*, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

<sup>8</sup> *Why Circuit City Busted, While Best Buy Boomed*, TIME BUSINESS AND MONEY, Nov. 11, 2008, available at <http://www.time.com/time/business/article/0,8599,1858079,00.html> (Last visited March 25, 2013).

<sup>9</sup> *Circuit City Stores, Inc. History*, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

<sup>10</sup> *Id.*

## 2. The Superstore Concept

Also in 1974, Wards began to shift its focus from appliances to the growing market in consumer electronics.<sup>11</sup> With this move, the company began to acquire numerous electronics retailers and operated stores from New York to California.<sup>12</sup> The company called this pioneering venture “The Wards Loading Dock.”<sup>13</sup> The new warehouse store had 40,000 square feet and displayed and sold a large selection of video and audio equipment and major appliances. The large facility, offering more than 2,000 products, enabled Wards to take a strong advantage over its competitors. The high volume of sales meant that the company could afford to offer lower prices than its smaller competitors.<sup>14</sup> In addition, the stores offered service incentives, such as home delivery, installation, and in-store repairs.<sup>15</sup> Wards was able to exploit growing consumer interest in the new electronics products by locating its stores in medium-sized markets largely served by mom and pop operations.<sup>16</sup> This new business strategy allowed the company to end 1979 with \$120 million in sales.<sup>17</sup>

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<sup>11</sup> *Id.*

<sup>12</sup> History of Circuit City, DAILY NEWS, (Last visited March 25, 2013), <http://www.nydailynews.com/news/money/history-circuit-city-article-1.368853>.

<sup>13</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

<sup>14</sup> *Id.*

<sup>15</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The Rise and Fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS, <http://www.aabri.com/manuscripts/121101.pdf> (Last visited March 25, 2013).

<sup>16</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

## B. Rapid Expansion in the 1980's

In 1981, Wards made its first incursion into a new market when it merged with the Lafayette Radio Electronics Corporation which ran eight consumer electronics stores in the New York City metropolitan area. Wards paid \$6.6 million for the bankrupt retailer.<sup>18</sup> As a result of this acquisition, Wards earned \$36.5 million in tax credits.

At the same time that Wards moved into the New York market, the company began to expand its Loading Dock superstore concept. These new outlets were named Circuit City Superstores.<sup>19</sup> By 1982, Wards was operating four retail chains, including Circuit City stores, Circuit City Superstores, its Lafayette properties in New York, and its operation as a discount store named Zody in California.<sup>20</sup> A total of 80 percent of Wards' revenue was derived from sales of consumer electronics, and the company relied on solid profits from its marketing of Sony Betamax videocassette recorders and Pioneer stereo equipment. Wards garnered 11 percent of the sales of consumer electronics in Washington, D.C., its largest market share.<sup>21</sup> By the end of 1983, Wards' consistent growth led to sales of \$246 million for the fiscal year.<sup>22</sup>

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<sup>17</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The Rise and Fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS, <http://www.aabri.com/manuscripts/121101.pdf> (Last visited March 25, 2013).

<sup>18</sup> See United States Court of Appeals, Second Circuit decision of 1984. Defendant Jonnet Development Corporation had a 1967 long-term lease of a retail store to Monroeville Lafayette, a wholly owned subsidiary of Lafayette. When Lafayette went bankrupt, the reorganization plan confirmed by the bankruptcy court in 1981, merged the six subsidiaries into Lafayette, and Lafayette was then merged into Wards. At this time, Jonnet took possession of the store and changed the lock, thus violating the automatic stay provisions of the Bankruptcy Code. [Websites\761F2d84.pdf](#) (Last visited May 23, 2013).

<sup>19</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/](#) (Last visited May 23, 2013).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*



Wards officially changed its corporate name to Circuit City Stores, Inc. in 1984.<sup>23</sup> At this time, the Circuit City stock was finally listed on the New York Stock Exchange. Alan Wurtzel stepped up to Chairman of the Board and was succeeded by Richard Sharp.<sup>24</sup> Although the leadership of the company changed, the basic direction of the company did not.<sup>25</sup> Sharp continued to consolidate the companies operation in very large stores, replacing regular Circuit City stores with Circuit City Superstores. This process began in Knoxville, Tennessee, Charleston, South Carolina, and Hampton, Virginia.<sup>26</sup>

These superstores all had a similar layout. They featured solid walls of television sets. Customers entered by walking past the service department. Popular items were located at the back of the store, to encourage impulse purchasing as the customers walked around the displays.<sup>27</sup> By 1984, Circuit City was operating 113 stores, making it the leading specialty retailer of brand-name consumer electronics. Technological innovations such as cordless telephones, microwave ovens, and VCRs helped to propel the company's expansion. In 1984,

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<sup>23</sup> [History of Circuit City, DAILY NEWS, \(Last visited March 25, 2013\),  
http://www.nydailynews.com/news/money/history-circuit-city-article-1.368853.](http://www.nydailynews.com/news/money/history-circuit-city-article-1.368853)

<sup>24</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013,  
http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/ \(Last visited May 23, 2013\).](http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/)

<sup>25</sup> See Richard L. Sharp, EXECUTIVE PROFILE. Richard Sharp's background was in computers, not retailing, and he had first come into contact with Circuit City when he installed a computer system to control the company's sales and inventory in some of its stores. Sharp served as President of Circuit City from 1984 to 1997 and it's CEO from 1986 to 2000. He co-founded CarMax Inc. and served as its Chairman of the Board until June 26, 2007. He has been an Independent Director of Star Scientific, Inc. since March 2011. He served as Director of CROCS Inc. until June 29, 2011. He currently serves as Trustee of Virginia Commonwealth University.

<sup>26</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013,  
http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/ \(Last visited May 23, 2013\).](http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/)

<sup>27</sup> *Id.*

the company planned a large expansion around Atlanta and opened 15 new stores in Florida.<sup>28</sup> Circuit City had a policy of clustering its stores together in the same geographic area which allowed for economies of scale in advertising and promotion.

Circuit City took the final steps in consolidating its operations in 1986. The company closed down its 15 unprofitable stores under the Lafayette name.<sup>29</sup> In addition, Circuit City cut its ties with Zody's, the discount store in California. The resources that were used to run these unprofitable stores were reinvested into more Circuit City Superstores located in the Southeast and California.<sup>30</sup>

In 1987, Circuit City's annual sales hit the \$1 billion mark, driven in large part by the demand for VCR's, televisions, and other audio equipment.<sup>31</sup> The company continued to expand and by 1988 the company owned 150 stores. Circuit City planned to add 20 new outlets called Impulse.<sup>32</sup> These stores were designed for malls and sold small electric products for personal use or to be given as gifts.<sup>33</sup> The outlets were deemed a success and three years later, the company announced that it planned to open 50 more of these outlets.<sup>34</sup>

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The Rise and Fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS, <http://www.aabri.com/manuscripts/121101.pdf> (Last visited March 25, 2013).

<sup>32</sup> See "Circuit City Expansion," *Television Digest*, April 17, 1995.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

Circuit City's profits tripled to \$69.5 million by 1989 despite a general recession in the consumer electronics retailing industry.<sup>35</sup> The consumer electronics market is propelled by innovation, which creates new product cycles and pushes current cycles forward more quickly than other retail markets. Circuit City was extremely dependent on product cycles. For example, during the strong cycles created by the introduction of the VCR, the CD player, and the DVD player, Circuit City outperformed the majority of retailers in its markets. Circuit City introduced the sale of personal computers in 1989 and recorded music in 1992.<sup>36</sup> Sensing these trends, the company adjusted its marketing formula by opening mini-superstores in markets too small for massive outlets.<sup>37</sup> By 1990, the overall sales hit \$2 billion.<sup>38</sup> The company's reliance on these technological cycles put it at a disadvantage when demand for its core products decreased and competition from other electronics superstores increased.

## **I. THE SEAS OF CHANGE**

### **A. Competition with Other Superstores**

Like any new concept, other companies began to mimic Circuit City's implementation of superstores. These companies, however, were better able to see the advantages and disadvantages of the superstore, and parlay that knowledge into quick growth rate and a higher return on equity than Circuit City.

