UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	
	)	Chapter 11
The SCO Group, Inc., et al.,	)	
	)	Case No. 07-11337 (KG)
Debtors.	)	(Jointly Administered)

Objection Deadline: June 5, 2009 at 4:00 p.m. (prevailing Eastern time)
Hearing: June 12, 2009 at 2:00 p.m. (prevailing Eastern time)

NOTICE OF MOTION

TO: (I) THE OFFICE OF THE UNITED STATES TRUSTEE; (II) ALL KNOWN CREDITORS, AND (III) THOSE PARTIES REQUESTING NOTICE PURSUANT TO BANKRUPTCY RULE 2002, IN ACCORDANCE WITH DEL. BANKR. L.R. 2002-1(B)

PLEASE TAKE NOTICE that Novell, Inc. ("Novell"), and its subsidiary, SUSE Linux GmbH ("SUSE" and together with Novell the "Novell Parties") filed their **Motion for Conversion** (the "Motion"). Copies of the Motion are available upon request to parties in interest by contacting the undersigned counsel.

PLEASE TAKE FURTHER NOTICE that objections to the Motion must be filed on or before **June 5, 2009 at 4:00 p.m. (ET)** (the "Objection Deadline") with the United States Bankruptcy Court for the District of Delaware, 824 Market Street, 3rd Floor, Wilmington, Delaware 19801. At the same time, you must serve a copy of the objection upon the Debtor's undersigned counsel so as to be received on or before the Objection Deadline.

PLEASE TAKE FURTHER NOTICE THAT A HEARING ON THE MOTION WILL BE HELD **JUNE 12, 2009 AT 2:00 P.M. (ET)** BEFORE THE HONORABLE KEVIN GROSS, UNITED STATES BANKRUPTCY JUDGE, AT THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE, 824 MARKET STREET, 6TH FLOOR, WILMINGTON, DELAWARE 19801.

PLEASE TAKE FURTHER NOTICE that, if you fail to respond on or before the Objection Deadline, the Court may grant the relief requested in the Motion without further notice or hearing.

Dated: May 11, 2009
Wilmington, Delaware

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NOVELL'S MOTION FOR CONVERSION

Novell, Inc. ("Novell"), and its subsidiary, SUSE Linux GmbH ("SUSE" and together with Novell the "Novell Parties") move the Court to convert these cases to chapter 7 (or to appoint a chapter 11 trustee). In the 19 months since they filed these cases, debtors and debtors in possession The SCO Group, Inc. ("SCO"), and its operating subsidiary, SCO Operations, Inc. ("Operations" and, together with SCO, the "Debtors"), have lost millions of dollars and prejudiced the payment prospects for their creditors by making one ill-considered and futile step after another in their single-minded pursuit of what they believe to be a big payday in litigation against Novell, IBM Corporation ("IBM") and others. It is time to shut down the Debtors' highly-unprofitable operations and place a reliable neutral in charge of making thoughtful decisions that are in the best interests of creditors (and even, if there is anything left for them, the Debtors' shareholders).

I. BACKGROUND

A. The Novell Litigation

1. Before filing these chapter 11 cases, SCO was involved in litigation against various parties, including both Novell and SUSE. (*See* Memorandum Opinion (filed herein November 27, 2007) (the "Opinion") 1-2.)[1]

2. On August 10, 2007, Novell won important rulings against SCO on summary judgment in the District Court. (Opinion 3-4.)

3. The trial on the issues left by the summary judgment was set for September 14, 2007, a Monday. (Opinion 4.) The Debtors filed their voluntary chapter 11 petitions before this Court on September 11, 2007, the preceding Friday. The filing stayed the District Court litigation.

4. In late November of 2007, Novell obtained stay relief – over the Debtors' opposition – to complete the litigation. (Dkt. Nos. 232, 233.) Ultimately, in late 2008, Novell obtained a judgment for over $3.5 million, including about $625,000 that SCO was to hold in trust for Novell. (*See* Final Judgment (a true and correct copy of which is attached as Exhibit A to Novell's Objection to the Debtors' Amended Disclosure Statement (Dkt. No. 704, filed February 18, 2009); Agreed Order Resolving Novell's Motion [etc.] (filed December 29, 2008, Dkt. No. 644.)

