

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:)	
)	Bankruptcy #13-43894
SCICOM DATA SERVICES, LTD.)	
)	Chapter 11 Bankruptcy Case
)	

NOTICE OF HEARING ON
MOTION TO DISMISS OR CONVERT CASE

TO: The debtors, all creditors and other parties in interest:

The United States Trustee has brought a motion before the court seeking either a dismissal of this case or a conversion of the case to one under chapter 7.

On Thursday, August 28, 2014, at 2:00 p.m. before the Honorable Michael E. Ridgway, U.S. Bankruptcy Judge, in Courtroom 7 West, United States Courthouse, 300 S. Fourth Street, Minneapolis, Minnesota, the Court will hold a hearing to determine whether this case should be dismissed or converted to chapter 7.

Any response to this motion must be filed and delivered not later than August 23, 2014, which is five days before the time set for the hearing, including Saturdays, Sundays, and holidays. See Fed.R.Bankr.P. 9006 and Loc. R. Bankr. P. 9006-1(c). **UNLESS A RESPONSE OPPOSING THE MOTION IS TIMELY FILED, THE COURT MAY GRANT THE MOTION WITHOUT A HEARING.**

Dated: _____

CLERK OF BANKRUPTCY COURT

By: _____
Deputy Clerk

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:)	
)	Bankruptcy #13-43894
SCICOM DATA SERVICES, LTD.)	
)	Chapter 11 Bankruptcy Case
)	

NOTICE OF HEARING AND
MOTION TO DISMISS OR CONVERT CASE

TO: The debtor, creditors and other entities specified in Local Rule 9013-3.

1. Daniel M. McDermott, the United States Trustee, by his undersigned attorney, moves the Court for the relief requested below and gives notice of hearing.

2. On Thursday, August 28, 2014, at 2:00 p.m. before the Honorable Michael E. Ridgway, U.S. Bankruptcy Judge, in Courtroom 7 West, United States Courthouse, 300 S. Fourth Street, Minneapolis, Minnesota, the Court will hold a hearing to determine whether this case should be dismissed or converted to chapter 7.

3. Any response to this motion must be filed and delivered not later than August 23, 2014, which is five days before the time set for the hearing, including Saturdays, Sundays, and holidays.

UNLESS A RESPONSE OPPOSING THE MOTION IS TIMELY FILED, THE COURT MAY GRANT THE MOTION WITHOUT A HEARING.

4. This Court has jurisdiction over this motion pursuant to 28 U.S.C. §§157 and 1334, FED. R. BANKR. P. 5005 and Local Rule 1070-1. The United States Trustee has standing to file this motion pursuant to 28 U.S.C. §586(a) and 11 U.S.C. §307. This matter constitutes a core proceeding.

5. This case was commenced by the filing of a voluntary petition for relief under

chapter 11 on August 6, 2013. The case is now pending before this court.

6. This motion arises under 11 U. S. C. §1112(b) and FED. R. BANKR. P. 1017 and 2002. This motion is filed under FED. R. BANKR. P. 9014 and Local Rules 9013-1 through 9013-3. Movant requests that this case be dismissed or converted to a case under chapter 7, preferably converted to chapter 7.

7. Pursuant to 11 U.S.C. §1112(b), the Court may dismiss or convert a chapter 11 case for cause after notice and a hearing. Section 1112(b)(4) states that cause for dismissal or conversion to chapter 7 includes, among other things:

- (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;
- (C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;
- (D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;
- (E) failure to comply with an order of the court;
- (F) 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;
- (G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 under the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;
- (H) failure timely to provide information or attend meetings reasonably requested by the United States Trustee
- (I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;
- (J) failure to file a disclosure statement or to file or confirm a plan within the time fixed by this title or by order of the court,
- (K) failure to pay any fees or charges required under chapter 123 of title 28;
- (L) revocation of an order of confirmation under section 1144 ;
- (M) inability to effectuate substantial consummation of a confirmed plan;
- (N) material default by the debtor with respect to a confirmed plan;
- (O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and
- (P) failure of the debtor to pay any domestic support obligations that first becomes payable after the date of the filing of the petition.

FACTS

8. The Debtor filed a voluntary petition commencing this case under chapter 11 on

August 6, 2013. At that time, the Debtor owned and operated a business engaged in “digital document management and distribution services”. The business was based in Eden Prairie, Minnesota at a location owned by the debtor.

