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

In re:	)	Case No. 07-_____
	)	Jointly Administered
MOVIE GALLERY, INC., et al., <sup>1</sup>	)	Chapter 11
	)	
Debtors.	)	
	)	

**MOTION OF THE DEBTORS FOR AN ORDER (A) AUTHORIZING,  
BUT NOT DIRECTING, THE DEBTORS TO PAY CERTAIN PREPETITION  
(I) WAGES, SALARIES, BONUSES AND OTHER COMPENSATION,  
(II) REIMBURSABLE EMPLOYEE EXPENSES AND (III) EMPLOYEE  
MEDICAL AND SIMILAR BENEFITS AND (B) AUTHORIZING  
AND DIRECTING BANKS AND OTHER FINANCIAL INSTITUTIONS TO  
HONOR ALL RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS**

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, (a) authorizing, but not directing, the Debtors to pay certain prepetition (i) wages, salaries, bonuses and other compensation, (ii) reimbursable employee expenses and (iii) employee medical and similar benefits and (b) authorizing and directing banks and other

<sup>1</sup> The Debtors in the cases include: Movie Gallery, Inc.; Hollywood Entertainment Corporation; M.G. Digital, LLC; M.G.A. Realty I, LLC; MG Automation LLC; and Movie Gallery US, LLC.



financial institutions to receive, process, honor and pay all checks presented for payment and electronic payment requests relating to the foregoing. In support of this Motion, the Debtors respectfully state as follows:<sup>2</sup>

### **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 bases for the relief requested herein are sections 105(a), 363(b), 507(a)(4), 507(a)(5), 541(b) and 1129(a)(9)(B) of the Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”).

### **Background**

4. On the date hereof (the “Commencement Date”), each of the Debtors filed a petition with the Court under chapter 11 of the Bankruptcy Code. 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, and no committees have been appointed or designated. Concurrently with the filing of this Motion, the Debtors have sought procedural consolidation and joint administration of these chapter 11 cases.

5. The Debtors are the second largest North American home entertainment specialty retailer. They currently operate approximately 4,200 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.

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<sup>2</sup> The facts and circumstances supporting this Motion are set forth in the Affidavit of William C. Kosturos, Chief Restructuring Officer of Movie Gallery, Inc., in Support of First Day Motions (the “First Day Affidavit”), filed contemporaneously herewith.

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.

7. Several factors have 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 has deteriorated, they have experienced contracting trade terms, which have had a negative impact on the Debtors' liquidity, which, in turn, has contributed to the Debtors' inability to comply with certain financial covenants under their credit agreements.

## **I. THE DEBTORS' WORKFORCE**

8. As of the Commencement Date, the Debtors and their non-Debtor affiliates employ approximately 38,800 employees (the "Employees"), of whom approximately 7,500 are full-time employees (the "Full-Time Employees") and approximately 31,300 are part-time employees (the "Part-Time Employees"). Approximately 33,600 Employees (86.6%) are paid on an hourly basis and approximately 5,200 Employees (13.4%) are paid salary. As of October 3, 2007, the Debtors' Movie Gallery business unit ("Movie Gallery") employed approximately 17,200 Employees and the Debtors' Hollywood Video business unit ("Hollywood") employed

approximately 20,100 Employees. Movie Gallery Canada, Inc., a non-Debtor entity, operates the Debtors' Canadian operations and employs approximately 1,500 Employees, each of whom are paid directly by Movie Gallery Canada, Inc.

9. The Employees perform a variety of critical functions, including customer service, inventory control, management, marketing, purchasing and sales, shipping, tax, technical services and other tasks. The Employees' skills and their knowledge and understanding of the Debtors' operations, customer relations and infrastructure are essential to the effective reorganization of the Debtors' businesses.

10. Therefore, to minimize the personal hardship that the Employees would suffer if prepetition Employee-related obligations are not paid when due or as expected and maintain morale and stability in the Debtors' workforce during this critical time, the Debtors, by this Motion, seek authority, to be exercised in their sole discretion, to pay and honor certain prepetition claims for, among other amounts, wages, salaries, commissions, bonuses and other compensation, federal and state withholding taxes and other amounts withheld (including, garnishments, Employees' share of insurance premiums, taxes and 401(k) contributions), health benefits, insurance benefits, workers' compensation benefits, vacation time, sick leave, life and accidental death and dismemberment insurance, short- and long-term disability coverage and all other benefits that the Debtors have historically provided in the ordinary course of business (collectively, and as more fully described below, the "Employee Wages and Benefits") and to pay all costs incident to the foregoing. The Debtors also seek authority, to be exercised in their sole discretion, to continue to reimburse Employees for various reimbursable expenses. In addition, the Debtors request the right to modify, change and discontinue any of the Employee Wages and Benefits, and the policy related to reimbursable expenses, and to implement new

Employee Wages and Benefits in the ordinary course of business during these chapter 11 cases in their sole discretion without the need for further Court approval.

## **II. EMPLOYEE OBLIGATIONS**

### **A. Unpaid Compensation**

11. In the ordinary course of business, the Debtors incur payroll obligations to the Employees. Such obligations generally comprise wages and salaries, but may also include incentive bonuses and commissions awarded for sales productivity and goal attainment. The Debtors pay their Employees periodic payments for wages and salaries, no less frequently than twice a month. Approximately half of the Debtors' payroll is made by direct deposit through electronic transfer of funds directly to Employees with the other half of Employees receiving checks. Of those Employees receiving payroll through electronic transfer of funds, approximately half receive their payroll at a bank account and half receive their payroll on an electronic pay card. On average, the Debtors have payroll expenses of \$41 million per month.