5. SCO thereafter appealed the District Court's judgment to the United States Tenth Circuit Court of Appeals, where the appeal is now pending. (*See* Disclosure Statement in Connection with Debtors' Amended Joint Plan of Reorganization (the "Amended Disclosure Statement") (Dkt. No. 655, filed January 8, 2009) 14.) The Tenth Circuit has set oral argument on May 6, 2009. (Transcript of March 30, 2009 Hearing ("3/30/09 Tr.") 8:4-9.)

[1] At the same time, an international arbitration (the "Arbitration") was set for December of 2007 between SCO and SUSE that related to certain issues that the District Court had agreed should be decided in the Arbitration. (Debtor The SCO Group, Inc.'s Motion to Enforce the Automatic Stay (filed September 28, 2007, Dkt No. 69) (the "Arbitration Stay Motion")); Transcript of Hearing of November 6, 2007, Dkt. No. 207) 34:19-36:20; 60:15-64:21.) SCO asked this Court to determine that the automatic stay barred continuation of the Arbitration. (Arbitration Stay Motion.) The Court granted the Arbitration Stay Motion as requested by SCO. (Order Granting The SCO Group, Inc.'s Motion to Enforce the Automatic Stay (filed November 14, 2007, Dkt. No. 204).)

B. Other Proceedings in the Case

6. These cases have been characterized by the Debtors' precipitous and ultimately wasteful actions arising from their singular focus on retaining control of and prosecuting their lawsuits, especially the one against Novell that they already have lost at the trial court. To serve this end, the Debtors have continued to claim that they have a business with breathtaking prospects, thus justifying preserving their plan exclusivity and case management authority. Unfortunately for everyone else, those operations have generated steady, material losses.

1. The York Sale Motion and Its Aftermath

7. Just two months after filing the case, the Debtors moved to sell substantially all their assets to York Capital Management ("York"). (Emergency Motion of Debtors [etc.] (filed October 23, 2007, Dkt. No. 149 (the "York Sale Motion").) Though a proposed sale of substantially all of the Debtors' assets, the York Sale Motion specifically excluded from the sale the Debtors' litigation against Novell and IBM. Clearly, the Debtors were prepared to sacrifice their other assets to fund the litigation.

8. The Court refused to approve the York Sale Motion in the face of substantial opposition focusing on, among other things, the motion's lack of definitive documents and other information. (*See, e.g.*, Novell's Objection to the Debtors' Proposed Disclosure Statement (filed March 26, 2008) (the "Novell DS Obj.") 2-3.) The Debtors withdrew the York Sale Motion altogether on November 20, 2007, just days after Novell and others filed objections to it. (Dkt. No. 225.)

9. Notwithstanding their misstep in the York Sale Motion, the Debtors nevertheless subsequently asked the Court to authorize them to pay York a gratuitous breakup fee even though there was no sale to York or anyone else, nor even any prior approval of any breakup fee. (Dkt. No. 367, filed February 29, 2008.) The Debtors withdrew this motion (the "York Compensation Motion"), too, in the face of substantial objections to it, though the Debtors plainly have not abandoned the idea of conferring this gift on York. (*See, e.g.*, Novell's

Objection to the Debtors' Request to Approve an Expense Reimbursement to York (Dkt. No. 411, filed March 26, 2008; Dkt. No. 472, filed May 12, 2008; Dkt. No. 492, filed June 12, 2008; Dkt. No. 710, Dkt. No. 515.)

2. The Original Plan

10. On February 29, 2008, the Debtors filed the Debtors' Joint Plan of Reorganization (the "Original Plan") and the related proposed Disclosure Statement in Connection with Debtors' Joint Plan of Reorganization (the "Original Disclosure Statement").

11. The outcome of this foray by the Debtors was *déjà vu* of the York Sale Motion. In the face of extensive objections filed by Novell and others (*see, e.g.*, Novell DS Obj.), many of which again focused on the lack of transparency and the categorical absence of any documentation of the underlying arrangements, the Debtors withdrew the Original Plan and Original Disclosure Statement. (Transcript of April 2, 2008 Hearing ("4/2/08 Tr."), 8:9-12:17.) In short, the Original Plan was another improvident step by the Debtors that was incompatible with judicious use of estate resources and the goal of reorganization.

