

CORPORATE REORGANIZATION AS CORPORATE REINVENTION:  
BORDERS AND BLOCKBUSTER IN CHAPTER 11

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At its heart, Chapter 11 is supposed to be about giving struggling businesses a new beginning, predicated on the idea that “a failing business can be reshaped into a successful operation . . . a predictable creation from a people whose majority religion embraces the idea of life from death and whose central myth is the pioneer making a fresh start on the boundless prairie.”<sup>1</sup> However, major Chapter 11 cases filed in the past few months, and the subsequent discussions they provoked, raise a new question to peruse: how *new* should the new beginning be—how *fresh* the fresh start? When a corporation vows to change its business model in order to pay back its debts and become more successful, how much is it supposed to change? Can it morph into a completely different corporation after it emerges? Corporations like Borders Group, Inc. (“Borders”) or Blockbuster Inc. (“Blockbuster”) might be making Chapter 11 the fashionable, new way to metamorphose.

As far as large corporations are concerned, Chapter 11 should be about capturing, retaining, and protecting something that is of value. If a corporation has nothing of worth that can be preserved through reorganization, there are very few reasons why it should not be liquidated immediately, its parts dissembled and auctioned, whatever lifeblood leftover to be given to its creditors. All reorganization efforts “proceed in the shadow of the [liquidation] alternative...[r]eorganizations are designed and evaluated by comparison with the outcomes available” under liquidation.<sup>2</sup> What this means is that some corporations should file for Chapter 11 bankruptcy, while others should liquidate, depending on what they have to offer.

In practice, however, Congress created powerful incentives for all corporations to choose Chapter 11 in the past three decades.<sup>3</sup> Among these incentives are strong presumptions in favor

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<sup>1</sup> Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 604 (2009).

<sup>2</sup> See ELIZABETH WARREN, *BUSINESS BANKRUPTCY* 28 (1993).

<sup>3</sup> Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1045 (1992) (noting that the “presumption favoring management’s continued control, when combined with other

of letting the debtor stay in control and the elimination of the insolvency requirement.<sup>4</sup> Related to this, legal academics have criticized reorganization procedures, regarding the system to be corrupt, due to forum-shopping, judicial irresponsibility, and competition.<sup>5</sup> But, these forces that guide corporations toward corruption are also steering companies into a new sort of reinvention bankruptcy—that is, a corporation that is popularly agreed to be not-viable nonetheless files for Chapter 11 with hopes of not only refinancing, re-designing, or changing its business model—by changing the entire business itself.

In reorganization, corporations need to have their reorganization plans confirmed by the bankruptcy judge, who, in turn needs to ascertain, *inter alia*, that confirmation “is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.”<sup>6</sup> As a result, at least theoretically, corporations should come up with plans that sound at least potentially successful. Blockbuster, which recently put itself up for sale when its reorganization plan collapsed,<sup>7</sup> can hardly be mentioned without an obligatory nod to Netflix and Redbox, both often credited with putting Blockbuster out of business, and both often cited as reasons why Blockbuster should have just liquidated instead of putting up a fight.<sup>8</sup> Netflix and Redbox are Blockbuster’s more digital age savvy competitors, famous for cheaper by-mail and vending-kiosk movie rentals, respectively. But now, Blockbuster is planning on “closing old-fashioned stores, installing new kiosks, and diving into digital delivery.”<sup>9</sup> In other words, Blockbuster is trying to turn into Netflix.

Observers have noted similarities between Blockbuster’s Chapter 11 and Borders’ Chapter 11.<sup>10</sup> Both are companies victimized by the digitalization of media and burdened with chains of large physical stores.<sup>11</sup> Borders’ bankruptcy has been attributed to “its failure to establish a

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provisions of Chapter 11 affording the corporate debtor considerable latitude regarding its treatment of creditors, effectively gave managers powerful incentives to pursue bankruptcy reorganization.”).

<sup>4</sup> See 11 U.S.C. § 1107 (2006).

<sup>5</sup> See, e.g., Bradley & Rosenzweig, *supra* note 3; see also Lynn M. LoPucki & Joseph W. Doherty, *Delaware Bankruptcy: Failure in the Ascendancy*, 73 U. CHI. L. REV. 1387 (2006); Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a ‘Race to the Bottom’*, 54 VAND. L. REV. 231 (2001).

<sup>6</sup> 11 U.S.C. §1129(a)(11) (2006).