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<sup>35</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/](http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/) (Last visited May 23, 2013).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

## 1. Best Buy Inc.

Circuit City continued to surge ahead in the early 1990s with strong sales growth and steady expansion into new markets. By 1994, it had close to 300 stores and planned to open almost 200 more.<sup>39</sup> The competition with Best Buy, Inc. was flourishing. The competition caused Circuit City to fight harder for market share and to search for new ways to make money. In late 1993, Circuit City announced it would cut prices in the markets it shared with Best Buy, sparking a price war between the two companies.<sup>40</sup> Although Circuit City and Best Buy sold similar products in the consumer electrics industry, they varied on the day to day operations of their superstores. Circuit City differed from Best Buy in offering a high-service, hard-sell sales environment, with salespeople working for commission.<sup>41</sup> Best Buy continued to be a “help yourself” retailer. Knowledgeable associates on an hourly wage assisted customers rather than attempting to sell customers. Circuit City publicly defended its more aggressive style of selling when it released the results of a survey in 1994 claiming that consumers preferred its level of service.<sup>42</sup> The survey was backed by the company’s 10-K filing for 1994 which reported the aggregate market value of the common shares was \$1,743,560,880.<sup>43</sup> Circuit City stated that the

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<sup>39</sup> See Form 10-K Annual Report of Circuit City Inc., SECURITIES AND EXCHANGE COMMISSION, Feb. 28, 1994.

<sup>40</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited March 25, 2013).

<sup>41</sup> Circuit City’s Strategic Miscues Added Up. THE DAILY PROGRESS. Gilligan, Gregory J. Nov. 10, 2008. [http://www.dailyprogress.com/news/business/article\\_8b66e633-59a4-5165-bf7b-2ff831cd1754.html](http://www.dailyprogress.com/news/business/article_8b66e633-59a4-5165-bf7b-2ff831cd1754.html). (Last visited April 25, 2013).

<sup>42</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited March 25, 2013).

company's goal was to ". . . secure leading market share in each market it serves. The benefits of this approach include improving competitive position, maximizing sales, and improving net profit margins. . ."<sup>44</sup> Although Circuit City was aware of the quick rise of Best Buy Inc., it continued to expand in the same way it had in the 1980s:

In fiscal 1995, the Company plans to open approximately 60 Superstores in new and existing markets. In the first quarter of fiscal 1995, the Company entered the Minneapolis, Minn. Market. The Company also expects to enter the following markets: Kansas City, Kan.; New Orleans, La.; Little Rock, Ark.; Seattle, Wash.; Portland, Ore.; and Cleveland, Ohio. In each regional area, stores are typically clustered within approximately 500 miles of an automated electronics distributions center.<sup>45</sup>

By 1995, half of Circuit City's stores were in markets shared by Best Buy and 70 percent of its markets were classified by analysts as highly competitive.<sup>46</sup> Best Buy's expansion strategy of opening new superstore chains was similar to Circuit City's expansion strategy in the 1980s.

However, with more modern-looking stores in more prominent areas, Best Buy's expansion strategy was more successful than Circuit City's. Circuit City's out-of-the-way locations were often too inconvenient for customers who would choose other retailers such as Best Buy.

Despite the competition, Circuit City had sales of about \$7 billion by 1995, and sales and earnings were rising by 20 percent annually.<sup>47</sup> These staggering results prompted Richard Sharp to say, "Circuit City's sales growth exceeded expectations throughout fiscal 1995. Our results were driven by the strong hard goods retail environment, our marketing programs and the

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<sup>43</sup> See Form 10-K Annual Report of Circuit City Inc., SECURITIES AND EXCHANGE COMMISSION, Feb. 28, 1994.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/>. (Last visited March 25, 2013).

<sup>47</sup> Circuit City Stores, Inc. Reports Record Results for Fiscal Year 1995 and March 1995 Sales, NEWSWIRE ASSOCIATION LLC, 1995.

outstanding performance of our Associates.”<sup>48</sup> March sales, however, were modestly below expectations. Best Buy eventually passed Circuit City during fiscal 1996 becoming the number one electronics retailer.<sup>49</sup> The 2002 Annual Report for Best Buy and Circuit City graphically illustrate Circuit City’s inability to keep up with Best Buy:

Circuit City <sup>50</sup>	2002	2001	2000	1999	1998	1997	1996	1995	1994
Revenue in Billions \$	12.8	12.9	12.6	10.8	8.87	7.66	7.03	5.58	4.13
Yearly Growth Rate %	(.7)	2.4	16.7	21.8	15.8	9	26	35	26.3
Return on Equity %	8.6	7.9	6.9	16.9	8.5	7.1	18.5	21.1	20.6
5 Yr. Annual Growth Rate	6								

Best Buy <sup>51</sup>	2002	2001	2000	1999	1998	1997	1996	1995	1994
Revenue in Billions \$	19.6	15.3	12.5	10.1	8.34	7.76	7.22	5.08	3
Yearly Growth Rate %	28	22.6	24	20.7	7.5	7.5	42	70	85
Return on Equity %	22.6	26.2	27.1	32.6	27.2	19	10.7	15.4	13.2
5 Yr. Annual Growth Rate	20.3								

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<sup>48</sup> *Id.*

<sup>49</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/>. (Last visited March 25, 2013).

<sup>50</sup> Circuit City Stores, Inc., ANNUAL REPORT 2002.

<sup>51</sup> Best Buy Co., Inc., FISCAL 2002 ANNUAL REPORT.

## 2. Wal-Mart Stores Inc.

The influence of Wal-Mart on Circuit City is best exemplified by the earnings hit Circuit City took in 2005. In an attempt to gain the title of the number one electronics retailer, Wal-Mart began to redesign the inside of its electronic departments and added new high-end products including Sony liquid-crystal-display televisions and Toshiba laptops.<sup>52</sup> While a new company entering the consumer electronics market was nothing new, Wal-Mart was attacking Circuit City's most profitable line of business: extended warranties.

Extended warranties are the high-priced, multiyear protection plans on TVs, computers, and other items that are sold by the retailers' salespeople at the close of each purchase. The 2005 fiscal year analysts estimated warranty sales would account for more than a third of Best Buy's operating profit and all of Circuit City's. On October 27, 2005, Wal-Mart attacked this profit source by pricing its own warranties at a 50 percent average below Best Buy's and Circuit City's.<sup>53</sup> Circuit City relied on the profit from extended warranties prompting Todd Kuhrt, a former consumer-electronics retailing analyst to state, "Wal-Mart is cutting right at the heart of [Circuit City's] business model."<sup>54</sup> Kuhrt estimated that, as a percentage of overall sales, a one percentage-point fall in warranty revenue would cause a 29 percent fall in Circuit City's operating profit.<sup>55</sup> In fact, fourth-quarter profit reduced by 5 percent alone which included the holiday season.<sup>56</sup>

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<sup>52</sup> Berner, Robert, *Watch Out, Best Buy and Circuit City*. BUSINESS WEEK. Nov. 21, 2005.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> Barbaro, Michael, *Price Cuts Drag Down Circuit City Earnings*, WASHINGTON POST, 2005.

## B. Trying to Stay Ahead

Competitors were on the fast track to overtake Circuit City. Desperate to keep a strong foothold in the market, the company began looking for new technology and innovations to invest in.

### 1. Divx Technology

In 1998, Circuit City, in an attempt to gain a market edge, introduced a new product, a digital movie disk called Divx.<sup>57</sup> Divx was pitched to Circuit City by a Los Angeles legal firm and Circuit City jumped at the opportunity to get in on a ground floor technology. Divx originally stood for digital video express, but it soon became known by the acronym. It was a disk digitally encoded with a movie which consumers could purchase for \$4 or \$5. The movie had to be watched within 48 hours and then thrown away. Divx players were hooked by phone line to a central computer which recorded when the movie was watched. If the movie was not watched within the 48 hour time frame, the customer would be billed an extra \$3.<sup>58</sup>

Divx competed directly with another digital movie format, the DVD. DVDs were disks offered for rent. In early 1998, both of these formats were struggling to capture the attention of the consumers because each offered only a few hundred movie titles. Sensing the lack of efficiency attributed to Divx, many of Circuit City's competitors refused to carry the technology. The costs of building up this new video format fell on Circuit City's shoulders, dragging on its stock. Financial analysts urged Circuit City to drop the operation and concentrate on its core business.<sup>59</sup> Circuit City had to fight Warner Home Video and traditional video rental firms in its advertisement of the Divx technology. Warner Home Video was one of the biggest proponents

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<sup>57</sup> [Armstrong, Larry, 8-Tracks, Betamax—And Divx? BLOOMBERG BUSINESSWEEK.. Nov. 8, 1998.](#)

<sup>58</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, \(Mar. 25, 2013\),   
http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/. \(Last visited March 25, 2013\).](#)

<sup>59</sup> [Dunnill, R.J., A Short History of the Divx Home Video System, DIVX OWNERS ASSOCIATION. 2008.](#)



of the DVD format while traditional video rental firms were afraid Divx would disrupt one of their most lucrative revenue streams: late fees.<sup>60</sup> In the spring of 1999, news sites reported that Circuit City tried to sell off the Divx operation to Blockbuster but the deal failed.<sup>61</sup> Circuit City corporate headquarters began battling with the Hollywood law firm partners as it sensed that Divx was becoming less significant than DVDs. Circuit City needed the firm to convince the studios they dealt with to license popular titles to the Divx format only.<sup>62</sup>

On June 16, 1999, Rick Sharp canceled the Divx development and marketing funding.<sup>63</sup> The news was broken to the Divx employees via a mass e-mail that morning. At the time, an estimated 10,000 retailers were selling DVDs and only about 740 of those 10,000 retailers also dealt with Divx.<sup>64</sup> Most of those retailers were Circuit City stores. Circuit City had invested \$233 million to develop and promote the new product.<sup>65</sup>

## 2. CarMax

In 1993, five years before the Divx failure, Circuit City opened up the first of what became a chain of used-car lots.<sup>66</sup> Richard Sharp wanted to move the company into used cars because he

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<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/>. (Last visited March 25, 2013).

