

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re : Chapter 11
THE SCO GROUP, INC., *et al.*, :
Debtors. : Case Number 07-11337 (KG)
 : (Jointly Administered)
 :

Hearing Date: June 12, 2009 at 2:00 P.M.
Objection Deadline: May 26, 2009

**MOTION OF THE UNITED STATES TRUSTEE
TO CONVERT CASES TO CASES UNDER CHAPTER 7**

In support of her motion for an order converting the above-captioned cases to cases under chapter 7, Roberta A. DeAngelis, Acting United States Trustee for Region 3 (“U.S. Trustee”), by and through her counsel, and based upon information and belief, avers:

PRELIMINARY STATEMENT

The above-captioned cases should be converted to cases under chapter 7 because there is a “continuing loss to or diminution of the [Debtors’] estate[s] and the absence of a reasonable likelihood of rehabilitation” under 11 U.S.C. § 1112(b)(4)(A). The Debtors are a technology “start-up” venture. Since the inception of the above-captioned cases nearly two years ago, the Debtors have continued to rapidly lose money; by their own admission, the Debtors have had in excess of \$3.5 million of negative cash flow post-petition. This fact, by itself, is sufficient to establish a continuing loss to, or diminution of, the Debtors’ estates. Additionally, there is not a reasonable likelihood that the Debtors will be rehabilitated. On three separate occasions over the past twenty-one months, the Debtors have started sale and/or plan processes designed to liquidate and/or

reorganize their business. All three of those attempts to resolve the cases failed. Under these circumstances, this Court is obligated to either convert the Debtors' cases to cases under chapter 7 or dismiss the cases, whichever is in the best interests of creditors and the estates pursuant to 11 U.S.C. § 1112(b)(1). The U.S. Trustee submits that conversion of the cases to cases under chapter 7 will be in the best interest of creditors and the Debtors' estates.

INTRODUCTION

1. Under (i) 28 U.S.C. § 1334, (ii) (an) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a) and (iii) 28 U.S.C. § 157(b)(2)(A), this Court has jurisdiction to hear and determine the Motion.

2. Under 28 U.S.C. § 586, the U.S. Trustee is generally charged with monitoring the federal bankruptcy system. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that U.S. Trustee has “public interest standing” under 11 U.S.C. § 307 which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the U.S. Trustee as a “watchdog”). “[I]n any case in which the United States trustee finds material grounds for any relief under section 1112 of [the Bankruptcy Code],” the U.S. Trustee is obligated to apply promptly after making that finding to the court for relief.” 28 U.S.C. § 586(a)(8).

3. Under 11 U.S.C. § 307, the U.S. Trustee has standing to be heard on this Motion.

GROUND/BASIS FOR RELIEF

Background

4. On September 14, 2007, the Debtors filed the petitions which initiated the above-captioned cases.

5. To date, this Court has not directed the appointment of a trustee or an examiner in the above-captioned cases.

6. On September 18, 2007, the Office of the U.S. Trustee (“OUST”) mailed a notice to the Debtors’ top twenty unsecured creditors informing them of the meeting to form an official committee of unsecured creditors. The scheduled date/time for the meeting was September 28, 2007. As of that date, the OUST had not received sufficient expressions of interest to appoint an official committee of unsecured creditors in the above-captioned cases. Accordingly, on September 28, 2007, the OUST filed a statement indicating that an official committee of unsecured creditors had not been formed.

Conversion

7. The U.S. Trustee submits that these cases are ripe for conversion to cases under chapter 7. 11 U.S.C. § 1112(b)(1) provides:

Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.¹

8. Under 11 U.S.C. § 1112(b)(4)(A), the term “cause” in 11 U.S.C. § 1112(b)(1) includes “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation.”

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11 U.S.C. § 1112(b)(3) requires that this Court commence a hearing on the U.S. Trustee’s conversion motion “not later than 30 days after the filing of the motion . . . unless the movant expressly consents to a continuance for a specific period of time” The U.S. Trustee consents to the initial scheduling of this motion for June 12.

