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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.)	
)	

**FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER EXTENDING THE
DEADLINE BY WHICH THE DEBTORS MUST ASSUME OR REJECT UNEXPIRED
LEASES OF NONRESIDENTIAL REAL PROPERTY**

On January 29, 2008, the Court heard argument on the Motion of the Debtors for an Order Extending the Deadline by Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property [Docket No. 1265] (the “Motion”) and several objections to the Motion (collectively, the “Objections”) filed on behalf of various landlord constituencies

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.



(collectively, the “Objecting Parties”).² In the Motion, the above-captioned debtors (collectively, the “Debtors”) sought approval of a 90-day extension of the deadline by which the Debtors must assume or reject unexpired leases of nonresidential real property pursuant to section 365(d)(4) of the Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”) without prejudice to the Debtors’ rights to seek further extensions of the time period to assume or reject such leases. The Objections, among other things, questioned whether section 365(d)(4) of the Bankruptcy Court permits the Court to grant the Debtors an extension of the 120-day period to assume or reject unexpired leases of nonresidential real property for the Debtors’ store locations (each, a “Lease” and collectively, the “Leases”) other than through the earlier of 90 days or the date of the entry of an order confirming a plan of reorganization. After hearing the respective arguments of counsel, the Court granted the Motion and overruled the Objections. For the reasons stated from the bench on January 29, 2008 (the “Hearing”) and herein, the Court will enter an order granting the Motion.

Findings of Fact³

1. 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

² The objections include eight objections that were filed opposing the relief requested in the Motion. See Docket Nos. 1310, 1313, 1315, 1317, 1318, 1323, 1324 and 1373.

³ This order constitutes the Court’s findings of fact and conclusions of law under Rule 52 of the Federal Rules of Civil Procedure, as made applicable by Rules 7052 and 9014 of the Federal Rules of Bankruptcy Procedure. Any and all findings of fact shall constitute findings of fact even if they are stated as conclusions of law, and any and all conclusions of law shall constitute conclusions of law even if they are stated as findings of fact.

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 Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). 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").

2. On December 22, 2007, after extensive negotiations with a number of their major creditor constituents, the Debtors filed (a) the Disclosure Statement to the Joint Plan of Movie Gallery, Inc. and Its Debtor Subsidiaries Under Chapter 11 of the Bankruptcy Code [Docket No. 1197], (b) the Plan and (c) the Motion of the Debtors for an Order Approving the Debtors' Disclosure Statement and Relief Related Thereto [Docket No. 1198]. As of February 4, 2008, the Court has not approved the Disclosure Statement and has not scheduled a hearing to consider confirmation of the Plan.

3. The time period within which the Debtors are required to assume or reject the Leases is set to expire on February 13, 2008. On January 9, 2008, the Debtors filed the Motion. The Debtors sought the extension requested in the Motion to further evaluate the profitability of the Leases and make decisions, in their sound business judgment, to reject additional Leases pursuant to the Plan or otherwise.

The following paragraphs constitute representations to the Court by counsel to the Debtors, which representations the Court accepts and finds as facts for purposes of this order:

4. 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.

5. 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.

6. 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.

7. Much has been done to rehabilitate the Debtors, not only during the postpetition period, but also in the weeks and months leading up to the Commencement Date. Specifically, the Debtors, as part of their prepetition and ongoing restructuring efforts, continue to evaluate

their operations and assets to seek to maximize the value of their estates. This evaluation has been primarily focused on the Debtors' key assets, including their Leases for the Debtors' store locations. Since the Commencement Date, the Debtors have moved expeditiously, yet methodically, to shed approximately 550 unprofitable Leases of store locations that have consistently generated negative earnings through various rejection motions and notices pursuant to Court-approved procedures.

8. In addition to the Debtors' operational restructuring achievements to date, the Debtors have made substantial progress in developing a consensual plan of reorganization. In furtherance of the Debtors' attempts to negotiate a consensual chapter 11 plan, the Debtors have continued the productive dialogue that began prepetition. As a result of these discussions, the Debtors have negotiated an agreement with Sopris Capital Advisors LLC ("Sopris"), certain first lien holders, certain second lien holders and certain holders of the notes issued under the Debtors' 11% senior notes (collectively, the "Consenting Holders"), pursuant to which (a) the Consenting Holders will agree to, among other things, support the Joint Plan of Movie Gallery, Inc. and Its Debtor Subsidiaries Under Chapter 11 of the Bankruptcy Code filed with the Court on December 22, 2007 [Docket No. 1196] (as amended from time to time, the "Plan") and (b) Sopris will agree, among other things, subject to terms and conditions of the Plan Support Agreement, to a backstop equity commitment in accordance with the terms of the Plan.

Position of the Parties

9. The Debtors assert that the Court should approve the Motion because section 365(d)(4) of the Bankruptcy Code grants the Court authority to approve a 90-day extension of the period within which the Debtors must assume or reject the Leases. Moreover, the Debtors

assert that section 1123(b)(2) of the Bankruptcy Code permits the Debtors to provide for the treatment of, among other executory contracts and unexpired leases, the Leases pursuant to a plan, thereby permitting the Debtors to establish an effective date of assumption or rejection of any Lease after the date of the entry of an order confirming a plan is entered.

