
**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: March 5, 2010 at 11:00 a.m.
Related Docket No.: 1051

**OBJECTION OF PETROFSKY TO MOTION OF CHAPTER 11 TRUSTEE
FOR ORDER (I) AUTHORIZING DEBTORS' ESTATES TO OBTAIN
POSTPETITION FINANCING AND TO GRANT SECURITY INTERESTS
AND SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS
PURSUANT TO 11 U.S.C. SECS. 105, 363(c), 364(c), 364(e) AND 507(b);
(II) MODIFYING THE AUTOMATIC STAY PURSUANT TO 11 U.S.C. SEC.
362; AND (III) GRANTING OTHER RELIEF**

1. I, Alan P. Petrofsky, an equity security holder of Debtor The SCO Group, Inc., hereby object to the *Motion of Chapter 11 Trustee For Order (I) Authorizing Debtors' Estates to Obtain Postpetition Financing and to Grant Security Interests and Superpriority Administrative Expense Status Pursuant to 11 U.S.C. secs. 105, 363(c), 364(c), 364(e) and 507(b); (II) Modifying the Automatic Stay Pursuant to 11 U.S.C. sec. 362; and (III) Granting Other Relief*, docket no. 1051, filed February 19, 2010 (the "Motion").

INTRODUCTION

2. The trustee, carrying on the tradition of the debtors-in-possession before him, has submitted another half-baked proposal to obtain funding from a non-existent counterparty. Should this party soon come into existence and execute the agreement, but never produce a dime of funds, the trustee wishes to provide it with a parting gift of up to \$50,000.

3. The trustee also asks for approval to use the funding, should it actually be obtained, “to operate the Debtors’ businesses as a going concern”, despite his failure to provide any current information about the profitability of those businesses, and despite the fact that the most recent reports that he has filed report that the operation of those businesses continues to damage the estates in the amount of hundreds of thousands of dollars per month.

4. Creditor Novell, Inc. states in its opposition to the motion that “If the litigation thrives, equity stands to profit” (docket no. 1065 at para. 9). However, all parties, including equity holders (other than Ralph Yarro), will be harmed if the estates pay a \$50,000 fee for nothing, or if they receive some financing but spend it on continuing the debtors’ money-losing operations.

THE MOTION’S PREMATURITY AND THE TRUSTEE’S LACK OF DILIGENCE

5. The motion has attached to it an incomplete and unexecuted proposed “Secured Super-Priority Credit Agreement” with “Seung Ni Capital Partners, L.L.C., a Delaware limited liability company” (the “Credit Agreement”)¹, and in the motion it states:

¹An electronically searchable copy of the proposed agreement is attached hereto as Exhibit A.

The Trustee is advised that Seung Ni Capital Partners, L.L.C. is a newly formed entity formed by Ralph J. Yarro III (“Yarro”) and was created for the purpose of providing postpetition financing to the Debtors.

(motion at para. 8)

6. Whoever provided the trustee with this advice appears to have been unwilling to perform even one minute of diligence. Seung Ni Capital Partners, L.L.C., was not a “formed entity” that had been “formed” or “created” for any purpose. More than a week later, it still isn’t. In fact, Yarro hasn’t even bothered to spend two minutes and seventy-five dollars on filing a name reservation with the Delaware secretary of state. Therefore, some unrelated person could use or reserve the name at any moment, which would then necessitate choosing a different name and revising the proposed order and the loan documents to reflect it. See the pages from the website of the Delaware secretary of state regarding the status of “Seung Ni Capital Partners, L.L.C.” as of February 26, 2010, attached hereto as Exhibit B; and 6 Del. C. 18-201(b) (a Delaware LLC is not a legal person until after the certificate of formation has been filed) and 18-102(3) (an LLC may not use a name that has already been used or reserved).

