
**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

The **SCO GROUP, INC.**, et al.,

Debtors.

Chapter 11

Case No. 07-11337 (KG)
(Jointly Administered)

Hearing:

December 30, 2009 at 10:00 a.m.

Objections due:

December 23, 2009 at 4:00 p.m.

**MOTION OF PETROFSKY FOR AN ORDER COMPELLING THE
TRUSTEE'S COMPLIANCE WITH REPORTING REQUIREMENTS AND
SETTING REPORTING DEADLINES**

1. I, Alan P. Petrofsky, an equity security holder of Debtor The SCO Group, Inc., hereby move the court for an order compelling the trustee's compliance with reporting requirements and setting reporting deadlines.

2. In the first three and a half months of the trustee's tenure, he has failed to fulfill a single one of his written reporting duties. Reports on estate disbursements are now 43 days overdue, and a report on the use of ordinary-course professionals is 54 days overdue. Worse, the debtors' money-losing business operations, which had already caused millions of dollars of damage to the estates, have now been operating in complete darkness for more than five months, with no Monthly Operating Reports having been filed for any period after June 30, 2009.

3. More than four months ago, the Court wrote that it was “now unwilling to continue to wait while Debtors’ losses mount.” (*Memorandum Opinion*, Docket No. 890, August 5, 2009, at 8). Since then, the Court and the parties have continued to wait, while the losses have presumably continued to mount, with the trustee making no detectable progress toward a sale of the business or a decision to recommend conversion. During this waiting, the trustee has ignored his reporting obligations, filing neither reports nor any extension motions showing cause to extend the reporting deadlines. The parties have been left without any information at all about the estates’ disbursements, receipts, or cash balances.

4. The Court and the parties should not have to take it on faith that the continuation of a debtor’s business operations – especially operations that are already proven money-losers – continues to make any sense. For that reason, the failure to fulfill reporting obligations is itself cause for conversion to Chapter 7.

5. Nevertheless, I am, at this point, only requesting the modest relief of an order: (1) compelling the trustee to file forthwith those reports for which there have been filing deadlines that he has ignored; and (2) setting specific, court-ordered filing deadlines for those reports that have lacked them.

6. Specifically, the proposed order: (1) compels the filing forthwith, and no later than 7 days after entry of the order, of: (a) the statements of disbursements for the period of July through September 2009 (overdue since October 31) and (b) the statement of payments to ordinary-course professionals for the period of July through September 2009 (overdue since October 20); and (2) (a) sets a deadline of January 15, 2010 for the filing of Monthly Operating Reports for July through November 2009; (b) sets Monthly Operating Report filing deadlines, for the December 2009 period and each future month, on the 20th day after the end of each month; and (c) sets

a filing deadline of January 20, 2010 for the first semi-annual subsidiaries report on Form 26.

JURISDICTION AND STATUTORY BASIS FOR RELIEF

7. The Court has jurisdiction over the matters subject of this motion pursuant to 28 U.S.C. §157 and §1334. The statutory predicates for the relief sought herein are 11 U.S.C. §§ 105(a), 327, 328, and 704(a)(8), and Pub. L. 109-8 §419, 119 Stat. 23, 109 (2005).

BACKGROUND

8. On September 14, 2007, The SCO Group, Inc. and SCO Operations, Inc. (the “Debtors”), commenced these cases by filing their voluntary petitions under Chapter 11 of the Bankruptcy Code. On September 18, 2007, the cases were administratively consolidated (see Docket No. 25).

9. On November 6, 2007, the Court entered its *Order Authorizing Retention of Professionals Utilized in the Ordinary Course of Business Pursuant to Sections 327 and 328 of the Bankruptcy Code* (the “Ordinary Course Professionals Order”) (Docket No. 192). The order provides that:

Twenty (20) days after the end of each calendar quarter (the first report’s period shall be from the Petition Date to December 31, 2007) the Debtors will file a statement with the Court certifying the Debtors’ compliance with the terms of the relief ordered herein, which statement shall include the following information: (i) the name of each Ordinary Course Professional and the aggregate amount paid as compensation for services rendered and as reimbursement of expenses incurred by each Ordinary Course Professional during the preceding 90 days and (ii) a list of any additional Ordinary Course Professionals that are retained or utilized after the Petition Date and who are not listed on Exhibit A hereto (the “Quarterly Statement”).