<sup>65</sup> *Id.*

<sup>66</sup> CarMax, Inc. History. FUNDING UNIVERSE, (MAR. 25, 2013). <http://www.fundinguniverse.com/company-histories/carmax-inc-history/>. (Last visited April 25, 2013).

saw that the existing market was lucrative, fragmented, and not well managed.<sup>67</sup> Customers disliked the haggling and distrusted salespeople in the traditional used car market. CarMax offered a huge, clean lot of cars marked with bar codes so the customer could easily locate the vehicles they were interested in from a central listing system.<sup>68</sup> Prices were fixed for each car. Each car on the CarMax lots was no more than five years old, had less than 70,000 miles, and went through a 110-point inspection with a CarMax 30-day warranty.<sup>69</sup> By 1996, there were five CarMax outlets. In 1997, Circuit City sold a 25 percent stake in CarMax through an IPO that raised almost \$438 million.<sup>70</sup> Doubts about the used-car superstore concept caused the stock to quickly lose ground. Only a few months after the IPO, the stock was down from \$20 a share to \$12.50, \$150 million less than what they were sold for in the IPO.<sup>71</sup>

By 1999, Circuit City was experiencing strong sales in its core electronics business, pushing revenues past the \$10 billion mark. CarMax, however, lost \$23.5 million in 1998, on sales of \$1.5 billion.<sup>72</sup> The chain had grown to more than 30 locations but Sharp halted further expansion in 1999 because sales had declined.<sup>73</sup> AutoNation, a copycat chain, proved to be a formidable competitor with CarMax. Some of CarMax's stores were too big and they could not

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<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> Knight, Jerry, *Initial Public Offerings Gain Quick Acceptance*, WASHINGTON POST, Apr. 27, 1998.

<sup>71</sup> *Id.*

<sup>72</sup> Circuit City Stores Inc., ANNUAL REPORT, 1999.

<sup>73</sup> *Id.*

fund the heavy cost of advertising.<sup>74</sup> At the turn of the century, Circuit City had become complacent and was in desperate need of change.

## II. THE DOMINOS BEGIN TO FALL

In June 2000, Alan McCollough was promoted from president and COO of Circuit City to president and CEO.<sup>75</sup> McCollough took over the title of chairman in 2002 from Sharp. McCollough immediately began making changes to the company.

### A. Exiting the Appliance Market

Just one month after he was named CEO, Circuit City announced it would stop selling appliances in order to focus on consumer electronics.<sup>76</sup> The plan was to take a \$1.2 billion, three-year overhaul of its 573 stores. After the announcement, Circuit City shares plunged 20 percent to a 52-week low.<sup>77</sup> Circuit City stores had generated 14 percent of their overall sales from appliances, but the appliance sector became less appealing after Home Depot, Inc. and Lowe's Companies, Inc. aggressively entered the market and began to engage in pricing battles. The decision also intended to have huge savings in warehouse storage and delivery costs.<sup>78</sup> In connection with this exit, Circuit City closed six distribution centers and eliminated 1,000 jobs.<sup>79</sup>

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<sup>74</sup> CarMax, Inc. History. FUNDING UNIVERSE, (MAR. 25, 2013). <http://www.fundinguniverse.com/company-histories/carmax-inc-history/>. (Last visited April 25, 2013).

<sup>75</sup> History of Circuit City, DAILY NEWS, (Last visited March 25, 2013), <http://www.nydailynews.com/news/money/history-circuit-city-article-1.368853>.

<sup>76</sup> Ramstad, Evan, *Circuit City Unveils Plans to Exit Appliance Business, Take Charges*, THE WALL STREET JOURNAL. Jul. 26, 2000.

<sup>77</sup> *Id.*

<sup>78</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The rise and fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS. (Last visited March 25, 2013), available at <http://www.aabri.com/manuscripts/121101.pdf>.

This decision was made in haste and had severe detrimental effects. The decision to move quickly resulted in Circuit City's appliance vendors not receiving notice prior to the announcement.<sup>80</sup> By exiting the appliance business, Circuit City lost the appliance customers and the traffic. The leadership of the retailer lacked an understanding of the metrics of the business. While the home appliance category may have operated at a loss, the margin dollars it generated were applied to the companies fixed overhead.<sup>81</sup> Eliminating the appliance market created a significant disruption for the retailer's brand because their customers had associated Circuit City's name with home appliances before their consumer electronics products.<sup>82</sup>

## B. Store Restructuring

The exit from the appliance market was accompanied by the announcement of an ambitious store remodeling program and new real estate investments. Best Buy had aggressively pursued "A" quality locations and strategic lease negotiations that resulted in the chain having better real estate than Circuit City.<sup>83</sup> Circuit City failed to secure prime real estate and instead opted for low cost leases in inferior locations that were inconvenient for customers.<sup>84</sup> The store restructuring included remodeling of the stores to make them more self-service and consumer-

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<sup>79</sup> [Circuit City Stores, Inc. History, FUNDING UNIVERSE, \(Mar. 25, 2013\), http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/.](http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/) (Last visited March 25, 2013).

<sup>80</sup> See [Eames, Don, \*Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company\*, Eames Management Group \(2009\)](#). Prior to founding EMG in 2006, Don Eames spent over 16 years with Best Buy Company. As Senior Vice President, Mr. Eames competencies included the development and implementation of comprehensive growth strategies, maximization of shareholder value, and development of cost reduction strategies which improved operational efficiencies.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> Reingold, Jennifer, *Short Circuit*, FAST COMPANY. Mar. 1, 2005.

<sup>84</sup> See [Eames, Don, \*Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company\*, Eames Management Group \(2009\)](#).

friendly, a concept taken from Best Buy's success story. The new format cut back on the amount of space taken up by the store's warehouse section, where most of the products had previously been stored, inaccessible to customers without the intervention of a salesperson.<sup>85</sup> Circuit City stores now had more floor space, with more products available for customers to pick up themselves and take to a checkout for purchase. Although salespeople remained on commission, they took a less aggressive approach than before.

To identify and secure better store locations, the company began testing "strategically differentiated" pilot stores by working with new master brokers under the direction of the recently named real estate vice president, Steven Jackson.<sup>86</sup> Part of the restructuring program consisted of closing underperforming locations and focusing on better executed expansions. Any store that was not scheduled for relocation was instead scheduled for remodeling. In January 2001, McCullough announced that instead of 140 stores that were originally planned for remodeling, only 20 to 25 stores would actually be remodeled.<sup>87</sup> The reason for scaling back the remodeling efforts was to save costs of \$1 million per store and the rollout would be completed over a longer time period.<sup>88</sup> Circuit City's faulty real estate strategy caused the company to fall behind the competition and continue to erode the customer experience.

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<sup>85</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, (Mar. 25, 2013), <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/>. (Last visited March 25, 2013).

<sup>86</sup> Wolf, A., *Circuit City Continues Making Changes*, TWICE, Sept. 26, 2005.

<sup>87</sup> *The rise and fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS, Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon. (Last visited March 25, 2013), available at <http://www.aabri.com/manuscripts/121101.pdf>.

<sup>88</sup> *Id.*

### C. The End of the Commissioned Sales Force

McCollough continued his efforts to revitalize the Circuit City franchise in 2003. His key strategic decision was the elimination of commissions at the stores as Circuit City adopted a single hourly pay structure nationwide.<sup>89</sup> This decision came 14 years too late, as Best Buy had eliminated their commissioned sales force in 1989.<sup>90</sup> It was Circuit City's belief that by training and compensating knowledgeable and professional sales people they could provide a superior shopping experience.<sup>91</sup> Faced with falling sales and profitability, Circuit City felt compelled to move to an hourly rate. The intention of the switch was to simplify store operations, create a united customer service objective, and reduce operating costs.<sup>92</sup> The results of this change were devastating. 3,900 sales people were terminated and sales in profitable categories quickly declined.<sup>93</sup> Circuit City was left with an ineffective, undertrained selling staff as the company continued to lose market share. Circuit City's weak market position was exemplified in 2003 when the owner of CompUSA, Inc., made a bid to acquire the company for about \$1.5 billion. The Circuit City board of directors rejected the proposal in June 2003.<sup>94</sup>

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<sup>89</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

<sup>90</sup> *Id.*

<sup>91</sup> See Eames, Don, *Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company*, Eames Management Group (2009).