<sup>7</sup> See Ben Fritz, *Blockbuster To Put Itself Up For Sale*, L.A. TIMES, Feb. 21, 2011, <http://articles.latimes.com/2011/feb/21/business/la-fi-ct-blockbuster-20110222>.

<sup>8</sup> See, e.g., The Feldman File, <http://feldmanfile.blogspot.com/> (Mar. 1, 2011, 13:32 CST); Mae Anderson, *Blockbuster, Creditors Agree on Sale Plan*, BLOOMBERG BUSINESSWEEK, Mar. 10, 2011, <http://www.businessweek.com/ap/financialnews/D9LSLSV00.htm>; Scott Gordon, *What is the Future of Blockbuster?*, NBC BUS. NEWS, July 9, 2010, <http://www.nbcdfw.com/news/business/What-Is-the-Future-of-Blockbuster-98149184.html>; *Blockbuster Files for Chapter 11 Business Reorganization*, BUSINESS FIRST, Sept. 23, 2010, <http://www.bizjournals.com/louisville/stories/2010/09/20/daily39.html> (noting that Blockbuster “lost out because Netflix and RedBox gained ground quickly with new platforms, and Blockbuster moved too late . . . like the Captain of the Titanic [Keyes, Blockbuster’s CEO] got on the ship after it hit the iceberg. He has been trying to bail it out with a bucket.”)

<sup>9</sup> Gordon, *supra* note 8.

<sup>10</sup> Nathan Borney, *Blockbuster’s Proposed Bankruptcy Sale is Uncomfortable Reminder for Borders*, ANN.ARBOR.COM BUSINESS NEWS, Feb. 22, 2011, <http://www.annarbor.com/business-review/blockbusters-proposed-bankruptcy-sale-is-uncomfortable-reminder-for-borders/>.

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

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strong online sales operation and a slow embrace of electronic books.”<sup>12</sup> Like Blockbuster, Borders is playing the chameleon by changing its identity: shifting “the focus away from its physical presence” and at the same time “overhaul[ing] its website and introduc[ing] a digital book store.”<sup>13</sup>

Borders and Blockbuster are merely two examples of companies that seem somewhat antiquated to the electronic generation. And as they flounder around in Chapter 11, they both have their eyes on becoming digitized, unrecognizable from their former selves. It is one thing to do a balance-sheet reorganization, refinance, close unprofitable chain stores, and rethink a business model, but it is another thing entirely to turn yourself from a video rental store into an online streaming service; or from a physical bookstore into Amazon.com. Yet this is what these corporations are considering.

In one sense, this is the same old story we have all heard before, that a bankrupt corporation must find new ways to make profits. However, practically speaking, this means that the 11 U.S.C. § 1129 hurdle should be relatively easy to clear as long as a corporation is flexible enough about its future. Any out-of-date corporation can turn around, point its finger at a more successful, technologically fashionable company and say, “I am going to be like that!” It is true that a judge might be skeptical about the ability of the corporation to change, especially in light of its debts, but Blockbuster is an example that is very established in its ways, with almost \$1 billion in debt at the time of filing.<sup>14</sup>

Furthermore, this is actually a radical shift in the essence of reorganizational bankruptcy: We are no longer considering a corporation that has any worth to preserve at the beginning of the reorganization, we are considering a corporation that wants to *create* worth by reinventing itself.<sup>15</sup> We are no longer dealing with a viable business that has fallen on hard times and needs some tweaking; we are dealing with businesses that are so admittedly unviable that they need to transform into a completely different business in order to convince the bankruptcy judges that they have a fighting chance at life.

Borders is transforming into Amazon.com. Blockbusters is transforming into Netflix. What is Chapter 11 reorganization transforming into? Perhaps—rebirth.

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<sup>12</sup> *Id.*

<sup>13</sup> Joseph Checkler, *Borders Files for Chapter 11 Bankruptcy Protection*, WALL ST. J. ONLINE, Feb. 17, 2011, <http://online.wsj.com/article/SB10001424052748703373404576147922340434998.html>.

<sup>14</sup> See Checkler, *supra* note 13.

<sup>15</sup> An argument that could be made is that the brand name itself (Borders or Blockbuster) is value worth preserving through Chapter 11, even if the companies themselves completely change into unrecognizably new companies. However, this departs from most of the traditional Chapter 11 discussions (which are mainly about preserving assets and jobs).