(Ordinary Course Professionals Order, Docket No. 192, November 6, 2007, at p. 4-5, ¶10)

10. The form for Monthly Operating Reports (“MOR”s) that is prescribed by the Office of the United States Trustee for Region 3 (the “OUST”) instructs debtors in possession and Chapter 11 trustees to “File with Court and submit copy to United States Trustee within 20 days after end of month” (Region 3 Form MOR, last revised April 2007) (see *Declaration of Alan P. Petrofsky* filed herewith (“Decl.”) at ¶6 and Ex. 4 and 5). It includes sections for a “Schedule of Cash Receipts and Disbursements” (at attachment MOR-1) and a “Schedule of Professional Fees and Expenses Paid” (at attachment MOR-1b).

11. For each month from the commencement of the cases in September 2007 through June 2009, the debtors in possession eventually filed an MOR for each debtor, concluding with the June 2009 MORs filed on August 3, 2009 in Docket Nos. 886 and 887. These filed MORs include statements of the disbursements in each month and lists of the amounts of compensation paid to each ordinary-course professional in each month.

12. In May, 2009, the OUST, as well as the two most active creditors, Novell and IBM, all filed motions to convert the cases to cases under Chapter 7. See, respectively, Docket Nos. 750, 753, and 751, filed May 5, 11, and 11, 2009.

13. On June 22, 2009, the Debtors filed a motion to approve a sale of substantially all of the operating business assets to Unxis, Inc. (*Debtors’ Motion for Authority to Sell Property Outside the Ordinary Course of Business Free and Clear of Interests and for Approval of Assumption and Assignment of Executory Contracts and Unexpired Leases in Conjunction With Sale*, Docket No. 815, June 22, 2009).

14. On August 5, 2009, the Court entered its opinion on the conversion and

sale motions and ordered the appointment of a trustee. (*Memorandum Opinion and Order*, Docket Nos. 890 and 891, August 5, 2009)

15. The Court denied the sale motion, explaining that “the Court is unable to find based on this record, the Debtors’ history of unsuccessful sale efforts and this sale’s peculiar and questionable timing that Unixis [sic] has acted in good faith”. (Opinion at 9)

16. The Court found that the continuation of the Debtors’ business operations had thus far been disastrous and that there was no hope of rehabilitation:

Debtors have lost \$8,652,612 since filing, without taking into account re-organization costs. . . . Debtors are, and do not deny, suffering substantial and continuing losses to and diminution of the estate. The losses are staggering. In addition, Debtors have no reasonable likelihood of rehabilitation. It is beyond peradventure that Debtors have abandoned rehabilitation by seeking to sell its operating business (except for Mobility which produces minimal revenues) and committing thereafter to dismiss its cases. So much for rehabilitation.

(*Id.* at 6 and 11)

17. The Court nevertheless declined to convert the cases and let a Chapter 7 trustee concentrate on pursuing the estate’s litigation claims. Instead, the Court chose the option of a Chapter 11 trustee, apparently in order to preserve “an opportunity for an unprejudiced party to evaluate the sale to Unixis [sic]” (*Id.* at 12).

18. On August 25, 2009, the OUST appointed Edward N. Cahn as trustee and the Court approved the appointment the same day.¹ (See appointment and order in

¹Cahn failed to qualify as trustee because no bond was “filed with the court” both “before five days after [his] selection, and before beginning official duties” (11 U.S.C. §322(a)). However: (1) he appears to have begun asserting trustee powers on August 25, 2009; (2) it does not appear that the Debtors made any timely challenge to his authority; and (3) he eventually filed an untimely bond on September 11, 2009 (Docket No. 911). Therefore, he can presumably be deemed to have been the trustee since August 25, 2009, pursuant to the de facto trustee doctrine. See *In re Granderson*, 252 B.R. 1 (1st Circuit 2000) and *In re Holiday Isles, Ltd.*, 29 B.R. 827 (Bankr. S.D.Fla. 1983).

Docket Nos. 898 and 900.)