<sup>92</sup> Wells, J. (2005). Circuit City Stores Inc., Strategic Dilemmas. HARVARD BUSINESS SCHOOL.

<sup>93</sup> See Eames, Don, *Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company*, Eames Management Group (2009).

<sup>94</sup> Circuit City Stores, Inc. History, FUNDING UNIVERSE, Mar. 25, 2013, <http://www.fundinguniverse.com/company-histories/circuit-city-stores-inc-history/> (Last visited May 23, 2013).

## D. Late is not Always Better than Never

In 2002, Best Buy launched Geek Squad which quickly grew into the number one electronics service organization, adding to their prestigious customer service reputation.<sup>95</sup> Geek Squad revenues were projected to reach over \$1 billion in 2009.<sup>96</sup> It took Circuit City four years to realize the benefits of this customer service. To challenge Geek Squad, Circuit City launched Firedog in 2006.<sup>97</sup> This move required a huge financial investment which put strain on the company's financial and employee resources. As with the decision to exit the appliance market, the implementation of Firedog was not well timed. The rollout lacked consistency, local ownership, and customer acceptance.<sup>98</sup> The introduction of the Firedog project became another money drain for Circuit City as Geek Squad already had developed into a very strong brand with a large, loyal customer base.

## E. Lost Talent

In 2004, Philip Schoonover was appointed executive vice president and chief merchandising officer of Circuit City.<sup>99</sup> Faced with falling sales and profits, Circuit City had to find way to improve their overall profitability.<sup>100</sup> The decision was made to reduce their labor costs. In one

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<sup>95</sup> [About Us. GEEK SQUAD. 2013.](#)

<sup>96</sup> [Best Buy Co. Inc., ANNUAL REPORT 2008.](#)

<sup>97</sup> [Nguyen, Tuan, \*Circuit City Launches Firedog, Competing with GeekSquad\*, DAILYTECH, Sept. 6, 2006.](#)

<sup>98</sup> [See Eames, Don, \*Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company\*, Eames Management Group \(2009\).](#)

<sup>99</sup> [See Philip J. Schoonover. BLOOMBERG BUSINESSWEEK..](#) Philip Schoonover was Executive Vice President at TOPS Appliance City prior to joining Best Buy in 1995 as its Executive Vice President of New Business Development. He served as Senior Vice President of Merchandising as well as Executive Vice President of Customer Segments. He was Chief Executive Officer of Circuit City from 2006 and President from 2005. Bloomberg Businessweek elected him one of the worst manager of 2008:

day, 3,400 sales associate jobs were eliminated.<sup>101</sup> The people holding these jobs were their most tenured, knowledgeable, successful and highly compensated employees. They were replaced with new, less experienced sales people who were unproven and under-trained. Schoonover said the cuts were necessary to save money; however, several months later, the company awarded retention bonuses to its top executives.<sup>102</sup> The morale of the remaining employees plummeted resulting in even more turnover. With the loss of its best employees, the Circuit City customer experience deteriorated. This led to unrest inside the organization, lost customers, lost productivity, lost revenue, and lost profits from which Circuit City could not recover.<sup>103</sup>

### III. ARROGANCE LEADS TO BANKRUPTCY

In the early 1990s, Circuit City was the leading electronics retailer in the United States with about 400 stores nationwide. Best Buy was a small struggling company with about 70 stores. Best Buy quickly ascended the ranks to become one of Circuit City's biggest rivals. Circuit City's reaction to Best Buy was to do nothing. Circuit City decided to stick to its existing real estate strategy and stay in their older store locations. Best Buy surpassed Circuit City in size and market share. The arrogance of the top leadership of Circuit City allowed Best Buy to implement their strategy. Circuit City's management refused to admit that they could be

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<sup>100</sup> Circuit City Inc., ANNUAL REPORT 2007.

<sup>101</sup> See Eames, Don, *Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company*, Eames Management Group (2009).

<sup>102</sup> *The rise and fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS, Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon. (Last visited March 25, 2013), available at <http://www.aabri.com/manuscripts/121101.pdf>.

<sup>103</sup> See Eames, Don, *Circuit City Six: Six Fatal Mistakes of a Once "Good to Great" Company*, Eames Management Group (2009).



challenged by such a small company.<sup>104</sup> The leaders held on to old business models and did not realize how important it was to change and adapt in the consumer electronics world. The mistake was not that they made the decision to go to a non-commission based selling model or implementing Firedog, it was that it took them so long to figure out that they needed to do so.

Alan McCollough's tenure lasted 5 years. During his tenure, Circuit City recognized a -50.4 percent total shareholder return, a 12.8 percent peer index return, and a -15.6 S&P 500 Index return. Yet he received total pay of \$12.2 million as the CEO.<sup>105</sup>

On April 15, 2008, Blockbuster offered about \$1 billion to purchase Circuit City.<sup>106</sup> Blockbuster withdrew their offer on July 1. "Based on market conditions and the completion of our initial due diligence process, we have determined that it is not in the best interest of Blockbuster's shareholders to proceed with an acquisition of Circuit City," stated Blockbuster Chairman and CEO Jim Keyes.<sup>107</sup> The decision to withdraw the offer was crippling to Circuit City. Circuit City's stock tumbled a further 15 percent to \$2.14 a share.<sup>108</sup> Amid immense shareholder pressure, Schoonover was forced to step down and was replaced by Mark Wattles.<sup>109</sup> At the time, in its most recent quarter ending May 31, Circuit City lost a net \$164.8 million and sales had fallen 11 percent.<sup>110</sup>

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<sup>104</sup> *Id.*

<sup>105</sup> Reingold, Jennifer, *Short Circuit*, FAST COMPANY. Mar. 1, 2005.

<sup>106</sup> Anthony, Scoot D., *Blockbuster's Bid for Circuit City*, BLOOMBERG BUSINESSWEEK, Apr. 15, 2008.

<sup>107</sup> Gogoi, Pallavi, *Circuit City Headed for a Blowout?*, BLOOMBERG BUSINESSWEEK, Jul. 02, 2008.

<sup>108</sup> *Id.*

<sup>109</sup> Gogoi, Pallavi, *Circuit City CEO Get Unplugged*, Bloomberg Businessweek, Sept. 22, 2008.

<sup>110</sup> *Id.*

On November 3, 2008, Circuit City announced that it would close 155 stores and lay off 17 percent of its workforce by year-end as a result of its ongoing struggle for profitability.<sup>111</sup> Days later, 700 corporate employees were laid off from Circuit City's headquarters and the 1,000 remaining corporate employees were merged into a single building in an effort to further cut costs.<sup>112</sup> On November 10, 2008 Circuit City filed for bankruptcy.<sup>113</sup> Circuit City had lost more than \$5 billion in stock market value over the past two years. The company's goal was to emerge from bankruptcy protection in mid-2009.

## **IV. BANKRUPTCY**

### **A. The beginning of the Chapter 11**

On November 10, 2008 the inevitable had happened, after years of speculation and mistakes, and then weeks and months of last ditch efforts to set things right, Circuit City filed for bankruptcy.<sup>114</sup> In a document filed with the United States Bankruptcy Court for the Eastern District of Virginia, in Richmond, Circuit City's plan for the immediate and distant future were laid out.<sup>115</sup> Circuit City's legal counsel of McGuire Woods LLP was retained for the process of the chapter 11 proceedings. The document was a declaration by Bruce Besanko the executive vice president and chief financial officer of Circuit City Stores Inc., and it was offered in support of the chapter 11 petitions and the first day pleadings. The declaration cited three main factors

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<sup>111</sup> Hart, Amy, Erika Matulich, Kimberly Rubinsak, Kasey Sheffer, Nikol Vann, and Myriam Vidalon, *The rise and fall of Circuit City*, JOURNAL OF BUSINESS CASES AND APPLICATIONS. (Last visited March 25, 2013), available at <http://www.aabri.com/manuscripts/121101.pdf>.

<sup>112</sup> *Id.*

<sup>113</sup> Boyle, Matthew and Aili McConnon, *Circuit City Files for Bankruptcy*, BLOOMBERG BUSINESSWEEK, Nov. 10, 2008.

