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Co-Counsel to the Debtors

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION**

In re:)	Case No. 07-33849
)	Jointly Administered
MOVIE GALLERY, INC., et al., ¹)	Chapter 11
)	Hon. Douglas O. Tice, Jr.
Debtors.)	

**NOTICE OF MOTION OF THE DEBTORS FOR AN ORDER AUTHORIZING THE
DEBTORS TO PAY LIMITED LIQUIDATION AND CLOSURE PERFORMANCE
BONUSES AND SEVERANCE PAYMENTS IN CONNECTION WITH POTENTIAL
STORE CLOSING SALES AND NOTICE OF HEARING UPON OBJECTION**

PLEASE TAKE NOTICE THAT the above-captioned debtors (collectively, the “Debtors”) have filed with the Court the Motion of the Debtors for an Order Authorizing the Debtors to Pay Limited Liquidation and Closure Performance Bonuses and Severance Payments in Connection with Potential Store Closing Sales (the “Motion”).

¹ The Debtors in these proceedings are: Movie Gallery, Inc.; Hollywood Entertainment Corporation; M.G. Digital, LLC; M.G.A. Realty I, LLC; MG Automation LLC; and Movie Gallery US, LLC.



PLEASE TAKE FURTHER NOTICE THAT your rights may be affected. You should read these papers carefully and discuss them with your attorney, if you have one in these bankruptcy cases. (If you do not have an attorney, you may wish to consult one.)

PLEASE TAKE FURTHER NOTICE THAT in connection with the Debtors' chapter 11 cases, an Order Establishing Certain Notice, Case Management and Administrative Procedures [Docket No. 88] (the "Case Management Order") was entered by the Court on October 17, 2007, which, among other things, prescribes the manner in which objections must be filed and served and when hearings will be conducted. A copy of the Case Management Order may be obtained at no charge at www.kccllc.net/moviegallery or for a fee via PACER at www.vaeb.uscourts.gov/.

PLEASE TAKE FURTHER NOTICE THAT if you do not timely file and serve a written objection to the relief requested in the Motion, the Court may deem any opposition waived, treat the Motion as conceded and enter an order granting the relief requested in the Motion without further notice or a hearing.

PLEASE TAKE FURTHER NOTICE THAT in accordance with the Case Management Order, if you wish to oppose the Motion, **on or before 5:00 p.m. prevailing Eastern Time January 25, 2008, or such shorter time as the Court may hereafter order and of which you may receive subsequent notice (the "Objection Deadline")**, you must file with the Court, at the address shown below, a written objection pursuant to Local Bankruptcy Rule 9013-1 and the Case Management Order:

Clerk of the Court
United States Bankruptcy Court
1100 East Main Street, Room 301
Richmond, Virginia 23219

PLEASE TAKE FURTHER NOTICE THAT in accordance with the Case Management Order, you must also serve a copy of your written objection on the Core Group, the 2002 List and the Affected Entities, as such terms are defined in Exhibit 1 to the Case Management Order so that the documents **are received on or before the Objection Deadline.**

PLEASE TAKE FURTHER NOTICE THAT no hearing is requested in this matter. If an objection is filed, however, the matter will be scheduled for the next applicable Omnibus Hearing, as such term is defined in Exhibit 1 of the Case Management Order, which hearing will be conducted on **January 29, 2008** at 10:00 a.m. prevailing Eastern Time, in the United States Bankruptcy Court, 1100 East Main Street, Room 335, Richmond, Virginia 23219.

PLEASE TAKE FURTHER NOTICE THAT you should consult the Case Management Order before filing any written objection to the Motion.

Richmond, Virginia
Dated: January 18, 2008

/s/ Peter J. Barrett

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**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION**

In re:)	Case No. 07-33849
)	Jointly Administered
MOVIE GALLERY, INC., et al., ¹)	Chapter 11
)	Hon. Douglas O. Tice, Jr.
Debtors.)	
)	

**MOTION OF THE DEBTORS FOR AN ORDER AUTHORIZING THE DEBTORS TO
PAY LIMITED LIQUIDATION AND CLOSURE PERFORMANCE BONUSES AND
SEVERANCE PAYMENTS IN CONNECTION WITH POTENTIAL STORE CLOSING
SALES**

The above-captioned debtors (collectively, the “Debtors”) hereby move the Court, pursuant to this motion (the “Motion”), for the entry of an order, substantially in the form of Exhibit A, authorizing the Debtors to pay limited liquidation and closure performance bonuses

¹ The Debtors in these proceedings are: Movie Gallery, Inc.; Hollywood Entertainment Corporation; M.G. Digital, LLC; M.G.A. Realty I, LLC; MG Automation LLC; and Movie Gallery US, LLC.

and severance payments in connection with potential store closing sales. In support of this Motion, the Debtors respectfully state as follows:

Jurisdiction

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).

2. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

3. The statutory basis for the relief requested herein is section 363 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”).

Background

4. On October 16, 2007 (the “Commencement Date”), each of the Debtors filed a petition with the Court under chapter 11 of the Bankruptcy Code (collectively, the “Chapter 11 Cases”). The Debtors are operating their businesses and managing their property as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No request for the appointment of a trustee or examiner has been made in these Chapter 11 Cases. On October 18, 2007, the Court entered an order jointly administering the Debtors’ Chapter 11 Cases pursuant to Bankruptcy Rule 1015(b). On October 18, 2007, the United States trustee appointed an official committee of unsecured creditors pursuant to section 1102 of the Bankruptcy Code (the “Committee”).

5. The Debtors are the second largest North American home entertainment specialty retailer. They currently operate approximately 3,640 retail stores located throughout all 50 states. They rent and sell DVDs, videocassettes and video games through three distinct brands — Movie Gallery, Hollywood Video and Game Crazy.

6. In 2006, the aggregate annual revenues of the Debtors and their non-Debtor affiliates, including rental revenue and product sales, exceeded \$2.5 billion. Of this amount, approximately 56% was attributed to DVD rentals, 15% to the sale of previously-rented DVDs, VHS cassettes and video games, 13% to the sale of new and used gaming products, 7% to game rentals, 4% to the sale of concessions and other miscellaneous products, 3% to the sale of movie-related products and merchandise and 2% to VHS cassette rentals. As of December 2, 2007, the Debtors and their non-Debtor affiliates employed approximately 38,400 employees, including approximately 6,800 full-time employees and 31,600 part-time employees.

7. Several factors led to the filing of these Chapter 11 Cases. First, the video rental industry is highly competitive. The Debtors face direct competition from competitors such as Blockbuster and Netflix and indirect competition from pay-per-view, cable television and big-box retailers who sell DVDs at increasingly lower prices. Furthermore, recent box office receipts of rental releases have declined over the previous year, contributing to an industry-wide decline in demand for video rentals. Finally, as the Debtors' financial performance deteriorated, they experienced contracting trade terms, which had a negative impact on the Debtors' liquidity, which, in turn, contributed to the Debtors' inability to comply with certain financial covenants under their credit agreements.

8. Prior to the Commencement Date, the Debtors conducted an extensive review of their store portfolio with the objective of identifying and closing unprofitable store locations. In August, 2007, the Debtors commenced store closing sales at approximately 70 locations, which were closed upon completion of the store closing sales. On September 25, 2007, the Debtors announced their decision to close approximately 520 additional store locations (the "Phase I

Locations”) and, immediately thereafter, the Debtors began the process of winding down operations and liquidating inventory at those store locations.

9. Pursuant to the Amended Order (A) Authorizing the Debtors to Conduct Store Closing Sales, (B) Approving Procedures with Respect to Store Closing Sales and (C) Authorizing the Debtors to Pay Limited Liquidation and Closure Performance Bonuses and Severance Payments in Connection with Store Closing Sales [Docket No. 872] (the “Store Closing Sales Order”), the Debtors continued to conduct, in their sole discretion, store closing sales to effectuate the liquidation of inventory, fixtures and equipment at the Phase I Locations (with future store closing sales, collectively, the “Store Closing Sales”).

10. Since the Commencement Date, the Debtors have continued to evaluate their store portfolio and are in the process of identifying additional underperforming or unprofitable store locations (the “Potential Store Closure Locations”).² As such, the Debtors’ current intentions are to conduct additional Store Closing Sales, in their sound business judgment, pursuant to the Store Closing Sales Order and, subsequently, close the Potential Store Closure Locations.