12. But the Debtors' new round of bad judgment was not limited to the Original Plan. Reminiscent of the York Compensation Motion, the Debtors separately also asked the Court to approve potentially lucrative compensation for the Original Plan's contemplated sponsor (known as "SNCP") via a contemporaneous motion (the "SNCP Compensation Motion"). This was to be SNCP's reward just for SNCP's willingness to be a plan sponsor, that is, regardless of whether the Court confirmed that plan. The compensation scheme, as did the Original Plan, focused on the litigation against Novell and others. (*See* Debtors' Motion to Approve Settlement Compensation [etc.] (filed February 14, 2008, Dkt. No. 346.) Once again, it was clear that the Debtors were willing to offer significant value to a party simply because that party gave Debtors some hope of controlling the Novell and related litigation.

13. In the face of objections to the SNCP Compensation Motion (*see, e.g.*, Novell's Objection to the Debtors' Motion to Approve Settlement Compensation or Sale Compensation

and Expense to Plan Sponsor, filed March 26, 2008, Dkt. No. 410), the Debtors dropped this request. (*See* Dkt. Nos. 425, 437.) But that was only after, as with the Sale Motion, the York Motion and the Original Plan, both the Debtors and other parties needlessly had to spend resources on proceedings that were plainly flawed from their inception.

3. The First Three Exclusivity Extensions

14. The Debtors have had an ample opportunity to propose and confirm a plan. In the first place, they obtained *three* formal extensions of their exclusive right to try to confirm a plan. Novell did not oppose the Debtors' first request for an extension. It did oppose the next two. Each time the Debtors explained that they needed the extension in order to file a *real* plan, lamenting that they could not do so in the meantime for various reasons (e.g., first, the Debtors needed to know the results of the Novell trial they previously had attempted to avoid through opposing Novell's stay relief motion; then, when the Debtors *had* the trial results, they suddenly needed to get their appeal filed to attract plan sponsors before they could file a plan). Each time, the Debtors assured the Court they would file a real plan when the time came.

4. The Debtors' De Facto Fourth Exclusivity Extension, the Amended Plan and Related Proceedings

15. The final formal exclusivity extension, granted by this Court in July, was to expire on December 31, 2008. True to form, to beat this deadline the Debtors filed their fourth motion to extend on December 30, 2008 (Dkt. No. 649), relying on the filing of the motion to effect a *de facto* extension under Local Bankruptcy Rule 9006-2. In early January, they filed their Debtors' Amended Joint Plan of Reorganization (the "Amended Plan") (Dkt. No. 654, filed January 8, 2009) and accompanying Amended Disclosure Statement. A month later, the Debtors also filed a motion (the "Auction Sale Motion") (Dkt. No. 695, filed February 4, 2009) to obtain procedures for an "auction" of their assets, allegedly in support of the Amended Plan but in fact inconsistent with it. The Debtors set a hearing on the Amended Disclosure Statement and Auction Sale Motion for February 25, 2009. (Dkt. Nos. 654, 655, 656, 695.)

16. As with every prior major initiative of the Debtors in these cases, the real focal point of the Amended Plan and Auction Sale Motion was to generate money for the litigation and to get *something* on file before exclusivity ran out so that the Debtors could remain in control of their cases. And equally as with the Debtors' prior filings, the Amended Plan, Amended Disclosure Statement and Auction Sale Motion therefore suffered from sweeping defects.

17. Accordingly, in a reprise of the past, the three filings drew substantial objections from both Novell and IBM. The objections, eventually in essence acknowledged by the Debtors, were familiar ones: woefully inadequate disclosure and documentation, unsubstantiated factual claims, internal and external inconsistency if not outright conflicts, and unconfirmability of the Amended Plan on its face. (*See* Novell's Objection to the Debtors' Proposed Amended Disclosure Statement (Dkt. No. 704, filed February 18, 2009); Novell's Objections to Debtors' Motion for an Order Establishing Sale and Bid Procedures and Related Relief (Dkt. No. 706, filed February 18, 2009); Objection of International Business Machines Corporation to Debtors' Motion to Approve Disclosure Statement (Dkt. No. 703, filed February 18, 2009); IBM's Objection to Debtor's [sic] Motion for an Order [etc.] (Dkt. No. 702, filed February 18, 2009).)