12. Because all of the Employees are paid in arrears, as of the Commencement Date, some of the Employees have not been paid all of their prepetition wages. Additionally, some Employees may be entitled to compensation because (a) discrepancies may exist between the amounts paid and the amounts that should have been paid and (b) some payroll checks issued to Employees prior to the Commencement Date may not have been presented for payment or may not have cleared the banking system and, accordingly, have not been honored and paid as of the Commencement Date.

13. The Debtors believe that, as of the Commencement Date, approximately \$18 million in accrued wages, salaries and other compensation (but excluding reimbursable expenses, commissions and vacation pay) earned prior to the Commencement Date remains unpaid to

Employees (the “Unpaid Compensation”).<sup>3</sup> The Debtors seek authority, but not direction, to pay prepetition amounts for Unpaid Compensation. The Debtors believe that no Employee is owed more than \$10,950 for Unpaid Compensation, commissions or cash for vacation pay in those states that require accrued vacation benefits to be paid to employees at the time of termination. Nevertheless, to the extent that the Debtors determine that any Employee holds claims greater than \$10,950 against the Debtors for Unpaid Compensation, vacation pay or commissions, the Debtors seek to pay such Employees the amount of any prepetition Unpaid Compensation, vacation pay or commissions that exceeds the \$10,950 cap imposed by sections 507(a)(4) and 507(a)(5). The Debtors believe that such payments are justified by the critical nature of the services provided by such Employees.

14. In addition, the Debtors procure the services of temporary workers and consultants who work on an hourly basis and whose services are procured through employment agencies. The Debtors remit compensation for the temporary workers’ services directly to the applicable employment agencies, which in turn pay the temporary workers (the “Temporary Compensation”). The Debtors incur approximately \$350,000 in Temporary Compensation obligations per month. The Debtors seek authority to pay any unpaid prepetition amounts for Temporary Compensation to the employment agencies and all costs incident thereto. In addition, the Debtors seek authority, but not direction, to continue to pay the Temporary Compensation in the ordinary course of business, as routinely done prior to the Commencement Date. The Debtors do not believe that any temporary worker or consultant is owed more than \$10,950.

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<sup>3</sup> All financial information is based on the Debtors’ last accounting period, which closed on September 2, 2007.

## **B. Deductions and Withholdings**

15. During each applicable pay period, the Debtors routinely deduct certain amounts from paychecks, including, without limitation, (a) garnishments, child support and similar deductions and (b) other pre-tax and after-tax deductions payable pursuant to certain of the Employee benefit plans discussed herein (such as an Employee's share of health care benefits and insurance premiums, contributions under flexible spending plans, 401(k) contributions, legally ordered deductions and miscellaneous deductions) (collectively, the "Deductions"). The Debtors forward the amount of the Deductions to the appropriate third-party recipients. On average, the Debtors have deducted approximately \$19.5 million from the Employees' paychecks per month. Due to the commencement of the chapter 11 cases, however, certain Deductions that were deducted from Employees' earnings may not have been forwarded to the appropriate third-party recipients prior to the Commencement Date. Accordingly, the Debtors seek authority to continue to forward these prepetition Deductions to the applicable third-party recipients on a postpetition basis, in the ordinary course of business, as routinely done prior to the Commencement Date.

16. Further, the Debtors are required by law to withhold from an Employee's wages amounts related to federal, state and local income taxes, social security and Medicare taxes for remittance to the appropriate federal, state or local taxing authority (collectively, the "Withheld Amounts"). The Withheld Amounts are approximately \$7.5 million per month. The Debtors must then match from their own funds for social security and Medicare taxes and pay, based on a percentage of gross payroll, additional amounts for federal and state unemployment insurance (the "Employer Payroll Taxes," and together with the Withheld Amounts, the "Payroll Taxes"). The Payroll Taxes, including both the employee and employer portions, for 2006 were

approximately \$11 million per month. Prior to the Commencement Date, the Debtors withheld the appropriate amounts from Employees' earnings for the Payroll Taxes but such funds may not yet have been forwarded to the appropriate taxing authorities. As a result, the Debtors seek authority, but not direction, to continue to honor and process the prepetition payments for the Payroll Taxes on a postpetition basis, in the ordinary course of business, as routinely done prior to the Commencement Date.

**C. Honoring Checks for, and Payment of, Reimbursable Expenses**

17. Prior to the Commencement Date and in the ordinary course of their business, the Debtors reimbursed Employees for certain expenses incurred on behalf of the Debtors in the scope of their employment (the "Reimbursable Expenses"). The Reimbursable Expenses include, without limitation, certain expenses for (a) car allowances, (b) business relocation expenses and (c) travel expenses for meals, hotels and rental cars.

18. The Debtors provide car allowances to certain Employees whose responsibilities require them to travel extensively (each, a "Car Allowance"). As of the Commencement Date, approximately 76 Employees receive a monthly Car Allowance at an aggregate cost to the Debtors of \$40,000 per month.

19. Moreover, the Debtors offer certain Employees reimbursement for relocation expenses to incentivize desirable candidates to accept positions with the Debtors (the "Relocation Expenses"). The Debtors spend approximately \$39,000 per month to compensate Employees for such Relocation Expenses. As of the Commencement Date, approximately \$160,000 in total Reimbursable Expenses remain unpaid.