19. On October 7, 2009, I sent an email to counsel for the trustee, in which I asked when the trustee expected to file MORs for July and August. (Decl. at ¶3, Ex. 1)

20. On November 27, 2009, I sent another email to trustee's counsel, in which I inquired about the lack of Monthly Operating Reports, quarterly statements of estate disbursements, quarterly statements of payments to ordinary-course professionals, and semi-annual subsidiaries reports, and cited the statutes, rules, and orders underlying each reporting requirement. (Decl. at ¶4, Ex. 2)

21. On December 4, 2009, I received a response from trustee's counsel, which said only that "the Trustee is working diligently to have the MORs filed, including those that were extant when the Trustee was appointed at the end of August. We expect they will be brought current very shortly." (Decl. at ¶5, Ex. 3). I have received no response as to the other reporting obligations about which I inquired in my November 27 message, and I have received no further response about the MORs. (Decl. at ¶5)

22. As of December 13, 2009, no statements of disbursements, no statements of payments to professionals, and no monthly operating reports have been filed for any period after June 30, 2009. No periodic subsidiaries reports on Official Form 26 have ever been filed for any period.

GROUNDNS FOR RELIEF

I. The Quarterly Disbursements Statements

23. Rule 2015(a)(5) dictates that:

A trustee or debtor in possession shall . . . in a chapter 11 reorganization case, on or before the last day of the month after each calendar quarter during which there is a duty to pay fees under 28 U.S.C. §1930(a)(6), file and transmit to the United States trustee a statement of any disbursements made during that quarter and of any fees payable under 28 U.S.C. §1930(a)(6) for that quarter.

24. The information provided to the parties by these statements (the “Quarterly Disbursements Statements”) would be redundant if the trustee were filing Monthly Operating Reports, because those reports include a schedule of disbursements (see Form MOR, at attachment MOR-1, Decl. Ex. 5), and the U.S. trustee fees can be computed from the amount of the disbursements (see 28 U.S.C. §1930(a)(6)).

25. However, when no MORs have recently been filed, the Quarterly Disbursements Statements serve to provide the parties with at least a minimal amount of information about the debtors’ operations.

26. For the July through September 2009 period, the trustee neither filed the Quarterly Disbursements Statements (for either debtor) by the deadline (October 31, 2009), nor attempted to obtain an extension of that deadline by filing a motion pursuant to Rule 9006(b)(1), nor even responded to any of my inquiries about this requirement.

27. The filing of the Quarterly Disbursements Statements and the deadline for filing them are prescribed by the Federal Rules of Bankruptcy Procedure, and therefore the trustee’s unexcused failures to file them are cause for conversion per 11 U.S.C. §1112(b)(4)(F) (“‘cause’ includes . . . unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter”).

28. These statements are 43 days overdue and will be 60 days overdue if they are not filed before the hearing date on this motion. The trustee should be ordered

to file the Quarterly Disbursements Statements forthwith.

II. The Quarterly Ordinary Course Professionals Statement

29. The Ordinary Course Professionals Order orders that:

Twenty (20) days after the end of each calendar quarter (the first report's period shall be from the Petition Date to December 31, 2007) the Debtors will file a statement with the Court certifying the Debtors' compliance with the terms of the relief ordered herein, which statement shall include the following information: (i) the name of each Ordinary Course Professional and the aggregate amount paid as compensation for services rendered and as reimbursement of expenses incurred by each Ordinary Course Professional during the preceding 90 days and (ii) a list of any additional Ordinary Course Professionals that are retained or utilized after the Petition Date and who are not listed on Exhibit A hereto (the "Quarterly Statement").

(Ordinary Course Professionals Order, Docket No. 192, at p. 4-5, ¶10)

30. As with the Quarterly Disbursements Statements, most of the information provided to the parties by these statements (the "Ordinary Course Professionals Statements") would be redundant if the trustee were filing Monthly Operating Reports, because those reports include a "Schedule of Professional Fees and Expenses Paid" (see Form MOR, at attachment MOR-1b, Decl. Ex. 5).

31. However, when no MORs have recently been filed, the Quarterly Ordinary Course Professionals Statements serve to provide the parties with at least a minimal amount of information about the debtors' operations, and about the trustee's use or abuse of the payment authority that was granted by the Ordinary Course Professionals Order.