18. Faced with these objections, the Debtors at first tried to buy more time by simply continuing the hearings, representing that they would make such revisions as were necessary to correct the problems. (Dkt. No. 712; 3/30/09 Tr. 6:10-7:2.) However, ultimately, the Debtors took the Auction Sale Motion off calendar altogether (Dkt. Nos. 717, 718), and on March 30 they admitted that after 18 1/2 months of exclusivity they were nowhere close to a plan or any other kind of deal:

> Those talks [with potential plan partners] have not come to the level that would be necessary for me to make any changes to the [January 2009 plan] documents . . . . and I promised your Honor some time ago with – *in the wake of another fiasco* that I would not burden this Court any further with plans or disclosure statements based on L[etters] O[f] I[ntent[] and that's what we've been offered, and I've told that to our negotiating partners on the other side, saying, you know, LOI doesn't – isn't worth anything. Well pointed out [by Novell and IBM, among others] a year ago in one transaction.

> So since I don't have such definitive documents, we don't have an amended disclosure statement, and that's because we don't have our negotiating partners at the place we want them. The deal isn't at a point that we want to close a deal.

(3/30/09 Tr. 7:3-19 (emphasis added).)

19. The "fiasco" to which the Debtors' counsel was referring in the prior quotation was actually *several* other fiascos, not merely one: the Original Plan and the York Sale Motion (exacerbated by the York Compensation Motion and the SNCP Compensation Motion), both of which the Debtors filed before they had a real deal, let alone definitive documents. Recognizing the shortcomings of these earlier proceedings at that time, the Debtors explained in April of 2008 at the demise of the Original Plan, "And we're working now with a new MOU and . . . new definitive documents will be prepared. *And we promise -- we promise we won't file it in pieces anymore.*" (4/2/08 Tr. 9:2-5 (emphasis added).) The Debtors repeated this commitment at the third exclusivity motion hearing a half year later, stating, "We *promised* Your Honor that we wouldn't come in again with a half-baked or quarter-baked plan. We would *make sure* everything is there." (Transcript of September 16, 2008 ("9/16/08 Tr.") 96:24-97:1 (emphasis added).) The Amended Plan did not live up to these promises.

5. The Debtors' Most Recent Adventures

20. Lacking even the semblance of a plan on March 30, 2009, the Debtors offered yet another apologia for why they still had not fulfilled their promises to file a real plan.[2] (3/30/09 Tr. 5:14-7:2.) The Debtors then asked for a further extension of their exclusivity deadline to the statutory limit of mid-May. In making that request, the Debtors lauded the prospects of their Tenth Circuit appeal, made speculative predictions about its outcome and asserted that their underlying business was prospering. (*See, e.g.*, 3/30/09 Tr. 8:4-16:13.)

[2] The most prominent such excuse was that having set an auction, the Debtors learned from alleged potential bidders that the latter preferred a private sale, not an auction. Having supposedly been in close contact with bidders throughout the case, the Debtors' management failed yet again in not discerning this reputed preference *before* the Debtors filed the Auction Sale Motion.

21. As Novell and others pointed out, however, despite their repeated promises to propose a confirmable plan, the Debtors not only have failed to do so, but have lost $8.65 million since the Debtors filed these cases on business operations alone.[3] (*See, e.g.*, 3/30/09 Tr. 17:12-21; 20:3-9; 32:20-34:1; Operations Monthly Operating Report for 3/31/09 (Dkt. No. 743), Statement of Operations, *Net* Profit *(Loss) Before Reorganization Items*, Cumulative Filing to Date: "($8,652,612)" (emphasis added).)[4]

22. Astonishingly, the Debtors denied these losses even though the Debtors themselves have reported them in their Monthly Operating Reports ("MOR"). Its counsel claimed that, "I'm assured by Mr. McBride very recently that the company on an operating basis . . .is in the black. It's the reorganization expenses overlay that makes it a loss." (3/30/09 Tr. 45:18-21.)