<sup>114</sup> <https://www.bloomberglaw.com/document/X1Q6MLV9U4O2> Doc 79

<sup>115</sup> *Id.* at 1.

which forced Circuit City into chapter 11 as: “(i) erosion of vendor confidence; (ii) decreased liquidity; and (iii) a global economic crisis.”<sup>116</sup> The company had the immediate goal of obtaining three types of relief, with the hopes of meeting their long-term turnaround. The first type of relief was approval of adequate post-petition financing to ensure a smooth transition into chapter 11. The second type was authorization to continue the closing sales of the stores. The final type of relief was the rejection of unnecessary unexpired leases of non-residential real property.<sup>117</sup>

## **B. First Day Motions and Orders**

Circuit City filed a total of 21 first day motions and an additional five administrative motions. The purpose of the first day motions were described by the declaration as, “(a) vital to enable the Debtors to make the transition to, and operate in, chapter 11 with a minimum interruption or disruption to their businesses or loss of productivity or value, (b) constitutes a critical element in achieving the Debtors’ successful reorganization, and (c) ensures that the Company complies with applicable non-bankruptcy law, to the extent such law remains applicable in a chapter 11 bankruptcy proceeding.”<sup>118</sup> In addition, Circuit City filed five administrative motions which, “(i) request a first day hearing on the Petition Date to consider the relief requested in each of the Motions, (ii) seek to have the Debtors’ bankruptcy cases jointly administered, (iii) seek the retention of Kurtzman Carson Consultants, LLC as claims, noticing and balloting agent, (iv) seek approval of case management procedures, and (v) request authority

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<sup>116</sup> *Id.* at 17.

<sup>117</sup> *Id.* at 21.

<sup>118</sup> *Id.* at 22.

to file a consolidated list of fifty (50) largest unsecured creditors.”<sup>119</sup> These administrative motions truly laid the groundwork for what would make up the bones of Circuit City’s plan. With the motions they established who they wanted to act as balloting agent as well as arranging who they owed the most money.

Continuing with the motions, Circuit City planned to file motions to continue certain banking and business practices and continue intercompany transactions. These motion requests were aimed at helping the company achieve some sort of normalcy during the chapter 11 proceedings. Because the company’s cash management system was comprised of a number of bank accounts, with collections and disbursements managed through well-established procedures, the company had to ensure that no changes were made to those systems. If the court did not allow Circuit City to continue to operate its cash management as they traditionally done, they would be burdened by using a different system.<sup>120</sup>

Circuit City then also stated plans on how it would continue to pay employees. The motions were designed to minimize the personal hardship that Circuit City’s employees would suffer if they were not paid on their usual schedule. The main obligations Circuit City were trying to satisfy were, “(i) prepetition obligations to current employees and to continue certain non-working day policies, employee benefit plans and employee programs; (ii) reimburse Employees for prepetition expenses Employees incurred on behalf of the Company; and (iii) pay all related prepetition withholdings and payroll-related taxes. In this regard, I believe that no Employee is presently owed in excess of \$10,950 for prepetition wages or salaries.”<sup>121</sup> What is very important to note is that Circuit City was able to keep up with the compensation of its

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<sup>119</sup> *Id.* at 23.

<sup>120</sup> *Id.* at 24.

<sup>121</sup> *Id.* at 26.

employees despite their struggles leading up to the chapter 11 filing. This is no small feat considering that none of its remaining employees from a lowly sales associate to their top executives were working without compensation. Other first day motions were based on the need to maintain the company's usual procedures for paying taxes, utilities, and insurance.

Circuit City also filed a first day motion to request to reject non-residential real property leases.

One important first day motion was the request to keep up with their Customer Programs. These Customer Programs consisted of gift cards, returns, refunds, exchanges, rebates, warranties, guarantees, and reward points.<sup>122</sup> These were the most important part of their plan if they planned to have any chance of making a long term recovery. Without being able to assure customers that the gift cards they would buy their families would be worth anything within a few months, many customers would be turned away. Further high priced items such as televisions and computers need to be backed by confidence in the company that sold them. What was most unfortunate however was the timing of the chapter 11 proceedings. The busy holiday season would not be helped by news of continued doom and gloom at Circuit City. To survive the chapter 11 proceedings, Circuit City would need a serious amount of DIP financing, which is what they sought.

### **C. DIP Financing**

One of the most important aspect of keeping a company staying and surviving during the bankruptcy process is acquiring Debtor-in-Possession financing. This financing is a loan provided to the debtor to maintain business operations. Under the United States Code §364, a

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<sup>122</sup> *Id.* at 29.

debtor can obtain credit in four different ways.<sup>123</sup> The first type is for debtors who borrow “in the ordinary course of business,” and therefore is allowed to obtain unsecured credit as an administrative expense.<sup>124</sup> The second type is for debtors, who do not typically borrow money in the typical course of business, but the court is willing to approval from a court order to receive unsecured credit; however, this path does not offer substantial protection for the lender.<sup>125</sup> The third type is for debtors who are unable to obtain unsecured credit, the court can allow the debtor receive credit as a super priority claim.<sup>126</sup> The final type of financing is for debtors who cannot receive any other sort of credit; the debtors may obtain credit by a senior or equal lien on property of the estate that is subject to a lien.<sup>127</sup>

Circuit City laid out their plans for obtaining Debtor-in-Possession financing in their initial Declaration. The company requested a revolving credit facility of \$1.1 billion. That amount would be reduced to \$900 million after the holiday season.<sup>128</sup> One of the major lenders for Circuit City’s financing would be Bank of America, although other lenders would assist them. Along with the Debtor-in-Possession financing, Circuit City also acquired a prepetition Revolving Credit Facility of a \$1.3 billion revolver. Of that amount, Circuit City had drawn \$898 million of that amount prepetition, meaning that the company already owed nearly a billion dollars in loans before requesting another \$1.1 billion. That amount of debt that was taken before the filing of chapter 11 bankruptcy would be rolled into Circuit City’s Debtor-in-

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<sup>123</sup> 11 U.S.C. §364.

<sup>124</sup> Chapter 11-101, page 164.

<sup>125</sup> 11 U.S.C. § 354(b).

<sup>126</sup> 11 U.S.C. § 354(c).

<sup>127</sup> 11 U.S.C § 354(d).

<sup>128</sup> <https://www.bloomberglaw.com/document/X1Q6MLV9U4O2> Doc 79

Possession financing, which they hoped would give them necessary liquidity to get them through the crucial holiday season. Circuit City provided plenty of support for its motion for Debtor-in-Possession financing. One of the most pressing reasons for Circuit City's need for immediate DIP financing was the fact that the company had struggled for such a long period of time. By the time Circuit City was filing for chapter 11 bankruptcy, the company did not have access to adequate funding under the Revolving Credit Facility.<sup>129</sup> The court approved an interim order allowing Circuit City to receive DIP financing under U.S.C. 11 §364(c) & (d) as a DIP Lien.<sup>130</sup> This meant that the company could receive funding as a super priority claim. The property included in the lien were accounts, equipment, general intangibles, inventory, commercial tort claims, deposit accounts, fixtures, real property, goods, investment property, and all of the debtors books, among many other assets.<sup>131</sup> The liens were superior to any security, mortgage, or collateral interest or lien or claim to the debtor-in-possession collateral.<sup>132</sup> Further, the lien was subject only to the Carve Out and the pre-petition liens which were valid, properly perfected, and unavoidable.<sup>133</sup> Circuit City was also granted permission on an interim basis to use Cash Collateral “and to use the advances under the DIP Credit Agreement during the period commencing immediately after the entry of the Interim Order an terminating upon notice being provided by the DIP Agents to the Debtors that (i) a DIP Order Event of Default has occurred

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<sup>129</sup> *Id.* at 35.

<sup>130</sup> Interim Order Authorizing Incurrence of Debtor's Post-petition Secured Indebtedness at page 15.

<sup>131</sup> *Id.* at 16.

<sup>132</sup> *Id.* at 18.