9. 11 U.S.C. § 1112(b)(2)(B) indicates that, if the U.S. Trustee moves for conversion under 11 U.S.C. § 1112(b)(4)(A) and establishes “cause” for relief, there are no “unusual circumstances” that would allow this Court to refrain from converting the above-captioned case to a case under chapter 7.

10. Through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), Congress eliminated this Court’s discretion that was previously reflected in the appearance of the permissive word “may” in 11 U.S.C. § 1112(b) and, through substitution of the mandatory word “shall” for “may,” directed this Court to convert or dismiss the case, “whichever is in the best interests of the creditors and the estate,” if “cause” is established. 7 COLLIER ON BANKRUPTCY § 1112.04(1) (15th ed. rev. 2005) (“ . . . as amended in 2005, section 1112(b) circumscribes the court’s discretion by directing certain instances in which the court must, and must not, convert or dismiss the case.”); cf. *Association of Civilian Technicians v. FLRA*, 22 F.3d 1150, 1153 (D.C. Cir. 1994) (“The word ‘shall’ generally indicates a command that admits of no discretion on the part of the person instructed to carry out the directive.”).

11. The purpose of 11 U.S.C. § 1112(b)(4)(A) is to “preserve estate assets by preventing the debtor in possession from gambling on the enterprise at the creditors’ expense when there is no hope of rehabilitation.” *In re Lizeric Realty Corp.*, 188 B.R. 499, 503 (Bankr. S.D.N.Y. 1995) (quoted in *Loop Corp. v. United States Trustee (In re Loop Corp.)*, 379 F.3d 511, 516 (8th Cir. 2004)).

12. “Substantial or continuing loss to or diminution of the estate” is established where a debtor has continuing, negative cash flow post-petition. *See Loop Corp.*, 379 F.3d at 515-16.

13. “Rehabilitation,” as the term is used in 11 U.S.C. § 1112(b)(4)(A), means “to put back in good condition; re-establish on a sound, firm basis.” 5 COLLIER ON BANKRUPTCY § 1112.03(2) (15th ed. 1980) (quoted in *In re L.S. Good & Co.*, 8 B.R. 315, 317 (Bankr. N.D. W.Va. 1980)).

14. In these cases, the “continuing loss/diminution” prong of 11 U.S.C. § 1112(b)(4)(A) is satisfied by statements in the Debtors’ most recent monthly operating reports, where SCO Operations, Inc. reports net negative cash flow of more than \$3.5 million in its March 2009 report (Docket Entry # 743).

15. Additionally, not only is there no reasonable chance of “rehabilitation” in these cases, the Debtors have tried – and failed – to *liquidate* their business in chapter 11. In the fall of 2007, the Debtors filed a motion seeking approval of emergency sale and bidding procedures and, later, the Debtors filed a copy of their proposed asset purchase agreement with York Capital Management, Inc. The sale process with York failed to move forward. Next, in or about February, 2008, the Debtors proposed that Stephen Norris Capital Partners, LLC (“SNCP”) would fund a “100 percent” plan that would make allowed, general unsecured claims whole. Like the York deal, the SNCP deal never materialized. Most recently, in January 2009 the Debtors again initiated a sale/plan process that was abandoned. In sum, there have been three unsuccessful attempts by the Debtors over the span of nearly two years to bring these cases to closure.

16. Under these circumstances, and consistent with 11 U.S.C. § 1112(b)(1), this Court is required to convert the above-captioned cases to cases under chapter 7 or dismiss the cases. In light of the facts and circumstances of these cases, the U.S. Trustee submits that conversion of the cases to cases under chapter 7 is the appropriate course of action.

RESERVATION OF RIGHTS/CONCLUSION

17. The U.S. Trustee reserves the right to amend and/or supplement this motion.

18. The U.S. Trustee reserves the right to conduct discovery in connection with this motion.

WHEREFORE the U.S. Trustee requests that this Court issue an order converting the above-captioned cases to cases under chapter 7.

Respectfully submitted,

**ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE**

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