23. Novell's counsel observed at the March 30 hearing that these losses mean that unless the Debtors some day achieve a fantastic win in the Novell litigation, the Debtors will be unable to pay creditors in full. (3/30/09 Tr. 20:3-21.) That is because the Debtors now show total assets of $8.3 million, of which the most important (Unrestricted Cash of $728,537, net Accounts Receivable of $1.4 million) total but $2.1 million; by contrast the Debtors state that prepetition liabilities (*without* the still-unliquidated claims of IBM or others in litigation with them) total $6.9 million and postpetition liabilities total $4.84 million. (March 31, 2009 MOR, Balance Sheet.) Similarly, the Debtors report that their assets have declined almost 50% since the filing of the cases from $15 million to the present $8.3 million, while their *prepetition* liabilities have *increased* almost fourfold from $1.9 million to the present $6.9 million (evidently, the Debtors have chosen not to reflect large unliquidated liabilities in their reporting). (*Id.*)

24. This grim situation is in stark contrast to the Debtors' categorical claims a year before that only their shareholders had any real stake in the plan process since all creditors would be

[3] Absent the Debtors' nearly $500,000 profit from the prepetition sale of a patent by their Cattleback subsidiary that this Court approved and was consummated postpetition (*see* Dkt. Nos. 194, 272), the Debtors' postpetition losses would be over $9 million.

[4] At the time of the March 30 hearing, the Debtors had not actually filed their February or March MORs. However, those MORs reported an additional loss for those two months of about $450,000, so even at the time of the hearing the Debtors had reported a loss of over $8 million on operations alone. (*See* Dkt. Nos. 721, 737.)

paid in full (4/2/08 Tr. 11:6-10 ("The only people who should care about these metrics and the other things will be the stockholders and perhaps Mr. McMahon or the U.S. Trustee because creditors will be getting cash on the barrel at the point of confirmation, so why do they care?")) and again just last September on the Debtors' third motion to extend exclusivity (9/16/08 Tr. 88:19-25 ("We always have intended to pay them [the creditors, including Novell] in full. We still can pay them in full, [even] if the worse [sic] should happen.")).

25. Now, the Debtors' only "plan" to honor that goal appears to be to spend more on its money-losing operations in the hope that they thereby can retain control the litigation until some day, somehow they score a big win. The Debtors added an appeal to what they depicted as the promising prospects of negotiations with potential partners, but these are the very discussions that the Debtors themselves had just described as virtually meaningless a few minutes earlier in the hearing. (3/30/09 Tr. 47:9-49:1.) Of course, while that "strategy" may suit the Debtors, it is abysmal for Debtors' creditors, as the Debtors' resources will continue to shrink until there is nothing left.

26. At the March 30 hearing, moreover, the Debtors made yet another statement that shows they cannot be entrusted with continued management of these cases. Novell and IBM argued that it is time for the appointment of a trustee – a neutral not bound to pursuing the litigation at all costs to the bitter end. (*See, e.g.,* 3/30/09 Tr. 19:16-20:20; 21:16-23:5; 31:24-35:8; 36:11-37:13.). In response, the Debtors declared that it was their affirmative decision to both pursue the litigation and continue operations. (3/30/09 Tr. 44:22-45-16.) In embracing this decision at the hearing, the Debtors displayed not the slightest thought that it might have been, or might now be, an unwise choice.

27. Although it denied without prejudice the March 30, 2009 oral motions of Novell and IBM for conversion to chapter 7, the Court also denied the Debtors' request for an extension of exclusivity. The Court found that the Debtors had misused Local Bankruptcy Rule 9006-2 preserving exclusivity during the pendency of a motion to extend by relying on the filing of January 2009 Amended Plan they had essentially abandoned by mid-February and that in any

case the Debtors lacked cause to extend exclusivity. (3/30/09 Tr. 53:22-54:19; Order Denying Fourth Motion [etc.] (filed April 21, 2009).)

II. THE COURT SHOULD CONVERT THE CASES

A. Applicable Law and Standards

28. Code section 1112(b) provides, in part, that:[5]

> (1) [O]n request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that established that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court *shall* convert a case under this chapter 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.
>
> (4) For purposes of this subsection, the term "cause" includes –
>
> (A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of *rehabilitation*;
>
> * * *
>
> (B) Gross mismanagement of the estate; [or]
>
> * * *
>
> (J) Failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by an order of the court[.]

(Emphasis added.) Section 1112(b)(1) permits the court alternatively to appoint a chapter 11 trustee in lieu of conversion or dismissal under section 1104(a)(3).