<sup>133</sup> *Id.*

and is continuing, and (ii) the termination of the DIP Credit Agreement.”<sup>134</sup> The actual events of default were detailed in a later court order. There were 25 events which would cause a default including:<sup>135</sup>

- *Failing to pay any principal of any loan or any reimbursement obligation*
- *Failing to pay any interest on any loan or any fee or any other amount*
- *The Loan Parties shall fail to observe or perform any covenant, condition, or agreement*
- *A Change in Control shall occur*
- *The occurrence of any uninsured loss to any material portion of the Collateral*
- *Except as otherwise permitted herein, the determination of any Loan Party, whether by vote of such Loan Party’s board of directors or otherwise to: suspend the operation of such Loan Party’s business in the ordinary course, liquidate all or a material portion of such Loan Party’s assets or store locations, or employ an agent or other third party to conduct any so-called store closing, store liquidation or “Going-Out-Of-Business” sales relating to all or a substantial portion of such Loan Party’s assets or store locations*

Under the DIP Credit Agreement, the lenders are allowed to have access to the Debtors assets to collect upon the debt.<sup>136</sup>

When acquiring Debtor-in-Possession financing, one important part is the carve-out portion which allows attorneys and the other professionals associated with the bankruptcy to receive compensation. Carve-out provisions are necessary because much of the debtor’s assets will be tied up by the lender’s lien. Because of this, there will likely not be any funding left over for the attorneys or other professionals.<sup>137</sup> To counter this, the parties involved in the DIP financing will agree to “carve-out” a portion of the funding that will not be touched by either party and comes first in regards to the payment from the debtor’s assets.<sup>138</sup> In the case of Circuit

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<sup>134</sup> *Id.* at 20.

<sup>135</sup> [DIP Credit agreement at page 119.](#)

<sup>136</sup> [Id. at 123.](#)

<sup>137</sup> Chapter 11-101 page 247.



City, a carve out of \$3,000,000 was agreed to between the parties.<sup>139</sup> The parties who were compensated by the carve-out were attorneys and financial advisors employed by both parties, as allowed in §327 and §1103 of the Bankruptcy Code.<sup>140</sup> Any amount over \$3,000,000 would require special approval and shall exclude any fees and expenses in connection with “the assertion or joinder in any claim, counterclaim, action, proceeding, application, motion, objection, defenses or other contested matter, the purpose of which to seek any order, judgment, determination or similar relief.”<sup>141</sup>

#### **D. 363 Sales**

One way for a company to save money and generate income during chapter 11 proceedings is to sell off unnecessary assets. 11 U.S.C. §363 lays out that:

The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless.<sup>142</sup>

Clearly, Circuit City had a tremendous amount of property which they could sell and desperately needed to sell. With over 500 stores nationwide, all stocked with merchandise and

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<sup>138</sup> *Id.*

<sup>139</sup> Interim Order Authorizing Incurrence of Debtor’s Post-petition Secured Indebtedness at page 15.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> 11 U.S.C.A. § 363 (West).

staffed with employees who were no longer needed, §363 sales were an absolute necessity.<sup>143</sup> Circuit City themselves estimated that the leases on 150 was at a cost of \$40 million annually.<sup>144</sup> On November 4, 2008, Circuit City drafted an agreement stating the plan and procedures for how the store closings would be handled.<sup>145</sup> The agreement was submitted as a motion to the bankruptcy court to secure the speedy approval of the judge on the same day the chapter 11 was filed with the court. Circuit City was so concerned about having the agreement motion approved that an order for the judge was drafted, with the hopes of saving time. The Store Closing Agreement was set out to form an agency among Hilco Merchant Resources, LLC and Gordon Brothers Retail Partners, LLC, and Circuit City Stores, Inc. where the two former companies act as an agent for sale of unneeded stores.<sup>146</sup> The agreement states that the agents would close 154 retail store locations and sell all of the merchandise in the store.<sup>147</sup> The agreement states that the proceeds of the sale would at a minimum be equal to 72% of the cost value of the merchandise in the sale plus an amount to cover the expenses. The agreement was clearly written with the intent for Circuit City to continue as a business; warranties on merchandise along with returns were to be honored during the store closing sales.<sup>148</sup> Bankruptcy Judge Kevin Huennekens approved a final version of the motion after the unsecured creditors were allowed an opportunity to object to the motion on December 10, 2008.<sup>149</sup> The order stated that the debtors' decision to create the

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<sup>143</sup> [Chang, Andrea and Zimmerman, Martin, \*Circuit City to lose remaining 567 stores in U.S.\*, LOS ANGELES TIMES, January 17, 2009. \(Last visited April 25, 2013\).](#)

<sup>144</sup> [Circuit City Receives Approval for \\$1.1 Billion DIP Loan.](#)

<sup>145</sup> [Motion of the Debtors to Continue Store Closing Agreement.](#)

<sup>146</sup> *Id.* at page 33.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* at page 37.

store closing agreement and continue the payments required by the agreement, was a reasonable exercise of the debtors' sound judgment and was in the best interest of all the parties involved.<sup>150</sup> Although the §363 sale was approved this order and the factor of time would later become a very big talking point less than six months later.

## V. BACK TO BUSINESS

Despite the world around them crashing and now having the public privy to every detail of Circuit City's failings, the company still had to sell electronics. There were many problems with this though. By the time Circuit City filed for bankruptcy, the company was very unhealthy and their business model was no longer effective. Making things worse was that with all of the doom and gloom, customers no longer had any confidence in anything they bought from the retailer. The biggest issue with the bankruptcy however was the timing of the proceedings, the critical holiday shopping season. Although it would seem that the timing of the bankruptcy right before the shopping season would provide a chance for Circuit City to get some revenue coming in, instead it had the opposite effect. A *New York Times* article from December 23, 2008 stated that because of the weak consumer spending environment, Circuit City sales dropped by as much as 50%.<sup>151</sup>

### A. Hope for a buyer

Before the Christmas shopping season however outlook was initially looking positive for the destitute retailer. On November 18, 2008, details began to emerge about a potential buyer for

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<sup>149</sup> [Final Order Granting Motion of Debtors for Entry of Order Pursuant To Bankruptcy code 105, 363 and 365.](#)

<sup>150</sup> *Id.*

<sup>151</sup> [Circuit City Receives Approval for \\$1.1 Billion DIP Loan, NY Times, available at dealbook.nytimes.com/2008/12/23/circuit-city-receives-approval-for-11-billion-dip-loan/.](#)

Circuit City.<sup>152</sup> The supposed purchaser was a Mexican retail and media tycoon by the name of Ricardo Salinas Pliego.<sup>153</sup> By November 18, 2008, Ricardo Salinas was in possession of 28% of Circuit City, and according to a representative from Salinas' business group, he had interest in purchasing more of Circuit City. Mr. Salinas came from a family which was involved in the retail industry for over 100 years.<sup>154</sup> Adding even more excitement to the situation was Mr. Salinas' ownership of Grupo Elektra SA de CV, which is a chain of electronics retailers with over 1000 stores.<sup>155</sup> The media along with Mr. Salinas' spokespeople painted a picture of an investor who was not only interested in the Circuit City brand name and trademark but the infrastructure as well. At that moment, it really appeared that in less than a month Circuit City had found its "knight in shining armor." Unfortunately, there was actually a large gulf between the reality and the appearance of the situation and Mr. Salinas' desire to purchase the company.

## **B. Hopes Dashed**

On January 10, 2008, two months after filing for chapter 11 bankruptcy, Circuit City announced that it would need a buyer by January 16, 2008 or it would have to shut down all of its stores.<sup>156</sup> On the 10<sup>th</sup> of January 2008, Circuit City was given permission by the bankruptcy court to sell all of the business and enter into a stalking horse agreement.<sup>157</sup> The order confirmed all of the deadlines and bidding procedures for any company, that wanted to make a bid on what

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<sup>152</sup> [Mexican tycoon Salina sets eyes on Circuit City, Reuters.](#)

<sup>153</sup> *Id.*

<sup>154</sup> [Mary Ellen Lloyd, Salinas Sees Circuit City Opportunity, THE WALL STREET JOURNAL, November 19, 2008. \(Last visited April 25, 2013\).](#)

<sup>155</sup> *Id.*

<sup>156</sup> [Circuit City Needs Buyer By Next Week UPI.com.](#)

<sup>157</sup> [Order Approving Procedures in Connection With Sale of All or Substantially All of the Business.](#)

remained of Circuit City.<sup>158</sup> Unfortunately for the company the deadline came and went, and on January 16, 2009, Circuit City announced that it failed to find a buyer and would liquidate its assets.<sup>159</sup> According to reports, Circuit City was in negotiations regarding a going concern transaction with two buyers. Circuit City never actually provided any hints as to who the buyers were, and simply mentioned them as unnamed parties. Many speculated that one of the interested parties was Mr. Salinas, the Mexican media and retail tycoon who owned over 28% of Circuit City. Once Circuit City failed due to its inability to secure a buyer, many questioned why Mr. Salinas would invest in the company and then allow it go bankrupt shortly after.<sup>160</sup> Whatever the reason for Mr. Salinas' inaction, the writing was on the wall for Circuit City. The company announced plans to provide more details regarding how the liquidation process would be handled. Circuit City announced that it reached an agreement with Hudson Capital Partners, Great American Group, SB Capital Group, and Tiger Capital Group as liquidators for the merchandise in Circuit City's 567 stores.<sup>161</sup> Over the course of the following months, Circuit City liquidated hundreds of stores and continued to pay back its unsecured creditors.<sup>162</sup> On March 8, 2009, the final Circuit City store closed its door, marking the end of an era.<sup>163</sup>

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<sup>158</sup> *Id.*

<sup>159</sup> Ruthie Ackerman, [Short Fuse at Circuit City](#), *Forbes*, January 17, 2009. (Last visited April 25, 2013).