20. The Reimbursable Expenses were all incurred on the Debtors' behalf and with the understanding that they would be reimbursed. Accordingly, to avoid harming Employees who

incurred the Reimbursable Expenses, the Debtors request authority, to be exercised in their sole discretion, to (a) continue reimbursing the Reimbursable Expenses in accordance with prepetition practices, (b) modify their prepetition policies relating thereto as they deem appropriate and (c) pay all Reimbursable Expenses that (i) accrued prepetition and (ii) accrue postpetition but relate to the prepetition period.

**D. Prepetition Employee Bonus Plans and Sales Commission Programs**

21. In the ordinary course of business, certain of the Debtors' Employees participate in quarterly or annual incentive-based bonus plans depending on their position and department. Salaried Employees who work at the Debtors' headquarters or the Debtors' distribution centers may be eligible for bonuses if the Debtors attain certain EBITDA targets. Full-Time hourly Employees in the Debtors' distribution centers who have been employed for at least 90 days may also be eligible to receive bonuses based on productivity, quality and safety. Further, retail managers, including store managers, district managers and regional managers responsible for overseeing operations at the Debtors' store locations may be eligible for certain bonuses based on maintaining certain behaviors that maximize revenue earned by their store, district or region.

22. As a result of lower than expected EBITDA in 2007, the Debtors revised their bonus plan for salaried Employees holding positions at the vice president level and below at the Debtors' headquarters and the Debtors' distribution centers. The amended 2007 bonus plan, which restates EBITDA targets for the fourth quarter, relates entirely to performance during the fourth quarter of the 2007 fiscal year. Additionally, the Debtors implemented a special one-time bonus plan for non-officer restricted stock recipients to cover any withholding tax liabilities related to the decrease in the value of the Debtors' stock in the period between the time the restricted stock vested in June 2007 and the time the restricted stock recipients were able to sell

their shares. The Debtors refer collectively to the bonus plans described herein as the “Bonus Plans.”

23. As of the Commencement Date, the Debtors’ obligations for the Bonus Plans are approximately \$5.0 million for all Employees at the retail and corporate level, which is approximately 1% of the Debtors’ total annual payroll. This includes an approximately \$1.0 million bonus payout under the amended 2007 bonus plan, payable to supervisors, managers, directors and vice presidents (and excluding senior vice presidents, executive vice presidents and presidents). Under all Bonus Plans, more than 5,000 Employees are entitled to receive bonuses and the maximum expected payout for any individual is \$10,500.

24. Prior to the Commencement Date, to incentivize store managers and Employees in their retail video, game and tanning stores to maximize sales, the Debtors offered various commissions programs (the “Commissions”). The Debtors’ obligations as of the Commencement Date for the Commissions are approximately \$215,000.

25. The Debtors hereby request the authority, to be exercised in their sole discretion, to continue paying amounts earned under the Bonus Plans and the Commissions in the ordinary course of business, to revise the Bonus Plans or the Commissions consistent with past practice and to pay any prepetition amounts related to the Bonus Plans or the Commissions.

### **III. EMPLOYEE BENEFITS**

#### **A. Medical, Dental and Vision Plans**

26. The Debtors offer their Employees the ability to participate in a number of insurance and benefits programs, including health care and dental plans, vacation time and other paid leaves of absence, retirement savings plans, flexible benefit plans, life insurance, accidental

death and dismemberment insurance, short-term and long-term disability insurance and accident insurance (collectively, the “Employee Benefit Programs”).

- a. Medical Plans: The Debtors’ primary medical, dental, vision and prescription drug plan for Full-Time Employees is the Movie Gallery/Hollywood Group Health Care and Dental Plan (the “Medical and Dental Insurance Plan”).<sup>4</sup> The Medical and Dental Insurance Plan is a self-insured plan that provides health care coverage to approximately 4,500 Employees and 4,000 dependents and dental care to approximately 4,500 Employees and 4,200 dependents. The Medical and Dental Insurance Plan is a self-funded welfare plan that costs the Debtors approximately \$1.5 million per month in gross claims and approximately \$150,000 per month in administrative fees to the third party administrator. Prior to the Commencement Date, the Debtors incurred certain administrative obligations to the third party administrator, which have not yet been paid. In addition, prior to the Commencement Date, certain Employees filed claims under the Medical and Dental Insurance Plan, which have not yet been paid.
- b. The Debtors also offer a fully-insured plan, HMSA Blue Cross Blue Shield Plan of Hawaii, to cover approximately six Employees located in Hawaii (the “Hawaii Plan”). This coverage costs the Debtors approximately \$1,500 in premiums per month.
- c. The Debtors provide a separate health care plan to the Part-Time Employees, the Aetna Affordable Health Choices Insurance Plan (the “Aetna Plan”), which includes medical, dental, term life and accidental death and short-term disability insurance. Premium contributions for the Aetna Plan are paid fully by the Part-Time Employees who participate in the program. The Debtors believe that they do not have any prepetition obligations under the Aetna Plan.
- d. The Debtors maintain excess insurance through Hilb, Rogal & Hobbs Company to cover any medical expenses under the Debtors’ Medical and Dental Insurance Plan that exceed \$150,000 per year per Employee up to a maximum payment of \$5.0 million per Employee per year (the “Stop Loss Insurance”). The Debtors pay a monthly premium of \$45,000 per month for the Stop Loss Insurance.