29. In applying section 1112(b)(1), the Court *must* dismiss or convert if it finds that "cause" exists under section 1112(b)(4). *In re Products Int'l Co.*, 395 B.R. 101, 107-09 (Bankr. D. Ariz. 2008); *see also In re Nelson*, 343 B.R. 671, 675 (9th Cir. BAP 2006) (applying identical chapter 11 standards in chapter 13 case); *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 560-61 (Bankr. M.D. Pa. 2007). The party opposing the motion to dismiss or convert has the

[5] The "Code" is the Bankruptcy Code, 11 U.S.C. §§ 101-1532. Unless otherwise stated, all statutory references in the balance of this motion are to the Code.

burden of proof to show unusual circumstances. *Id.* at 561. Though Novell therefore will not now address the defense of unusual circumstances, it is worth noting now that "[t]he phrase 'unusual circumstances' contemplates conditions that are not common in chapter 11 cases. *In re Fisher*, 2008 WL 1775123 (Bankr. D. Mont. 2008)." *Products International*, 395 B.R. at 109 (citing to 7 COLLIER ON BANKRUPTCY, ¶ 1112,04[3], p. 1112-26-1112-27 (15th ed. rev.). In any case, if "cause" is present "unusual circumstances" are *not* an exception to appointment of a chapter 11 trustee, only to conversion or dismissal. *Products International*, 395 B.R. at 107.

30. Section 1112(b)(4) sets forth various sufficient species of "cause" for conversion or dismissal, and Novell is relying specifically on the three it excerpts above: continuing loss/diminution and unlikely rehabilitation; gross mismanagement; and failure to confirm a plan within the time set by statute or the Court. However, "cause" is a flexible standard and the section 1112(b)(4) criteria are non-exclusive. *Products International*, 395 B.R. at 107. *See also Gateway Access Solutions*, 374 B.R. at 561; *In re The AdBrite Corp.*, 290 B.R. 209, 216-17 (Bankr. S.D.N.Y. 2003); *Santa Fe Minerals, Inc. v. BEPCO, L.P. (In re 15375 Memorial Corp.)*, 382 B.R. 652, 682 (Bankr. D. Del. 2008); § 102(3) (in the Code, "'includes' and 'including' are not limiting"). Since the Court may apply section 1112(b)(1) *sua sponte*, *In re Starmark Clinics, LP*, 388 B.R. 729, 735 (Bankr. S.D. Tex. 2008), the Court here may convert the case on *any* ground specified in section 1112(b)(4) or other sufficient "cause" that it finds even if not set forth in this motion.

B. The Essential Facts

31. Before turning to the specific grounds upon which Novell seeks conversion of these cases to chapter 7, it is useful to recap the essential facts in the history of the cases that Novell has recounted above:

- The cases have been on file for 19 months.

- The Debtors have faced relatively little interference from the creditors, whose occasional involvement the Debtors' usual retreat in those instances reflects was justified.
- Despite four extensions of exclusivity, the Debtors have failed to propose a confirmable plan or to accomplish any other material step towards their reorganization, let alone their *rehabilitation.*
- The Debtors have instead subordinated everything else to finding ways for them to retain exclusive control over the litigation that they (want to) believe will afford them a rich payday some day.
- In service of their objective of retaining personal control over the litigation, the Debtors have wasted everyone's time and resources with a number of ill-conceived and premature steps.
- The Debtors repeatedly have promised but failed to advance their reorganization. What the parties have seen instead are proceedings involving incomplete transactions, potential giveaways of substantial value, obscure information, and unsubstantiated predictions and projections.
- As a result of their continuing operations, the Debtors have lost millions o dollars, are continuing to lose money, are unlikely to reverse that trend in the foreseeable future (if it all), and have, consequently, materially prejudiced the interests of creditors in getting a meaningful dividend on their claims.

C. Conversion for Diminution/Rehabilitation; Section 1112(b)(4)(A)

32. The purpose of section 1112(b)(4)(A)'s test for conversion of whether the estate is being diminished and the debtor has a prospect of rehabilitation "is to prevent the debtor-in-possession from gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation." *AdBrite*, 290 B.R. at 215 (citation omitted). In applying section 1112(b)(4)(A), "the inquiry here is twofold. First, the Court must look at the track record of the debtor to

determine if it is suffering losses or making gains. Second, the Court must determine whether rehabilitation is likely given the evidence presented at the hearing." *Gateway Access Solutions*, 374 at 562.