10. The Objecting Parties assert that section 365(d)(4) of the Bankruptcy Code provides that the Court may only grant an extension of the period within which the Debtors must assume or reject the Leases through the earlier of 90 days or the date of the entry of an order confirming a plan, and that the provisions of section 1123(b)(2) of the Bankruptcy Code are by their terms expressly subject to section 365 of the Bankruptcy Code.

Conclusions of Law

11. 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).

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

13. Section 365 (d)(4) of the Bankruptcy Code states, in relevant part:

(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of —

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B)(i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

11 U.S.C. § 365(d)(4). Accordingly, the Court may order, for cause, a 90-day extension of the period within which the Debtors must assume or reject the Leases, potentially subject to certain restrictions, upon the filing of a motion requesting such relief within the 120-day period.

14. The term “cause,” as used in section 365(d)(4), is not defined in the Bankruptcy Code. In determining whether cause exists for an extension of the 120-day period, courts have substantial discretion and generally have relied on several factors, including the following:⁴

- a. the significance of the leases to a debtor’s business and plan;
- b. whether rejection will produce a windfall to the landlord;
- c. whether the debtor has had sufficient time to appraise its financial situation and the potential value of the leases to the formulation of the plan;
- d. the complexity of the case and number of leases involved;
- e. whether the debtor has paid postpetition rent and generally complied with the lease obligations under the leases affected by the extension sought;
- f. whether landlords affected by the extension have suffered damages that are not compensable under the Bankruptcy Code; and
- g. other factors showing the lack of reasonable time to decide whether to assume or reject.

⁴ While the cases cited herein were decided prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the relevant criteria for determining whether an extension of the period within which the Debtors must assume or reject the Leases is appropriate remains the same. See Collier on Bankruptcy ¶ 365.04, at 365.04[4] (15th ed. rev. 2007) (stating that “although [section 365(d)(4) of the Bankruptcy Code] was extensively rewritten, much of the language tracks the prior provision, so much of the case law interpreting former section 365(d)(4) will remain applicable.”).

See In re 611 Sixth Ave. Corp., 191 B.R. 295, 298 (Bankr. S.D.N.Y. 1996); see also In re Serv. Merch. Co., Inc., 256 B.R. 744, 748 (Bankr. M.D. Tenn. 2000); In re Ernst Home Ctr. Inc., 209 B.R. 974, 980 (Bankr. W.D. Wash. 1997).

15. For the reasons stated in the Motion and from the bench at the Hearing, the Debtors have established that cause exists to grant an extension of the period within which the Debtors must assume or reject the Leases.

16. While the Court recognizes that section 1123(b)(2) of the Bankruptcy Code permits the Debtors to provide for the treatment of the Leases pursuant to a plan, subject to section 365 of the Bankruptcy Code, the dispute presently before the Court need not be determined at this time, and the language contained in this Order (as defined herein) reserves the rights of any party, including the Objecting Parties, the Lessors and the Debtors, to raise issues at the hearing to confirm any plan, if such hearing occurs prior to May 13, 2008, with respect to whether the Debtors are permitted to reject or assume the Leases after the date of the entry of an order confirming a plan.

WHEREFORE, upon the Motion of the Debtors for the entry of an order extending the deadline by which the Debtors must assume or reject the Leases (the “Order”) and the arguments made at the Hearing; it appearing that the relief requested in the Motion is in the best interests of the 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 on the terms of this Order.
2. The period by which the Debtors must assume or reject the Leases is hereby extended, pursuant to section 365(d)(4) of the Bankruptcy Code, for 90 days through and including May 13, 2008, subject to the provisions of any order entered by the Court confirming a plan in the Debtors' Chapter 11 Cases modifying such deadline.
3. The rights of the Objecting Parties, the Lessors and the Debtors to raise issues at the hearing to confirm any plan, if such hearing occurs prior to May 13, 2008, with respect to whether the Debtors are permitted to reject or assume the Leases after the date of entry of an order confirming a plan are specifically reserved.
4. The entry of this Order shall be without prejudice to (a) the rights of the Debtors to request and receive further extensions of the period by which the Debtors must assume or reject the Leases subject to section 365(d)(4) of the Bankruptcy Code, (b) the rights of any party to oppose such requests and (c) the rights of any party to oppose the Debtors' request to reject or assume any Lease.
5. The entry of this Order shall be without prejudice to the rights of any party under section 365 of the Bankruptcy Code, including the right, if any, to seek to compel the Debtors to assume or reject any Leases.

6. Nothing herein shall apply to the Lease for the premises located at 6301 Troost, Kansas City, Missouri, which Lease terminated by its own terms on December 31, 2007.

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

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

9. 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/ Michael A. Condyles

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Seen and objected to (but language agreed to):

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LOCAL RULE 9022-1(C)(2) CERTIFICATION

The undersigned hereby certifies that the foregoing proposed Findings of Fact, Conclusions of Law and Order Extending the Deadline by Which the Debtors Must Assume or Reject Unexpired Leases of Nonresidential Real Property (“Findings of Fact”) has been served upon all necessary parties, which necessary parties consist of the creditors and parties in interest constituting the Core Group and the 2002 List, as such terms are defined in that certain Order Establishing Certain Notice, Case Management and Administrative procedures [Docket No. 88] entered by the Court on October 17, 2007 and to the Objecting Parties. On February 5, 2008, service of the proposed Findings of Fact was effected on the aforementioned parties by electronic mail, overnight mail and/or first class mail, postage prepaid (only if electronic mail or overnight mail was unavailable).

/s/ Michael A. Condyles _____