7. This is not the first time in these cases that the Court has been asked to approve a deal with a party that did not legally exist. See the “Memorandum of Understanding” with “Stephen Norris Capital Partners, LLC, a Delaware limited liability company”, dated February 13, 2008, Ex. A to docket no. 346; and my objection, docket no. 414 at paras. 7-15.

8. Furthermore, there is a long and consistent history in these cases of purported financiers offering the estates funding that never materializes. See the offer in October 2007 of \$20,000,000 in cash and financing from JGD Management Corp. d/b/a York Capital Management (motion to approve in docket no. 149, withdrawn in docket no. 225); the offer in February 2008 of \$105,000,000 in cash and financing

from Stephen Norris Capital Partners, LLC (motion to approve in docket no. 346, permanently taken off calendar in docket no. 421); and the offer in June 2009 of \$5,000,000 from Unxis, Inc. (motion to approve in docket no. 815, denied in docket no. 891, after Unxis's president, Stephen Norris, testified that Unxis had only \$10,000 to its name (see July 27, 2009 transcript, docket no. 892, at 354:3-6)).

9. To prevent wasting the Court's and the parties' resources on examining such stillborn proposals, the trustee should refrain from making any motion to approve a funding deal until after: (1) the proposed counterparty entity actually *exists*; (2) the entity has actually *executed* an agreement that is binding if the court approves it; and (3) there is evidence that the entity is capable of actually *producing* the funding that it has promised. Before filing the current motion, the trustee didn't even make it to step one.

10. Other problems indicating the general unreadiness of the proposal include:

- (a) The Credit Agreement states that a "Collateral Agent Agreement" is "attached hereto" (Credit Agreement at sec. 1.01, p. 7), but no such agreement is attached; and
- (b) it also states that a list of "Security Documents" is "attached hereto" (*Id.* at sec. 1.01, p. 13), but no such list is attached.

THE IMPROPER \$50,000 FOR THE LENDER DESPITE THE LACK OF ANY COMMITMENT

11. The Credit Agreement purports to commit the lender to provide at least \$800,000 by the closing date, which is to be no later than March 8, 2010 (Credit Agreement at sec. 2.01 and sec. 1.01, p. 8). However, there is no adverse consequence for the lender if it fails to provide the funds. Thus, producing the funds (and thereby obtaining the lien) is simply an option that the lender may or may not decide to take, and the agreement explicitly provides that if the lender opts not to produce the funds, it will nevertheless receive \$50,000:

If for any reason the amount of the Loan is less than Eight Hundred Thousand and 00/100 Dollars (\$800,000.00), Borrower may, in its discretion, either elect to waive such minimum Loan amount requirement and close the Transactions, or Borrower may elect not to close the Transactions, in which event Borrower shall nonetheless pay Lender's legal fees, subject to the foregoing \$50,000.00 cap.

(Credit Agreement at sec. 8.17(c), p. 37-38)

12. This proposal to pay all of an alleged suitor's expenses even if there is no evidence that it ever even had a dime to its name, let alone any obligation or intention of actually parting with any of its money, is wholly meritless.

13. This aspect of the agreement is reminiscent of the motion made by the debtors in possession (who were controlled by a board of directors chaired by Ralph Yarro) to pay a \$150,000 expense reimbursement to former suitor York Capital, as a "moral matter" (docket no. 367, February 29, 2008, at para. 4).

14. As the U.S. trustee and other objectors pointed out, that motion was ridiculous. See docket nos. 411, 440, and 443. The debtors never went through with a hearing on it.

15. The current proposal, to pay the lender \$50,000 even if the lender never lends anything, fails for similar reasons. It would be a breakup fee for a lender that is controlled by a long-time insider and was never even contingently obligated to provide any funds. This does not come close to meeting the requirement that breakup fees be "actually necessary to preserve the value of the estate" *In re O'Brien Environmental Energy, Inc.*, 181 F.3d 527 (3rd Cir. 1999).