33. Clearly, the estates have been sorely diminished. As Novell has demonstrated above, the Debtors' own financial reporting establishes that they have lost substantial amounts of money through operations since they filed these cases even without consideration of the reorganization costs; additional losses through reorganization costs have been exacerbated by the Debtors' repeated initiation of ill-conceived proceedings in the cases. Thus, the Debtors almost surely will continue to drain their financial tanks going forward. By the same token, the Debtors' net worth has tumbled dramatically. Even now, absent a big win in the Novell litigation at some undetermined time in the future, there is *no* chance that general unsecured creditors will get a meaningful dividend, let alone payment in full, contrary to what the Debtors asserted as essentially automatic as recently as last September. And as time goes on and the Debtors continue to operate at a loss, the situation for creditors will only worsen. The first prong of section 1112(b)(4)(A) is, therefore, satisfied beyond genuine dispute.

34. What, then, of the Debtors' chances at "rehabilitation", the second part of "cause" for conversion under section 1112(b)(4)(A)? The concept of rehabilitation is more than a question of whether the debtor can confirm a plan of reorganization (which might include a liquidation). "It means to put back in good condition and reestablish on a sound basis. . . . . It signifies that the debtor will be reestablished on secured [sic] financial basis, which implies establishing a cash flow from which its current obligations can be met." *AdBrite*, 290 B.R. at 216 (citations omitted); *see also Santa Fe Minerals*, 382 B.R. at 683; *In re Schriock Constr. Co., Inc.*, 167 B.R. 569, 576 (Bankr. D.N.D. 1994) (negative postpetition cash flow, cram down plan not feasible, case converted). The Debtors' prospects must be more than "visionary schemes" or "unsubstantiated hopes." *Gateway Access Solutions*, 374 B.R at 562 (citing to *In re Brown*, 951 F.2d 564, 572 (3d Cir. 1991) and finding that decision to be relevant to the standard of section 1112(b)(4)(A)).

35. In these cases, despite all their costly activity, the Debtors have made *no* progress towards a financial resolution of these cases, let alone towards "rehabilitation." The Debtors' only gestures towards some proceeding resolving the cases have been ill-starred and wasteful, and their unprofitable operations during that time have only intensified the problem.

36. The Debtors have managed to keep the litigation alive, it is true, litigation that might some day benefit the creditors (although the Debtors' loss to Novell at trial bodes ill for them whatever they may say about their hopes on appeal). But the preservation of the litigation could have been done in a chapter 7 case from the outset just as well but without the severe deterioration in the Debtors' finances that has prevailed in the 19 months of these cases. A chapter 11 case was not essential to the litigation then, and it is even less so now. All the chapter 11 has done is allow the Debtors' management to keep the Debtors' in control of the litigation by sacrificing every other prospect of financial benefit for the creditors.

37. These cases parallel the pattern of several reported cases in which the court has granted motions under section 1112(b)(4)(A) because management has jeopardized the prospects of creditor recovery by wasting time and resources through putting its inflated views of the debtor's future above the interests of creditors without ever consummating the plan or deal that always seems to be "just around the corner." *See, e.g., Gateway Access Solutions, supra* (case converted to chapter 7) (case filed in January of 2007, deadline for plan expired in November of 2007 without the filing of any plan; court rejects debtor's appeal to the court to focus on the alleged value of its assets that it proposes to sell rather than its continuing losses, finding that the debtor's "unsupported speculation," lack of real deals and absence of support for its projections cannot be overlooked); *In re Forest Hill Funeral Home & Mem'l Park,* 364 B.R. 808, 823 (Bankr. D. Okla. 2007) (case dismissed because no reasonable likelihood of rehabilitation, in part because sale only solution and "there is nothing to indicate that a sale is in prospect . . . .[or that] the Debtor's precarious cash flow [will improve]").

38. Similarly, after considering the 15 months the debtor had been in chapter 11, the debtor's failure to accomplish sale of key assets as promised, the debtor's continuing poor

relations with key creditors on crucial issues, and the decline in prospective recovery for unsecured creditors the court in *Tiana Queen Motel, Inc. v. A. Illum Hansen, Inc. (In re Tiana Queen Motel, Inc.)*, 749 F.2d 146 (2d Cir. 1984), affirmed the district court's order converting the case. It wrote:

> We cannot say that the judge's conclusion that cause for conversion existed was unjustified. In light of the proven record for overestimating their chances of success, the judge could conclude that the 'best interests of creditors and the estate[s],' § 1112(b) would be served by conversion. The purpose of § 1112(b) is not to test a debtor's good faith; it is to provide relief where the debtor's efforts, however heroic, have proven inadequate to the task of reorganizing his affairs within a reasonable amount of time.