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> [About.com, Circuit City's Final Sales Day: Key Indicators Found in Chapter 11 of the US Retail Industry Story](#), March 8, 2009 available at [retailindustry.about.com/b/2009/03/08/circuit-citys-final-sales-day-key-indicators-found-in-chapter-11-of-the-us-retail-industry-story.htm](http://retailindustry.about.com/b/2009/03/08/circuit-citys-final-sales-day-key-indicators-found-in-chapter-11-of-the-us-retail-industry-story.htm). (Last visited April 25, 2013).

<sup>163</sup> *Id.*

### C. Stalking Horse Systemax

On April 16, 2009, the Bankruptcy Court approved a motion setting out the sale of intellectual property, internet-related property and customer information with stalking horse buyer Systemax.<sup>164</sup> Systemax Inc. is a large American company that specializes in the sales of personal computers, consumer electronics, computer supplies, and industrial products.<sup>165</sup> Based out of Port Washington, N.Y., the company published a statement on April 13, 2009 stating their intentions for the purchase of Circuit City's assets.<sup>166</sup> The proposed plan was for Systemax to purchase the assets of Circuit City's e-commerce business since all of the physical Circuit City locations were liquidated and closed. The agreed price was a measly \$6.5 million in cash and a share of future revenue generated utilizing the assets over a 30-month period. Systemax aimed to become the leader in online electronics retail and their acquisition of defunct retail CompUSA showed their dedication.<sup>167</sup> Although the company simply existed in name only, Circuit City still had a place in the retail industry as Systemax's online electronic retailer. This continued on until it was announced on November 2, 2012 that amid declining sales, Systemax would discontinue usage of the Circuit City name and simply operate as Tiger Direct.<sup>168</sup> After over 60 years of electronics retail success, the Circuit City name mercifully shook loose its mortal coil.

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<sup>164</sup> [Systemax Order.](#)

<sup>165</sup> [Systemax Inc. Signs Stalking Horse Purchase Agreement for Circuit City E-Commerce Business, April 13, 2009.](#)

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> [Steve Smith, Systemax To Cut Circuit City, CompUSA Brands, Exit PC Manufacturing, November 2, 2012, available at www.twice.com/articletype/news/systemax-cut-circuit-city-compusa-brands-exit-pc-manufacturing/103788.](#)

## D. Legal Fees

From the very start of the bankruptcy proceedings, Circuit City retained legal counsel of McGuireWoods LLP. McGuireWoods is a large law firm with over 900 lawyers in 19 offices worldwide.<sup>169</sup> For the Circuit City chapter 11 case, attorneys from the Norfolk and Richmond Virginia offices were used. The attorneys assigned to the case were, Daniel Blanks, Sarah Boehm, Douglas Foley, Dion Hayes, and Joseph Sheerin. McGuireWoods LLP worked on the Circuit City chapter 11 bankruptcy from November 10, 2008, the start of the bankruptcy through July 31, 2010, the last date the firm requested compensation.<sup>170</sup> The final order authorizing payment lists a total amount of reimbursement of expenses by the Liquidating Trustee of Circuit City was \$149,857.55 while the unpaid portion still owed to McGuireWoods LLP was \$5,729,451.25.<sup>171</sup> A detailed application for compensation by McGuireWoods LLP provides more insight into how Circuit City amassed such a large attorney's fee.<sup>172</sup> The detailed application shows hours and expenses from a period of November 10, 2008 through January 31, 2009. McGuireWoods LLP charged on an hourly rate based on its attorneys and paraprofessional's rates, which are set by each individual's seniority and experience.<sup>173</sup> The firm also charged Circuit City for out of pocket expenses stemming from photocopying, travel expenses, phone calls, and court fees, among others. At the time of filing the first application for reimbursement, the firm held a retainer of \$348,500.00 from Circuit City. During the time of the application, attorneys working on the Circuit City were paid an hourly rate ranging from \$190.00

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<sup>169</sup> [Mcguirewoods.com/our-firm/firm-profile.aspx](http://Mcguirewoods.com/our-firm/firm-profile.aspx).

<sup>170</sup> Order Granting Compensation.

<sup>171</sup> *Id.*

<sup>172</sup> [First Application for Reimbursement](#).

<sup>173</sup> *Id.*

to \$805.00. In terms of hours, the busiest attorney booked 319.4 hours during one calendar year, while the majority of the attorneys logged less than 50 hours in a calendar year. Over the 2008 and 2009 years, McGuireWoods LLP attorneys billed over 1800 hours on the matter for a fee of \$773,022.00. Among paraprofessionals, McGuireWoods LLP billed over 800 hours for a total fee of \$133,171.25. The grand total simply for labor was \$906,193.25, with an average hourly rate of \$436.54. Finally among notable expenses, McGuireWoods billed Circuit City a total of \$37,355.72.<sup>174</sup>

### **E. House Subcommittee**

As the final days of Circuit City's existence were winding down, interest was growing in how the plan to restructure was handled. The most interested party in all of this was no less than a House Subcommittee, which was focused on Commercial and Administrative Law.<sup>175</sup> The House Subcommittee on Commercial and Administrative Law met on March 11, 2009 and received testimony from professors and experts on bankruptcy law from around the nation, the report was titled: Circuit City Unplugged: Why did Chapter 11 Fail to Save 34,000 Jobs?<sup>176</sup> The actual report explained the basics of how bankruptcy functioned and the ideals chapter 11 hopes to achieve. The issue the committee was discussing was that many in the bankruptcy community feel as though chapter 11 no longer works as Congress intended in light of 2005 amendments in the Bankruptcy Code. The amendments the Committee refers to is the Bankruptcy Abuse, Prevention and Consumer Protection act of 2005 which was part of the major overhaul of the Code that took place that year. One of the key aspects for the 2005 changes was

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<sup>174</sup> *Id.*

<sup>175</sup> Did bad bankruptcy Laws Doom Circuit City? Cbsnews.com.

<sup>176</sup> Circuit City Unplugged: Why Did Chapter 11 Fail to save 34,000 Jobs?



to help balance the relationship between the vendors and shopping-center landlords. The big issue BAPCPA tried to address was the issue of a debtor simply squatting in a location they have already leased while they were working through chapter 11. This caused issues where stores in malls and shopping centers would go unused, which would have the potential to empty a whole mall if enough vendors were struggling through chapter 11. Among those who offered testimony, Richard M. Pachulski of Pachulski Stang Ziehl & Jones, LLP offered interesting insight into three ways chapter 11 had failed Circuit City. The three factors were the general downturn in the US economy, the tight credit market which led to a great lack of any DIP financing, and section 503(b)(9) of the Bankruptcy Code. The first aspect was very clear as there was a significant decrease in customers coming into the store and the customers were limited because they had borrowed too much from credit cards and loans. The second factor was the reduction in financing available to Circuit City before they filed chapter 11 bankruptcy. A few weeks before filing the company was only able to borrow \$50 million, which was not nearly enough to keep the business afloat. The DIP financing received was also a large factor as the banks required Circuit city to pay \$30 million in fees for the \$50 million in credit. Further, they had to work on a very tight timeline on the sale of the business and the banks had the ability to call a default for almost any reason. The final issue was section 503(b)(9), which as Mr. Pachulski states, “upon its enactment in 2005 was that goods received by a debtor within 20 days before the date of the commencement of the Chapter 11 case would be provided administrative-claim status. In order to confirm a plan of reorganization, administrative claims must be paid in full on the effective date of a plan of reorganization.” This terrible encumbrance meant that Circuit City had to pay \$215 million before they could have a reorganization plan accepted. Many of the other experts who appeared at the congressional hearing shared Mr. Pachulski’s

opinions and offered more opinions on how the efforts to make chapter 11 move more swiftly had hurt those in chapter 11 significantly.<sup>177</sup> Although none of the problems faced by Circuit City were solved at the House Subcommittee that day, the fact that they met at all spoke volumes about the impact Circuit City's failure had. It once again proved that the right mixture of bad circumstances can topple even the biggest companies. It also illustrated how desperate times were during the period of 2008 to 2009 in terms of the economy and consumers access to credit. Finally, the Circuit City collapse showed the genuine issues with the chapter 11 as a whole, as within a period of three months the company had entered chapter 11 and then been liquidated. Clearly the reform was brought about to keep Circuit City from sitting about trying to make decision while local landlords suffer; however, 34,000 employees suffered in the end because of the problems with chapter 11.