11. To ensure that the Debtors retain sufficient personnel to conduct the Store Closing Sales at the Potential Store Closure Locations, the Debtors request the authority, in their sole discretion, to pay limited liquidation and closure performance bonuses to various district and store-level employees to incentivize them to continue work from the time the Debtors announce any Potential Store Closure Locations through the closure of any Potential Store Closure Locations, notwithstanding that many of these employees will be terminated after completion of

² As of the filing of this Motion, the Debtors may close in the near future several hundred underperforming or unprofitable Potential Store Closure Locations as part of a “Phase II” store closure initiative (collectively, the “Phase II Locations”) and may determine to close additional locations.

the Store Closing Sales (the “Liquidation and Closure Performance Bonuses”). In no event will a Liquidation and Closure Performance Bonus exceed \$1.00 per hour worked per store-level employee from the time the Debtors announce any Potential Store Closure Locations through the closure of any Potential Store Closure Locations, \$100.00 per week per store director or store manager from the time the Debtors announce any Potential Store Closure Locations through the closure of any Potential Store Closure Locations and \$2,000.00 in total per district manager. The Store Closing Sales are anticipated to last between three and seven weeks, on average, at the Potential Store Closure Locations and the Debtors intend to close such locations thereafter. As such, the Debtors will pay the Liquidation and Closure Performance Bonuses after the completion of each Store Closing Sale or the closure of each Potential Store Closure Location for affected store-level employees, store directors and store managers. For district managers, the Debtors will pay Liquidation and Closure Performance Bonuses after the completion of all Store Closing Sales or the closure of all Potential Store Closure Locations within a particular district. The Debtors estimate that the average Liquidation and Closure Performance Bonuses are not expected to exceed \$1,200 for any individual Potential Store Closure Location.

12. In addition, the Debtors request authority to pay severance benefits to district managers whose positions will be eliminated as a result of the Debtors’ closure of the Potential Store Closure Locations (the “Severance Payments”). The Debtors estimate that the Severance Payments are not expected to exceed \$5,000 for any individual district manager and, in no event, will payments exceed \$10,000 for any individual district manager.

13. There are no “insiders” of the Debtors, within the meaning of section 503(c) of the Bankruptcy Code, that are eligible for either the Liquidation and Closure Performance Bonuses or the Severance Payments.

14. As part of the Store Closing Sales Order, the Court previously authorized performance bonuses and severance payments with respect to the Phase I Locations consistent with the Liquidation and Closure Performance Bonuses and Severance Payments requested herein. See Store Closing Sales Order, ¶¶ 5 and 6. Based on the Debtors’ experience with the Phase I Locations, the Debtors believe that the aggregate amount of the Liquidation and Closure Performance Bonuses and Severance Payments for the Phase II Locations is not expected to exceed \$1 million.

Relief Requested

15. By this Motion, the Debtors seek the entry of an order authorizing the Debtors, in their sole discretion, to pay Liquidation and Closure Performance Bonuses and Severance Payments in connection with potential Store Closing Sales.

Basis for Relief

16. Section 363(b) of the Bankruptcy Code provides that a debtor “after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.” To approve a use, sale or lease of property other than in the ordinary course of business, the court must find “some sound business purpose.” See In re W.A. Mallory Co., 214 B.R. 834, 836 (Bankr. E.D. Va. 1997); see generally In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).

17. Courts generally show great deference to a debtor’s decisions when applying the business judgment standard. See In re Global Crossing, Ltd., 295 B.R. 726, 744 n.58 (Bankr.

S.D.N.Y. 2003) (“[T]he Court does not believe that it is appropriate for a bankruptcy court to substitute its own business judgment for that of the [d]ebtors and their advisors, so long as they have satisfied the requirements articulated in the caselaw.”). Deference is inappropriate only if such business judgment is “so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.” Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1047 (4th Cir. 1985).

18. As set forth herein, sound business reasons exist to justify the Debtors paying Liquidation and Closure Performance Bonuses and Severance Payments. The Debtors submit that obtaining the authority to pay Liquidation and Closure Performance Bonuses and Severance Payments prior to commencing the Store Closing Sales at the Potential Store Closure Locations is necessary to ensure that employees, many of whom may be faced with increased responsibility and imminent termination of employment, continue to fulfill their employment obligations prior to, and throughout, the potential Store Closing Sales.