Id., 749 F.2d at 152.

39. A further negative for the Debtors' prospects of paying creditors is the Debtors' management, as Novell will cover more extensively in the next section. Be it noted here, however, that management has been characterized by bad decisions, exuberant claims about the Debtors' affairs and a focus on litigation to the exclusion of every other important interest. Conversion to chapter 7 (or the appointment of a chapter 11 trustee if the Court thinks that the Debtors should continue their money-losing operations) will place in charge a neutral who is not bound by preconceptions or governed by historic the fond hopes of the management.

40. In sum, contrary to the teaching of *AdBrite, supra*, the Debtors have been "gambling" at the expense of their creditors, the very evil that section 1112(b)(4)(A) is to prevent. The next section of this brief will further underscore this point. Conversion is necessary.

D. Gross Mismanagement; Section 1112(b)(4)(B)

41. In *Products International*, 395 B.R at 110, the court appointed a chapter 11 trustee after finding "gross mismanagement" under section 1112(b)(4)(B). In ruling, the court concluded that the debtor failed to maintain an "effective management team" and "lacks a focused reorganization management team" in part because that team was more interested in its own concerns than its fiduciary duties to creditors. *See also Gateway Access Solutions*, 374 B.R.

at 564-65 (also endorsing the need for effective and focused management team). The reason that the *Products International* court appointed a chapter 11 trustee rather than converting or dismissing was that, unlike in this case, the debtor still had successful operations and valuable assets despite the debtor's ineffective management.

42. Here, the Debtors have materially prejudiced the interests of creditors through a regime of devotion to retaining the control of the litigation that has produced one false and wasteful start after another and 19 months of unsuccessful operations. All the while, the Debtors have been telling the Court and creditors how promising things are. It is time to replace the Debtors' management. And since the Debtors are likely to continue to lose money, both because their business is weak and because their management's judgment is unlikely to improve, it is appropriate to serve the estate's interests by replacing management through a mechanism that will also result in the termination of those operations: conversion of this case to a chapter 7.

E. Failure to File Disclosure Statement or Confirm Plan; Section 1112(b)(4)J)

43. The grounds for conversion in section 1112(b)(4)(J) are the easiest to meet in this motion. The Debtors have filed two purported "plans" and "disclosure statements". However, as the oppositions and the Debtors' own responses thereto in each instance demonstrated, none of these was even close to being approvable or confirmable. In essence, the filing of these documents served as a placeholder for the Debtors in their attempt to preserve their control over the litigation by preserving exclusivity based the continued appearance of a viable business and "progress" towards a plan. And, of course, the Debtors said after the Original Plan fiasco that they would never file a "half-baked" plan again, but that is, of course, just what they did when they finally filed another plan eight months later to again try to preserve exclusivity.

44. In any case, the Debtors have no plan or disclosure statement on file now, but their exclusivity has run out (and even their statutory outside exclusivity deadline of mid-May of this year would have expired before this motion is heard had they been able to get a further extension

on March 30). If these circumstances do not satisfy the criteria of section 1112(b)(4)(J), it is hard to imagine what would.

F. Cause Generally

45. Even were the Court to find that the facts and circumstances that Novell has marshaled in support of conversion under sections 1112(b)(4)(A), (b)((4)() and (b)(4)(J) fail to add up to grounds for conversion under those specific provisions of the Code, Novell submits that the facts and circumstances together, as discussed at length in Part I of this motion and summarized in part IIA, *supra*, constitute "cause", which is not limited to the criteria specifically delimited in section 1112(b)(4).

III. CONCLUSION

46. The Debtors have had an ample chance to reorganize in this chapter 11 case. Through their decisions and judgments, they have altogether fumbled whatever opportunity they had to propose and confirm a plan. In the process, they have done (and demonstrated they will do) irreparable harm to the creditors if they are left in charge of these cases. It is time to re-balance the playing field by converting the cases to chapter 7, thereby placing a trustee in charge of making decisions and stemming the loss of the estate's remaining precious resources.

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