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<sup>177</sup> *Id.*

## Appendix A

# Circuit City



- Founded by Sam Wurtzel as WARDS Company in 1949
- Specialized in consumer electronics market
- Began expanding in 1965
- Implemented Superstore Concept in 1974

## Brief History

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- Started by acquiring numerous electronics retailers from NY to CA
- “Wards Loading Dock”
- 40,000 sq. feet with over 2,000 products
- High volume of sales allowed the company to offer lower prices than competitors
- Service incentives
- 1979 saw \$120 million in sales

## **Superstore Concept**

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- Expanded superstore concept and named the outlets “Circuit City Superstores”
- In 1982 Wards had four retail chains
- Consolidated to Circuit City, INC. in 1984
- Alan Wurtzel named chairman of the board
- Began replacing smaller stores with superstores.
- 113 stores by 1984

## **1980's**

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- Sales reach \$1 Billion in 1987
- Fueled by demand of VCR's, TV's, Cordless telephones, and microwave ovens.
- 155 stores by 1988
- Planned outlets called Impulse
- 1989 profits of \$69.5 million and overall sales hit \$2 Billion

## 1980's Continue

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- 1993 price war with Best Buy, INC.
- Circuit City vs. Best Buy



## Competition

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- Circuit City claimed the aggressive style of selling was working.
- Continued to expand in the same way as the 1980's.
- Best Buy had more modern-looking stores in more prominent areas.
- Surpassed Circuit City in 1996

## Circuit City vs. Best Buy

Circuit City	2002	2001	2000	1999	1998	1997	1996	1995	1994
Rev. \$Bil.	12.8	12.9	12.6	10.8	8.87	7.66	7.03	5.58	4.13
% Growth	(.7)	2.4	16.7	21.8	15.8	9	26	35	26.3
% Equity Return	8.6	7.9	6.9	16.9	8.5	7.1	18.5	21.1	20.6
Overall Growth	6								

Best Buy	2002	2001	2000	1999	1998	1997	1996	1995	1994
Rev. \$Bil.	19.6	15.3	12.5	10.1	8.34	7.76	7.22	5.08	3
% Growth	28	22.6	24	20.7	7.5	7.5	42	70	85
% Equity Return	22.6	26.2	27.1	32.6	27.2	19	10.7	15.4	13.2
Overall Growth	20.3								

- Wal-Mart attacks extended warranties
- 1% fall in warranty revenue = 29 % fall in operating profit
- Fourth Quarter profit alone fell 5%, which included the holiday season
- Lowe's
- Home Depot

## Other Competition

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### DivX

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- DivX Technology introduced in 1998
- Failed because of DVD's
- \$233 million investment

### CarMax

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- Introduced in 1993
- Fixed the fragmented used car industry
- 1997 IPO raised \$438 mil
- Only a few months later stock was down from \$20/share to \$12.50
- \$150 mil less than IPO
- Lost \$23.5 mil in 1998

## Trying to Stay Ahead

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- June 2000, Alan McCollough took over as President and CEO
- Announced exit from appliance market in a \$1.2 billion, three-year overhaul of 573 stores
- Lost appliance customer and traffic

## **Exit the Appliance Market**

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- Best Buy had strategic lease agreements and location compared to Circuit City's inconvenient location.
- Wanted to make stores more self-service and consumer-friendly
- Sales staff remained on commission

## **Store Restructuring**

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- 2003 sales force moved to hourly pay nationwide
- 3,900 layoffs
- Left Circuit City in weak market position and CompUSA, INC. offered to acquire the company for \$1.5 billion

## **Ending the Commissioned Sales Force**

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- Best Buy launched Geek Squad in 2002 which had revenues over \$1 Billion in 2009.
- Circuit City launched Firedog in 2006 and could not compete



## **Late Better than Never?**

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- 2004, Philip Schoonover appointed VP
- Eliminated 3,400 sales associates in one day
- Schoonover and other top executives receive bonuses a few months later.

## **Lost Talent**

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- Circuit City's reaction to Best Buy's expansion was to do nothing and refused to acknowledge they could be challenged by a small company.
- Alan McCollough's tenure lasted 5 years. His record recognized a -50.4% shareholder return, -15.6 S&P Index Return but he received \$12.2 million as CEO

## **Arrogance Leads to Bankruptcy**

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- Blockbuster offered \$1 billion for Circuit City in 2008 and quickly withdrew their offer.
- Schnoonover was forced to step down
- Awarded “worst manager of 2008” by Bloomberg BusinessWeek
- Nov. 3 announced closing of 155 stores
- Filed bankruptcy on Nov. 10

**2008**

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- On November 10, 2008 Circuit City announced its bankruptcy
- The Bankruptcy was filed in the US Bankruptcy Court for the Eastern District of Virginia, Richmond Division

**Beginning of Chapter 11**

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- Executive VP and CFO of Circuit City issued a declaration describing their plan and supporting their first day motions
  - The plan had the goal of obtaining three types of relief to meet their long term turnaround
    - Approval of adequate post petition financing
    - Authorization to continue the Store Closing Sales
    - Rejection of unnecessary unexpired leases of real property
- 

- Circuit City stated the following regarding their first day motions:
  - They are vital to enable the Debtors to make the transition to, and operate in, chapter 11 with a minimum interruption or disruption to their business or loss of productivity or value
  - They constitute a critical element in achieving the Debtors' successful reorganization

## **First Day motions**

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- Circuit City filed 21 first day motions
- The majority of the first day motions were for orders pursuant to the Bankruptcy Code sections:
  - 105
  - 363
  - 364
  - 1107a
  - 1108

## **First Day Motions**

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- Circuit City filed five administrative motions
  - Request a first day hearing on the Petition Date to consider the relief requested in each of the Motions
  - Seek to have the Debtors' bankruptcy cases jointly administered
  - Seek retention of Kurtzman Carson Consultants, LLC as claims, noticing and balloting agent
  - Seek approval of case management procedures
  - Request authority to file a consolidated list of the largest unsecured creditors

## **Administrative Motions**

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- Circuit City filed a motion for interim and final orders authorizing post petition financing
- Prior to the DIP financing Circuit City was using an asset backed loan
- The company requested an initial amount of \$1.1 billion which would be reduced to \$900 million following the holiday season
- Circuit City was granted automatic stay in line with the DIP agreement

## DIP Financing

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- The Carve-Out allowed administrative expenses, expenses incurred by the Statutory Committee, and “Case Professionals” up to an amount of \$3,000,000 as long it is approved by the bankruptcy court
  - In the event of default the DIP financing would be terminated and the DIP lenders would be able to seek remedy
-

- Circuit City had a great number of leases which needed to be exited
- On the 29<sup>th</sup> of December 2008 Circuit City was allowed to sell and exit unexpired nonresidential real property leases free and clear of liens, claims and encumbrances
- Circuit City closed 155 stores


## **363 Sale**

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- On November 18, 2008 there was hope of a recovery, as Mexican billionaire Ricardo Salinas Pliego emerged as the largest shareholder
- Salinas accumulated 28.5% of Circuit City
- Salinas also hinted at purchasing the company out of Chapter 11
- At that point shares in the company were 20 cents per share


## **Hope for Purchaser**

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- After filing for bankruptcy, sales were down by 50%, despite the holiday shopping season
  - On January 10, 2009 Circuit City announced that if a buyer was not found by the 16<sup>th</sup> the company would permanently shut down
  - Circuit City claimed to have interest from two unnamed potential purchasers, however that never materialized

## **Hopes Dashed**


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- On January 16, 2009 Circuit City announced that it would liquidate its assets and close down all stores
  - A total of 567 US stores would be liquidated

## **The End**


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- Circuit City reached an agreement with the following liquidators:
    - Great American Group
    - Hudson Capital Partners
    - SB Capital Group
    - Tiger Capital Group

## **Liquidation**

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- The last Circuit City store closed on March 8, 2009
  - More than 30,000 workers lost their jobs over the course of Circuit City's bankruptcy

## **Last Day of Business**

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- In April 2009 Circuit City was authorized to accept bids on the remaining assets of the company
- The highest bidder was announced on May 13, 2009 as Systemax
- The purchase price for the assets of Circuit City was \$14 million and included the brand name, trademarks and website
- On November 2 2012 Systemax cut the Circuit City brand

## **Stalking Horse**

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