16. Furthermore, if the agreement is to include the possibility that the lender produces, and the trustee accepts, less than the \$800,000 minimum, then the \$50,000 legal fee cap should be prorated down according to the size of the funding actually produced (just as the "Loan Fee" is prorated down according to the amount of funding produced; see Credit Agreement at sec. 1.01, p. 11). If, for example, the lender comes

up with only \$100,000 and the trustee decides to accept it, then paying a full \$50,000 of fees would be an unreasonably large surcharge by any standard.

CONTINUING THE BUSINESS OPERATIONS WILL NOT PRESERVE ESTATE ASSETS

17. The trustee acknowledges that one test he must meet to be entitled to financing under sec. 364(c) is that “the credit transaction is necessary to preserve the assets of the estate” (motion at para. 17(b), quoting *In re Crouse Group, Inc.*, 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987)).

18. The proposed agreement provides that up to 50% of the collateral may be used to fund business operations (agreement at sec. 5.10(a)), and the trustee asserts that “Without postpetition financing, the Trustee would be unable to operate the Debtors’ businesses as a going concern, which would significantly impair the value of their assets to the detriment of all stakeholders.” (motion at para. 18)

19. There is no evidence that continuing to operate the businesses will “preserve the assets of the estate”, and there is overwhelming evidence to the contrary.

20. The primary source of information about the state of the businesses should be the monthly operating reports (“MOR”s):

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 B.R. 427, 433 (Bankr. N.D. Ind. 1991))

21. Unfortunately, the trustee has failed to file any MORs for November 2009, December 2009, or January 2010. This is despite his assurances – given at the December 30 hearing as part of his successful effort to persuade the Court not to take

any action regarding his numerous reporting delinquencies – that the November and December reports would be filed by January 31.

22. The most recent month for which the trustee has filed any MORs is October 2009, and the most recent month for which he has filed MORs without an extraordinary disclaimer and reservation of the right to amend is September 2009.²

23. It has now been more than half a year since the trustee’s appointment, and he has yet to report a single month in which the debtors’ continuing operations were not a disaster. In the last three reported months, the debtors’ business operations have resulted in net losses, *before reorganization items*, of another \$1,068,209: \$370,984 in August, \$132,138 in September, and \$565,087 in October. (See docket nos. 1003, 1005, and 1056, each at p. MOR-2)

24. These ongoing losses show that continuing to operate the business is destroying, not preserving, the assets of the estate. Accordingly, any deal to obtain financing for the purpose of operating the business does not meet the requirements of sec. 364(c), per *Crouse*, 71 B.R. at 549.

25. Also, the diminution of the estates that is attributable to the consistently unprofitable operations has been ongoing for nearly two and a half years now, and it strongly suggests that these cases should be converted to Chapter 7 (and, indeed, should have been converted long ago). Thus, it would be imprudent to enter into any agreement that obligates the estates to stay in chapter 11, as the Credit Agreement does at sec. VII(i) (defining conversion as an Event of Default).

²The July through September MORs originally included a similar reservation, but the trustee elaborated that “[t]he Trustee is mindful of his responsibilities and will file revised MORs, if he determines such re-filing is needed, for July, August and September 2009, before the end of January 2010” (docket no. 1006 at para. 9, fn. 3), and the absence on the docket of any such re-filing before the end of January 2010 shows that he determined that no such re-filing was needed and the reservation has now expired.

**THERE IS NO SHOWING THAT THE FINANCING IS CURRENTLY
NECESSARY**

26. The motion does not provide any information about the estates' current cash balances and their projected cash needs over the next few months. Thus, regardless of whether the financing is to be used to fund the litigation expenses or to continue the business operations, there has been no showing that the financing is in any way "necessary to preserve the assets of the estate" (*Crouse*, 71 B.R. at 549.).

CONCLUSION

27. I respectfully request that the Court enter an order denying the motion.

Dated: February 28, 2010,

/s/ Alan P. Petrofsky

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