27. By this Motion, the Debtors seek authority, to be exercised in their sole discretion, to (a) continue the Medical and Dental Insurance Plan, the Hawaii Plan and the Aetna Plan for their Employees in the ordinary course of business, (b) continue making the above-described

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<sup>4</sup> Prior to the merger between Movie Gallery and Hollywood, full-time Hollywood Employees were covered by the Hollywood Entertainment Health Plan. Effective January 1, 2007, the Medical and Dental Insurance Plan was amended to cover Hollywood Employees. The Debtors believe that they do not owe any amounts on account of remaining claims under the Hollywood Entertainment Health Plan.

contributions to such benefit programs, (c) pay any amounts related thereto, including on account of any premiums and claim amounts, to the extent that they remain unpaid as of the Commencement Date and (d) maintain the Stop Loss Insurance.

**B. Workers' Compensation**

28. The Debtors provide workers' compensation insurance for their Employees at the statutorily-required level for each state (the "Workers' Compensation Program"). These benefits are currently provided for Employees through Liberty Insurance Corporation and Liberty Mutual Insurance Company (collectively, "Liberty").<sup>5</sup> Liberty administers and pays the Debtors' workers' compensation claims, subject to the Debtors' deductible of \$500,000 per incident. The Debtors expect to pay annual insurance premiums and fees to Liberty in an aggregate amount of approximately \$1.1 million for the policy period April 1, 2007 through April 1, 2008 (the "Policy Period"). The Debtors expect to pay additional claims handling fees of approximately \$250,000 for the Policy Period. The Debtors project that their deductible payments will be \$5.1 million for the Policy Period.

29. Certain benefits under the Workers' Compensation Program have been incurred prepetition but have yet to be fully paid, and certain other claims were filed prepetition but have yet to be resolved. As of the Commencement Date, the Debtors estimate that outstanding workers' compensation claims are approximately \$13.3 million. A letter of credit covers virtually all exposure for such claims. For the claims administration process to operate in an efficient manner and to ensure that the Debtors comply with their state law requirements, claim assessment, determination and adjudication must continue.

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<sup>5</sup> Employees in Oregon and Wisconsin are covered by Liberty Insurance Corporation and Employees in all other states are covered by Liberty Mutual Insurance Company.

30. By this Motion, the Debtors request authority to continue to maintain, to be exercised in their sole discretion, their Workers' Compensation Program in the ordinary course of business and to pay in their sole discretion any and all prepetition amounts related thereto including, without limitation, any payments for workers' compensation claims, deductibles, premiums and fees owed for administrative costs and other amounts required in connection with the Workers' Compensation Program, as such amounts become due in the ordinary course of the Debtors' business.

**C. Vacation, Sick Leave and Other Leaves of Absence**

31. The Debtors provide vacation time to their Full-Time Employees as a paid time-off benefit (the "Vacation Time"). The amount of Vacation Time available to a particular Employee and the rate at which such Vacation Time accrues is generally determined by the Employee's position and the length of full-time employment. When a Full-Time Employee elects to take Vacation Time, that Employee is paid his or her regular hourly or salaried rate. Employees generally may not cash out their unused Vacation Time at the time of termination, unless the applicable state law requires the Debtors to cash out Vacation Time for such Employees. For Employees in those states that require employers to cash out Vacation Time, the Debtors estimate that approximately \$5 million of earned but unused Vacation Time will have accrued as of the Commencement Date.

32. In addition, in the ordinary course of business, Employees are eligible for sick leave due to illness or injury up to five days per year for Hollywood Employees and up to four days per year for Movie Gallery Employees ("Sick Leave"). Employees may not cash out their unused Sick Leave upon termination.

33. The Debtors also allow their Employees to take certain other leaves of absence for personal reasons, many of which are required by law (“Leaves of Absence”). Leaves of Absence include family medical leaves, pregnancy, adoption and foster care leaves, military leaves, jury duty, voting leaves, personal leaves and bereavement leaves.

34. By this Motion, the Debtors request that they be authorized, but not directed, to continue to honor their Vacation Time, Sick Leave and Leaves of Absence policies in the ordinary course of business, and to honor and pay any prepetition amounts related thereto. Moreover, the Debtors anticipate that their Employees will utilize any accrued Vacation Time, Sick Leave and Leaves of Absence in the ordinary course of business, which will not create any material cash flow requirements beyond the Debtors’ normal payroll obligations.

**D. Employee Savings and Retirement Plans**

35. The Debtors maintain a retirement savings plan meeting the requirements of Section 401(k) of the Internal Revenue Code for the benefit of all Full-Time Employees (the “401(k) Plan”). Full-Time Employees who are over the age of 21 and who have completed 90 days of employment are eligible to participate in the 401(k) Plan (the “Participants”). Temporary workers and highly compensated Employees are not eligible to participate in the 401(k) Plan. The 401(k) Plan allows for automatic pre-tax salary deductions of eligible compensation up to the limits set by the Internal Revenue Code. Approximately 850 Full-Time Employees currently participate in the 401(k) Plan, and the approximate monthly amount withheld from the Participants’ paychecks for 401(k) contributions is \$175,000. The Debtors, in their discretion, may make matching contributions under the 401(k) Plan at the end of the plan year.

36. By this Motion, the Debtors seek authority, but not direction, to continue the 401(k) Plan in the ordinary course of business.

**E. Additional Employee Benefits**

- i. Life Insurance, Accidental Death and Dismemberment Insurance, Short and Long-Term Disability Benefits and Accident Insurance

37. The Debtors provide all Full-Time Employees with primary life insurance coverage and primary accidental death and dismemberment insurance through Reliance Standard, a third-party insurer (the “Life and AD&D Insurance”). This coverage costs the Debtors approximately \$26,000 per month. Full-Time Employees are also offered the opportunity to purchase supplemental life insurance through the Movie Gallery/Hollywood Group Supplemental Life and Accidental Death and Dismemberment Insurance Programs (the “Supplemental Life and AD&D Insurance”), the premiums for which are paid entirely by the electing Employee. The Debtors estimate that approximately 4,000 Employees have elected to purchase Supplemental Life and AD&D Insurance. The Debtors estimate that they have withheld approximately \$14,000 in Employee contributions for Supplemental Life and AD&D Insurance prior to the Commencement Date, which amount has not yet been transferred to Reliance Standard.