19. The relief requested herein would permit the Debtors to notify their employees of the Liquidation and Closure Performance Bonuses and the Severance Payments prior to any announcements of potential Store Closing Sales, thereby providing employees in the field sufficient incentive to continue their employment with the Debtors. The Debtors believe that without this ability to announce Liquidation and Closure Performance Bonuses and the Severance Payments prior to the potential Store Closing Sales, many employees simply would leave their positions rather than wait for the Debtors to obtain the relief requested herein, which relief, if requested at that time, potentially may not be granted until after the conclusion of the Store Closing Sales. If too many employees leave, the Debtors would be faced with the possibility of

conducting Store Closing Sales without adequate staffing, thereby diminishing the value that could be realized through the Store Closing Sales. Furthermore, if the Debtors are able to conduct Store Closing Sales more efficiently through the use of Liquidation and Closure Performance Bonuses and Severance Payments, the Debtors can minimize any accrual of administrative expenses by rejecting, terminating or assuming and assigning unnecessary unexpired leases pursuant to section 365 of the Bankruptcy Code or otherwise as early as possible for the benefit of the Debtors' estates and their creditors.

Notice

20. Notice of this Motion has been given to the Core Group and the 2002 List as required by the Case Management Procedures.³ In light of the nature of the relief requested, the Debtors respectfully submit that no further notice is required.

No Prior Request

21. No prior motion for the relief requested herein has been made to this or any other court.

³ Capitalized terms used in this paragraph 20 but not otherwise defined herein shall have the meanings set forth in the Notice, Case Management and Administrative Procedures established by the Order Establishing Certain Notice, Case Management and Administrative Procedures [Docket No. 88] entered on October 17, 2007.

WHEREFORE, for the reasons set forth herein, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto as Exhibit A, (a) authorizing the Debtors to pay Liquidation and Closure Performance Bonuses and Severance Payments to certain employees in connection with Store Closing Sales and (b) granting such other and further relief as is just and proper.

Richmond, Virginia
Dated: January 18, 2008

/s/ Peter J. Barrett

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EXHIBIT A

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In re:)	Case No. 07-33849
)	Jointly Administered
MOVIE GALLERY, INC., et al., ¹)	Chapter 11
)	Hon. Douglas O. Tice, Jr.
Debtors.)	

**ORDER AUTHORIZING THE DEBTORS TO PAY LIMITED LIQUIDATION AND
CLOSURE PERFORMANCE BONUSES AND SEVERANCE PAYMENTS IN
CONNECTION WITH POTENTIAL STORE CLOSING SALES**

Upon the motion (the “Motion”)² of the above-captioned debtors (collectively, the “Debtors”) for the entry of an order (the “Order”) authorizing the Debtors to pay limited liquidation and closure performance bonuses and severance payments in connection with potential store closing sales; it appearing that the relief requested in the Motion is in the best interests of the

¹ The Debtors in these proceedings are: Movie Gallery, Inc.; Hollywood Entertainment Corporation; M.G. Digital, LLC; M.G.A. Realty I, LLC; MG Automation LLC; and Movie Gallery US, LLC.

² Capitalized terms used but not otherwise defined herein shall have the meanings set forth in the Motion.

Debtors' estates, their creditors and other parties in interest; the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157 and 1334; consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); venue being proper before the Court pursuant to 28 U.S.C. §§ 1408 and 1409; proper notice of the Motion having been provided to all necessary and appropriate parties, including pursuant to the Order Establishing Certain Notice, Case Management and Administrative Procedures [Docket No. 88] entered by the Court on October 17, 2007, and no further notice being necessary; and after due deliberation and sufficient cause appearing therefor, it is hereby **ORDERED, ADJUDGED and DECREED** that

1. The Motion is granted in its entirety.
2. The Debtors are authorized, in their sole discretion, to pay Liquidation and Closure Performance Bonuses in connection with potential Store Closing Sales; provided that the Liquidation and Closure Performance Bonuses shall not exceed \$1.00 per hour worked per store-level employee from the time the Debtors announce any Potential Store Closure Locations through the closure of any Potential Store Closure Locations, \$100.00 per week per store director or store manager from the time the Debtors announce any Potential Store Closure Locations through the closure of any Potential Store Closure Locations and \$2,000.00 in total per district manager; provided, further that no Liquidation and Closure Performance Bonuses will be paid to an "insider" of the Debtors within the meaning of section 503(c) of the Bankruptcy Code.
3. The Debtors are authorized, in their sole discretion, to provide Severance Payments to eligible district managers; provided that no Severance Payments will be paid to an "insider" of the Debtors within the meaning of section 503(c) of the Bankruptcy Code.

4. The Debtors are authorized to take all actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Motion.

5. The terms and conditions of this Order shall be immediately effective and enforceable upon its entry.

6. The Court retains jurisdiction with respect to all matters arising from or related to the implementation of this Order.

United States Bankruptcy Judge

We ask for this:

/s/ Peter J. Barrett

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