32. For the July through September 2009 period, the trustee neither filed the Quarterly Ordinary Course Professionals Statement by the deadline (October 20,

2009), nor attempted to obtain an extension of that deadline by filing a motion pursuant to Rule 9006(b)(1), nor even responded to any of my inquiries about this requirement.

33. The filing of the Quarterly Ordinary Course Professionals Statement and the deadline for filing it are prescribed by court order, and therefore the trustee's unexcused failure to file it is grounds for conversion per 11 U.S.C. §1112(b)(4)(E) ("cause' includes . . . failure to comply with an order of the court").

34. This statement is now 54 days overdue and will be 71 days overdue if it is not filed before the hearing date on this motion. The trustee should be ordered to file the Quarterly Ordinary Course Professionals Statement forthwith.

III. The Monthly Operating Reports

35. Monthly Operating Reports are vitally important:

Timely and accurate financial disclosure is the life blood of the Chapter 11 process. Monthly operating reports are much more than busy work imposed upon a Chapter 11 debtor for no reason other than to require it to do something. They are the means by which creditors can monitor a debtor's post-petition operations. *In re Chesmid Park Corp.*, 45 B.R. 153, 159 (Bankr. E.D.Va. 1984). As such, their filing is very high on the list of fiduciary obligations imposed upon a debtor in possession.

(*In re Berryhill*, 127 BR 427, 433 (Bankr. N.D. Ind. 1991))

36. The Debtors' business has now been operating for more than five months without any operating reports being provided to the Court or the parties. The trustee has never even revealed so much as a cash balance.

37. Although the filing of periodic operating reports is required by the Bankruptcy Code, neither the code nor the Federal Rules of Bankruptcy Procedure set any deadlines, leaving this task to the local court or United States Trustee:

The trustee shall . . . if the business of the debtor is authorized to be operated, file with the court . . . periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires

(11 U.S.C. §704(a)(8))

38. This region’s OUST has prescribed a nominal deadline for Monthly Operating Reports of “20 days after end of month” (Form MOR, in Decl. Ex. 5; see also Decl. at ¶6 and Ex. 4).

39. However, the OUST may extend the MOR deadlines it sets, and, despite my best efforts, I have been unable to learn whether any such extensions are in place. See Decl. at ¶7-9 and Ex. 6-7. Indeed, counsel for OUST appears to be so overworked that when I spoke to him this week, even *he* did not know whether any such extensions were in place. See Decl. at ¶8 and Ex. 7. Therefore, I cannot contend, and do not contend, that the trustee has failed to meet any deadline established by the OUST.

40. This is not the first time in these cases that a party has been unable to determine whether or not a long period of no reporting had been excused by the OUST. For example, at the March 30, 2009 hearing on terminating exclusivity, Creditor IBM’s very able counsel, Richard Levin, represented to the court that the operating reports were late and overdue, only to be contradicted by Debtors’ very able counsel, Arthur Spector:

MR. LEVIN: . . . the operating report for February 28th has not yet been filed. It’s overdue. In fact, the operating report for January was way overdue. It was filed in mid to late March. I think it was the 20th or 23rd of March that it was filed. So it was at least a month late as well.

(March 30, 2009 hearing transcript, Docket No. 739, at 32:11-15)

MR. SPECTOR: Let's see. The MORs are late. No. We got extensions on those from the U.S. Trustee who was gracious enough to give it . . . Mr. McMahon has been kind enough to allow us an extension when we needed it. So they're not really late

(*Id.*, at 47:6-14)

41. Currently, the status of the estates is triply obscured:
- (a) None of the information that would be on the Monthly Operating Reports, if there were any, is being provided to the Court or the parties;
 - (b) No information about whatever cause may exist for extending the MOR filing deadlines is being provided to the Court or the parties; and
 - (c) The parties are unable even to determine whether or not the OUST has extended any of the MOR deadlines.

42. If the Court were to set its own deadlines, they would be extensible only by court order, or by operation of Local Rule 9006-2 upon the filing and service of an extension motion. Thus, the parties would be assured of either getting actual reports, or at the very least learning what extraordinary cause there is to justify months and months without any reports.