38. In addition, the Debtors provide Full-Time Employees with short- and long-term disability benefits through Reliance Standard (the “Short-Term Disability Benefits” and the “Long-Term Disability Benefits,” respectively). The Debtors pay for basic disability coverage for all Full-Time Employees. This coverage costs the Debtors approximately \$81,500 per month. Full-Time Employees may purchase additional Short-Term Disability Benefits and Long-Term Disability Benefits at their own cost. The Debtors estimate that approximately 900 Employees have elected to pay for additional disability benefits, and, prior to the

Commencement Date, the Debtors withheld approximately \$12,000 in Employee contributions for such additional disability benefits, which amount has not yet been transferred to Reliance Standard.

39. The Debtors also offer Full-Time Employees the opportunity to purchase discount accident benefits through the Movie Gallery/Hollywood Group Accident Insurance Program (the “Accident Insurance”) from UNUM Provident, the premiums of which are paid entirely by the electing Employee. The Debtors estimate that approximately 1,900 Employees have elected to purchase Accident Insurance. The Debtors estimate that they withheld approximately \$45,000 in Employee contributions for Accident Insurance prior to the Commencement Date, which amount has not yet been transferred to UNUM Provident.

ii. Flexible Benefit Plan

40. The Debtors offer their Full-Time Employees the ability to contribute a portion of their pre-tax compensation to flexible spending accounts to pay for eligible out-of-pocket health care and dependent care premiums and expenses (the “Flexible Benefit Plan”). Approximately 270 Employees participate in the health care portion of the Flexible Benefit Plan and approximately 30 Employees participate in the dependent care portion of the Flexible Benefit Plan. The administration of the Flexible Benefit Plan costs the Debtors approximately \$250 per month.

iii. Gym Membership

41. The Debtors reimburse certain Full-Time Employees for gym memberships (the “Gym Memberships”). Approximately 41 such Employees currently have Gym Memberships and, as of the Commencement Date, the Debtors’ costs for the Gym Memberships are approximately \$750 per month.

iv. Tuition Reimbursement Program

42. Certain Full-Time Employees who enroll in an accredited college or university are eligible to participate in the tuition reimbursement program (the “Tuition Reimbursement Program”). Prior to the Commencement Date, 10 such Employees were participants in the Tuition Reimbursement Program at a cost to the Debtors of approximately \$1,200 per month.

43. By this Motion, the Debtors seek authority, but not direction, to (a) continue (i) the Life and AD&D Insurance and the Supplemental Life and AD&D Insurance, (ii) the Short-Term Disability Benefits and the Long-Term Disability Benefits, (iii) the Accident Insurance, (iv) the Flexible Benefit Plan, (v) the Gym Memberships and (vi) the Tuition Reimbursement Program, (b) continue making the above-described contributions to such benefit programs, (c) pay any amounts related thereto, including on account of any premiums and claim amounts, to the extent that they remain unpaid on the Commencement Date and (d) revise any of the above-described benefit programs in the ordinary course of business.

**Relief Requested**

44. By this Motion, the Debtors seek authority to pay and honor, in the ordinary course of business and in their sole discretion, prepetition claims and obligations related to (a) Unpaid Compensation and Temporary Compensation, (b) Deductions and Payroll Taxes, (c) Reimbursable Expenses, (d) the Bonus Plans and the Commissions and (e) the Employee Benefit Programs, all as defined and described in more detail herein.

45. In addition, the Debtors request that banks and other financial institutions be authorized and directed to receive, process, honor and pay all checks presented for payment and electronic payment requests relating to the foregoing, whether such checks were presented or electronic requests were submitted prior to or after the Commencement Date. The Debtors also

request that all such banks and financial institutions be authorized to rely on the Debtors' designation of any particular check or electronic payment request as appropriate pursuant to this Motion. The Debtors further request that all banks and other institutions, including but not limited to financial institutions be authorized and directed to receive and honor payments from the Employees' electronic pay cards.

### **Basis for Relief**

#### **A. Sufficient Cause Exists for the Court to Authorize the Debtors to Honor Employee Wage and Benefit Obligations**

46. Pursuant to sections 507(a)(4) and 507(a)(5) of the Bankruptcy Code, the Debtors' obligations for the Employee Wages and Benefits are entitled to priority treatment. Therefore, the relief sought herein would only affect the timing, and not the amount, of the payment of the employee claims to the extent they constitute priority claims. Additionally, the Debtors may pay to the appropriate entities the Deductions and Payroll Taxes because those amounts are not property of the Debtors' estates under section 541. The Court may also authorize the Debtors to honor their obligations for the Employee Wages and Benefits pursuant to section 363(b)(1). In addition, section 105(a) provides the legal basis for the Court to authorize payment of prepetition claims out of necessity.

47. The Debtors believe that the vast majority of the prepetition wages and other employee claims they seek to pay would be entitled in any event to priority treatment to the extent of \$10,950 for each individual under sections 507(a)(4) and 507(a)(5). As priority claims, the Debtors are required to pay these claims in full to confirm a chapter 11 plan. See 11 U.S.C. § 1129(a)(9)(B) (requiring payment of certain allowed unsecured claims for wages, salaries and commissions for contributions to an employee benefit plan). Thus, granting the relief sought herein would only cause such employee claims to be paid early in the cases, instead of waiting

until confirmation, to the extent that they constitute priority claims. Further, the amount by which these claims exceed \$10,950 per individual is insignificant in consideration of the value that these Employees will provide to the Debtors' reorganization efforts.

48. Indeed, "wage priority has been a feature of the bankruptcy law since 1898." In re Garden Ridge Corp., No. 04-10324, 2006 WL 521914, at \*2 (Bankr. D. Del. Mar. 2, 2006) (quoting 4 Collier on Bankruptcy, § 507.05[1] (15th Ed. 2005)). "Its purpose is to 'alleviate hardship on workers... 'who may have no other source of income and 'to encourage employees to stand by an employer in financial difficulty.' This priority extends to certain other 'benefits that are considered akin to compensation, such as vacation, severance and sick leave pay.'" Id.

49. Moreover, as part of the relief requested herein, the Debtors seek authority to pay to the appropriate entities the Deductions and the Payroll Taxes. These amounts principally represent Employee earnings that governments, Employees and judicial authorities have designated for deduction from Employees' paychecks. Indeed, certain Deductions like contributions to the Employee Benefit Programs, child support and alimony payments are not the Debtors' property, but rather, have been withheld from Employees' paychecks on another party's behalf. See 11 U.S.C. § 541(b). Moreover, the Debtors and their officers are required by federal or state laws to make certain tax payments that have been withheld from their Employees' paychecks. 26 U.S.C. §§ 6672 and 7501(a); see also City of Farrell v. Sharon Steel Corp., 41 F.3d 92, 95-97 (3d Cir. 1994) (state law requiring debtor to withhold city income tax from its employees' wages created trust relationship between debtor and city for payment of withheld income taxes); In re DuCharmes & Co., 852 F.2d 194, 196 (6th Cir. 1988) (noting individual officers of a company may be held personally liable for failure to pay trust fund taxes). Further, because the Deductions and Payroll Taxes are not property of the Debtors' estates, these amounts

are not subject to the normal bankruptcy prohibitions against payment. See In re Dameron, 155 F.3d 718, 721 (4th Cir. 1998). The Debtors therefore request that the Court confirm that such trust fund withholding is not property of the Debtors' estates and that the Debtors may transmit the Payroll Taxes to the proper parties in the ordinary course of business.

50. The Court may also grant the relief requested herein pursuant to section 363 of the Bankruptcy Code. Section 363 provides that "[t]he [debtor], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). Under this section, a court may authorize a debtor to pay certain prepetition claims. See In re Ionosphere Clubs, Inc., 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (affirming lower court order authorizing payment of prepetition wage claims pursuant to section 363(b)). To do so, "the debtor must articulate some business justification, other than the mere appeasement of major creditors." Id. at 175.

51. Paying prepetition wages and employee benefits will benefit the estates and their creditors by allowing the Debtors' business operations to continue without interruption. Indeed, the Debtors believe that without the requested relief, their Employees may seek alternative employment opportunities, perhaps with the Debtors' competitors. Such a development would deplete the Debtors' workforce, hindering the Debtors' ability to meet their customer obligations and, likely, diminishing stakeholder confidence in the Debtors' ability to successfully reorganize. The loss of valuable Employees and resulting recruiting of new employees that would be necessary to find replacements would be distracting at this critical time when the Debtors are stabilizing operations and continuing operational restructuring in chapter 11. Further, if the Debtors lose valuable Employees, they will incur recruiting expenses in locating replacement workers. Accordingly, there can be no doubt that the Debtors must do their utmost to retain their

workforce by, among other things, continuing to honor all wage, benefit and related obligations, including the Employee Wages and Benefits that accrued prepetition..

52. The Court may also rely on its general equitable powers to grant the relief requested in this Motion as codified in section 105(a) of the Bankruptcy Code. Section 105 empowers the Court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code].” 11 U.S.C. § 105(a). A bankruptcy court’s use of its equitable powers to “authorize the payment of pre-petition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept.” Ionosphere Clubs, 98 B.R. at 175-176 (citing Miltenberger v. Logansport, C. & S.W. R.Co., 106 U.S. 286 (1882)). Section 105(a) authorizes a court to “permit pre-plan payment of a pre-petition obligation when essential to the continued operation of the debtor.” In re NVR L.P., 147 B.R. 126, 127 (Bankr. E.D. Va. 1992); see also In re Just for Feet, Inc., 242 B.R. 821, 825 (D. Del. 1999).

53. Application of section 105(a) in the context of this Motion is also appropriate because the relief requested herein is consistent with the rehabilitative policy of chapter 11 of the Bankruptcy Code. A debtor in possession is a fiduciary with a duty to protect and preserve the estates, including the value of the business as a going concern. In re CoServ, L.L.C., 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) (“There are occasions when this [fiduciary] duty can only be fulfilled by the preplan satisfaction of a prepetition claim.”). Granting the relief requested in this Motion will enhance the likelihood of the Debtors’ successful rehabilitation, maximize the value of the estates’ assets and thus benefit the estates’ creditors.