43. For the estates to endure five months of operations, more than three of them under the auspices of the current trustee, without a drop of "the life blood of the Chapter 11 process" (*Berryhill*, 127 B.R. at 433), and without even any showing of cause for the long delay in reporting, is grossly unjust. The Court should enter an order establishing reasonable deadlines for the MORs.

IV. The Semi-Annual Subsidiaries Reports

44. Periodic financial reports, on Official Form 26, of the value, operations, and profitability of the entities in which the estates hold a controlling or substantial interest, are required to be filed every six months, per Rule 2015.3.

45. The Supreme Court ordered that Rule 2015.3 “shall take effect on December 1, 2008, and shall govern in . . . , insofar as just and practicable, all proceedings then pending” (Order adopting bankruptcy rule amendments, 553 U.S. ____, April 23, 2008).

46. Applying the rule would surely be just and in furtherance of the rule’s statutory purpose, “to assist parties in interest taking steps to ensure that the debtor’s interest in any [subsidiary] is used for the payment of allowed claims against debtor” (Pub. L. 109-8 §419(b), 119 Stat. 23, 109 (2005)), in light of the perplexing shenanigans revealed at the July hearing, which involved the billing of \$100,000 of purported “consulting services” by Stephen L. Norris (the ineffective financier at the center of both the first failed reorganization plan and the last failed asset sale motion) to debtor SCO Group, Inc. and then their rebilling to the non-debtor Japanese subsidiary. See July 27, 2009 hearing transcript, Docket No. 892 at 253:9-256:9.

47. It is also surely practicable for the first Form 26 report to be filed by January 20, 2010, by which time the trustee will have been in place for 148 days, more than four times the 33 days that are allowed for the filing of the first report in cases that are commenced under the current rules. See Rules 2015.3(b) (first report to be filed 7 days before creditors meeting) and 2003(a) (creditors meeting to be held within 40 days after commencement).

48. It would be both just and practicable for the trustee to file such subsidiaries reports, and therefore Rule 2015.3 governs in these cases. The court should enter an order establishing a reasonable deadline for the first report.

NOTICE

49. Notice of this motion has been or will be given to the following entities: (i)

the trustee; (ii) the Office of the United States Trustee; (iii) the creditors holding the 20 largest unsecured claims against the Debtors' estates (on a consolidated basis); and (iv) every party that has made a request for notices that has been filed and entered on the Court's docket prior to the date of this motion.

CONCLUSION

50. The Debtors' business operations had been losing money for years before the bankruptcy, and they have now been losing money for years during the bankruptcy. Apparent offers to buy the operations as a going concern have always turned out to be vaporous upon closer inspection. Common sense would indicate that the sooner the cases are converted to Chapter 7 and the bleeding is stopped, the more value will be left for creditors, and – if the litigation is ultimately successful – the more will be left to distribute to the debtors (per 11 U.S.C. §726(a)(6)), to the ultimate benefit of the Equity Security Holders.

51. Indeed, the OUST and the two active creditors reached that common sense conclusion more than seven months ago when they filed their motions to convert.

52. However, rather than recommend conversion and then concentrate on the estates' litigation, or expeditiously complete a sale of the business that was supposedly on the verge of completion way back in June, the trustee has instead continued to operate the business for more than three months, while not yet even proposing bid procedures for any sale of the business.

53. Although one may believe that there's some possibility that the lack of movement is somehow prudent, it's certainly not prudent for the trustee to continue money-bleeding operations for month after month after month, *but completely ignore his duty to report on those operations*. The dubious decision to perpetuate the estates'

agony should not be allowed to escape all scrutiny.

54. WHEREFORE, I respectfully request that the Court enter an order, substantially in the form attached hereto, granting (i) this motion, and (ii) such other and further relief as the Court deems proper and just.

Respectfully submitted this Thirteenth day of December, 2009,

/s/ Alan P. Petrofsky

Alan P. Petrofsky, Equity Security Holder
PO Box 6263
San Rafael CA 94903
Telephone: (650)520-0626
Facsimile: (415)499-8385
E-mail: al@scofacts.org