54. The Debtors seek authority to honor their obligations for the Employee Wages and Benefits to ensure the continued operation of the Debtors’ business and to maintain the morale of their Employees, many of whom would suffer extreme personal hardship and financial

difficulty if they are not paid. In addition, the Employee Benefit Programs are an important part of each Employee's total compensation. The Debtors estimate that the aggregate cost of providing the Employee Benefit Programs pales in comparison to the value generated by the Debtors' workforce. Moreover, as with non-payment of wages or reimbursable expenses, any indication that the Employee Benefit Programs may disappear or may not be honored will prove detrimental to the Debtors' ability to successfully reorganize.

55. Similar relief has been provided in this district and other jurisdictions. See, e.g., In re The Rowe Cos., Case Nos. 06-11142, 06-11143, 06-11144 (SSM) (Bankr. E.D. Va. Sept. 20, 2006); In re US Airways, Inc., Case No. 04-13819 (SSM) (Bankr. E.D. Va. Sept. 14, 2004); In re NTELOS, Inc., Case No. 03-32094 (DOT) (Bankr. E.D. Va. Mar. 4, 2003); In re Orbital Imaging Corp., Case No. 02-81661 (RGM) (Bankr. E.D. Va. Apr. 9, 2002); In re Motient Corp., Case No. 02-80125 (RGM) (Bankr. E.D. Va. Jan. 11, 2002); see also In re Chateaugay Corp., 80 B.R. 279, 287 (S.D.N.Y. 1987) (affirming a bankruptcy court order authorizing the debtor to pay pre-bankruptcy wages, salaries, employee benefits and reimbursements, and workers' compensation claims and premiums); In re The Boyds Collection, Ltd., Case No. 05-43793 (Bankr. D. Md. Oct. 18, 2005); In re Kmart Corp., Case No. 02-B02474 (Bankr. N.D. Ill. Jan. 25, 2002); In re Gulf Air, Inc., 112 B.R. 152, 154 (Bankr. W.D. La. 1989) (authorizing the debtor to pay current employees' pre-bankruptcy wages, salaries, medical benefits and business expense claims); Ionosphere Clubs, 98 B.R. at 177 (same).

56. The Debtors do not at this time seek to assume any executory contracts or obligations, and the Motion should not be deemed to be an assumption or adoption of any employee agreements or policies. Rather, the Debtors merely seek to take steps that they believe to be necessary to keep their existing workforce intact to maximize the value of the bankruptcy

estates, pending further decisions relevant to the contemplated reorganization. Also, the Debtors will retain the discretion to not make the payments contemplated by the Motion for particular Employees, and nothing in the Motion shall, in and of itself, confer upon any Employees or other parties an entitlement to administrative priority or other preferences in distribution from the Debtors' estates.

**B. Cause Exists to Authorize the Debtors' Financial Institutions to Honor Checks and Electronic Fund Transfers**

57. Under the Debtors' existing cash management system, the Debtors represent that checks or wire transfer requests can be readily identified as relating to an authorized payment in respect of the prepetition claims of the Employees. Accordingly, the Debtors believe that checks or wire transfer requests, other than those relating to authorized payments, will not be honored inadvertently and that all applicable banks and other financial institutions should be authorized and directed, when requested by the Debtors, to receive, process, honor and pay any and all checks or wire transfer requests in respect of the prepetition claims of the Employees.

58. For all of the foregoing reasons, the Debtors believe that granting the relief requested herein is appropriate and in the best interests of all parties in interest.

**Waiver of Memorandum of Points and Authorities**

59. The Debtors respectfully request that this Court treat this Motion as a written memorandum of points and authorities or waive any requirement that this Motion be accompanied by a written memorandum of points and authorities as described in Rule 9013-1(G) of the Local Bankruptcy Rules for the Eastern District of Virginia.

**Notice**

60. The Debtors have provided notice of this Motion to: (a) the Office of the United States Trustee for the Eastern District of Virginia; (b) the entities listed on the Consolidated List

of Creditors Holding the 30 Largest Unsecured Claims filed pursuant to Bankruptcy Rule 1007(d); (c) counsel to the agent for the Debtors' proposed postpetition secured lenders; (d) counsel to the agent for the Debtors' prepetition first lien facilities; (e) counsel to the agent for the Debtors' prepetition second lien facility; (f) the trustee for the Debtors' 11% senior unsecured notes; (g) counsel to Sopris Capital Advisors LLC; (h) the trustee for the Debtors' 9.625% senior subordinated unsecured notes; (i) counsel for certain movie studios; (j) the Internal Revenue Service; (k) the Securities and Exchange Commission; and (l) the banks that process disbursements in the Debtors' cash management system (Bank of America, Canadian Imperial Bank of Commerce and Wachovia Bank). In light of the nature of the relief requested, the Debtors respectfully submit that no further notice is necessary.

WHEREFORE, for the reasons set forth herein and in the First Day Affidavit, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto as Exhibit A, (a) authorizing, but not directing, the Debtors to pay certain prepetition amounts for (i) Unpaid Compensation and Temporary Compensation, (ii) Deductions and Payroll Taxes, (iii) Reimbursable Expenses, (iv) the Bonus Plans and the Commissions and (v) the Employee Benefit Programs, (b) authorizing and directing banks and other financial institutions to receive, process, honor and pay all checks presented for payment and electronic payment requests relating to the foregoing and (c) granting such other and further relief as is just and proper.

Richmond, Virginia  
Dated: October 16, 2007

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## **EXHIBIT A**

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

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In re:	)	Case No. 07-_____
	)	Jointly Administered
MOVIE GALLERY, INC., et al., <sup>1</sup>	)	Chapter 11
	)	
Debtors.	)	
	)	

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**ORDER (A) AUTHORIZING, BUT NOT DIRECTING, THE DEBTORS TO PAY  
CERTAIN PREPETITION (I) WAGES, SALARIES, BONUSES AND OTHER  
COMPENSATION, (II) REIMBURSABLE EMPLOYEE EXPENSES AND  
(III) EMPLOYEE MEDICAL AND SIMILAR BENEFITS AND (B) AUTHORIZING  
AND DIRECTING BANKS AND OTHER FINANCIAL INSTITUTIONS TO  
HONOR ALL RELATED CHECKS AND ELECTRONIC PAYMENT REQUESTS**

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Upon the motion (the “Motion”)<sup>2</sup> of the above-captioned debtors (collectively, the “Debtors”) for the entry of an order (the “Order”) (a) authorizing, but not directing, the Debtors to pay certain prepetition (i) accrued wages, salaries and other compensation (the “Unpaid Compensation”) and compensation for the services of temporary workers (the “Temporary

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<sup>1</sup> The Debtors in the cases include: Movie Gallery, Inc.; Hollywood Entertainment Corporation; M.G. Digital, LLC; M.G.A. Realty I, LLC; MG Automation LLC; and Movie Gallery US, LLC.

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

Compensation”) (ii) payroll deductions, including, without limitation, (a) garnishments, child support and similar deductions and (b) other pre-tax and after-tax deductions payable pursuant to certain of the Employee benefit plans discussed in the Motion (such as the Employee’s share of health care benefits and insurance premiums, 401(k) contributions, legally ordered deductions and miscellaneous deductions) (collectively, the “Deductions”) and the withheld amounts related to federal, state and local income taxes, social security and Medicare taxes and the Debtors matching amounts for social security and Medicare taxes and pay and additional amounts for federal and state unemployment insurance (the “Payroll Taxes”), (iii) certain work-related expenses incurred by the Employees on behalf of the Debtors (the “Reimbursable Expenses”), (iv) accrued amounts for quarterly or annual bonus plans, including amendments thereto (the “Bonus Plans”), commissions programs for Employees in the Debtors’ retail video, game and tanning stores (the “Commissions”) and other compensation and (iv) amounts accrued in relation to the Debtors’ health insurance and benefits programs, including health care and dental plans, workers’ compensation insurance, vacation time and other paid leaves of absence, retirement savings plans, flexible benefit plans, life insurance, accidental death and dismemberment insurance, short-term and long-term disability insurance and accident insurance (collectively, the “Employee Benefit Programs”) and (b) authorizing and directing banks and other financial institutions to receive, process, honor and pay all checks presented for payment and electronic payment requests relating to the foregoing and the First Day Affidavit; it appearing that the relief requested 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 this

court pursuant to 28 U.S.C. §§ 1408 and 1409; notice of the Motion having been adequate and appropriate under the circumstances; and after due deliberation and sufficient cause appearing therefor, it is hereby ORDERED

1. The Motion is granted in its entirety.
2. The Debtors are authorized, but not directed, to honor and pay the Employee Wages and Benefits<sup>3</sup> in accordance with the Debtors' stated policies and prepetition practices, including, but not limited to, prepetition amounts owed in connection with (a) Unpaid Compensation and Temporary Compensation and (b) the Bonus Plans and the Commissions.
3. The Debtors are authorized, but not directed, to continue to allocate and distribute the Deductions and the Payroll Taxes in accordance with the Debtors' stated policies and prepetition practices.
4. The Debtors are authorized, but not directed, to pay the Reimbursable Expenses in accordance with the Debtors' stated policies and prepetition practices.
5. The Debtors are authorized, but not directed, to honor the Employee Benefit Programs, make any necessary contributions to such programs and pay any unpaid premium, claim or amount owed as of the Commencement Date, including, but not limited to, honoring: (a) the Medical and Dental Insurance Plan, the Hawaii Plan and the Aetna Plan; (b) the Stop Loss Insurance; (c) the Workers' Compensation Program; (d) Vacation Time, Sick Leave and Leaves of Absence policies; (e) the 401(k) Plan; (f) the Life and AD&D Insurance and Supplemental Life and AD&D Insurance; (g) the Short-Term Disability Benefits and the Long-Term Disability

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<sup>3</sup> As defined in the Motion, "Employee Wages and Benefits" means wages, salaries, commissions, bonuses and other compensation, federal and state withholding taxes and other amounts withheld (including garnishments, Employees' share of insurance premiums, taxes and 401(k) contributions), health benefits, insurance benefits, workers' compensation benefits, vacation time, sick leave, life and accidental death and dismemberment insurance, short-and long-term disability coverage and all other benefits that the Debtors have historically provided in the ordinary course of business.

Benefits; (h) the Accident Insurance; (i) the Flexible Benefit Plan; (j) the Gym Memberships and (k) the Tuition Reimbursement Program.

6. In accordance with this Order and any other order of this Court, the Debtors are authorized, but not directed, to pay all processing fees associated with, and all costs incident to, payment of the Employee Wages and Benefits and the Reimbursable Expenses.

7. The banks and financial institutions on which checks were drawn or electronic payment requests made in payment of the prepetition obligations approved herein are authorized and directed to receive, process, honor and pay all such checks and electronic payment requests when presented for payment, and that all such banks and financial institutions are authorized to rely on the Debtors' designation of any particular check or electronic payment request as approved by this Order.

8. The Debtors are authorized to reissue any check or electronic payment that originally was given in payment of any prepetition amount authorized to be paid under this Order and is not cleared by the applicable bank or other financial institution.

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

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

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

Richmond, Virginia  
Date: October \_\_\_\_, 2007

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United States Bankruptcy Judge