9. On August 7, 2013, the day after the bankruptcy case was filed, the debtor filed a motion for authority to sell all of its operating assets free and clear of liens to an entity known as Venture Solutions, Inc. (Venture). The sale agreement was negotiated and entered pre-petition (on July 29, 2013), and the sale motion brought by the Debtor sought approval of the sale without traditional marketing of the business or any other efforts to find buyers who would pay more than Venture. On September 26, 2013, the court entered an order authorizing the sale to Venture (Docket #67). The sale has now closed and the debtor is no longer running any business operations.

10. Part of the motion to sell the Debtor’s business to Venture included a short term lease of the debtor’s real property to Venture for a limited period (through March 31, 2014) for the purpose of transitioning the business operations to Venture as the new owner. On March 17, 2014, the debtor moved the court for an order extending the occupancy agreement between the debtor and Venture on a month-to-month basis. It is not clear if Venture remains in possession of the Debtor’s real property in any limited way, but major printing presses have now been returned to the lessor, Xerox (see below).

11. In conjunction with the motion to sell the Debtor’s business to Venture, the Debtor filed a number of motions to approve the assumption and assignment of certain leases and executory contracts. See Docket #48, #55, #56, #57, #58, #59 and #66. Those assumptions and assignments were approved by the court on October 11, 2013. See Docket #74. They did not include the assumption of any leases with Xerox Corporation.

12. On September 13, 2013, the U.S. Trustee appointed an Official Committee of Unsecured Creditors (UCC). Docket #41. The committee consists of Wewco, Roberts Business Forms, and the Pension Benefit Guarantee Corporation (PBGC). The UCC hired Fafinski Mark and Johnson to represent it. Docket #71.

13. On October 22, 2013, the Debtor brought a motion seeking the allowance and authorization to pay wages and benefits to remaining employees holding administrative and pre-petition priority claims. Docket #81. That motion was approved by the court on November 6, 2013 (Docket #87), and on information and belief, the Debtor's employees have all now been paid their final paycheck and no employee remains other than Debtor's President, Timothy Johnson.

14. On November 4, 2013, the court entered an order approving the Debtor's employment of Binswanger as a realtor to sell the real property at which it previously conducted its business. On information and belief, efforts to find a buyer for the real estate continue and, upon a sale and closing, the additional sale proceeds will be available for the benefit of creditors. According to the liquidation analysis attached to Debtor's plan, the real estate should bring between \$3 million and \$3.8 million.

Litigation During the Chapter 11 Case

15. On December 5, 2014, the Debtor hired George F. McGunnigle to mediate a dispute between the Debtor and Actuate Corporation over Actuate's claim #12 in the amount of \$4,267,130. The mediation was the continuation of mediation with Judge McGunnigle commenced prior to the filing of the debtor's bankruptcy case. The mediation was successful and Actuate now has an allowed claim of \$999,999.00. See Docket #141.

16. On May 13, 2014, Venture Solutions filed an objection to confirmation of Debtor's

liquidating plan. Docket #178. In its objection, Venture raised the issue of a possible unresolved administrative expense claim arising from the rejection of the Debtor's executory contracts with Xerox Corporation. Docket #178, pp.5-6.

17. On May 20, 2014, apparently in response to Venture's objections to plan confirmation, the Debtor filed a motion regarding the assumption of executory contracts (Docket #181). In that response, the Debtor alleged that during negotiations regarding the purchase agreement with Venture Solutions, Venture made (apparent verbal) representations that it had no intent of taking an assignment of Debtor's contracts with Xerox, but after the closing of the sale, Venture changed its position to seek an assumption and assignment by the Debtor of the Xerox contracts. Docket #181, p.7, ¶¶19-20. The dispute, in turn, resulted in the need for additional negotiation between Xerox and Venture. *Id.* at 21. Importantly, in its Memorandum in support of that motion, the Debtor went on to accuse Venture of acting in bad faith, improperly colluding with Xerox, engaging in a scheme to make the Debtor pay a second time for Xerox equipment, and challenging the nature of its contracts as executory. Docket #181, Memorandum, pp. 3-6.

18. On July 18, 2014, the Debtor went one step further and commenced an adversary proceeding against the buyer of its assets, Venture Solutions. Adv.Proc. #14-04135. In its complaint, the Debtor alleges that Venture, *inter alia*, "negotiated an amendment to the Xerox Leases (and other agreements) with Xerox without the Plaintiff's knowledge". Adv.Proc. #14-04135, Docket #1, p.3, ¶16. The complaint also alleges that Venture used the Xerox equipment without making payment to the debtor or Xerox. *Id.* at p.4, ¶24. It goes on to claim that had the Debtor known Venture was using the equipment without paying Xerox, the Debtor "would have taken action to prevent the accrual of monthly lease payments due under the Xerox leases". *Id.* at p.5, ¶33. It is unclear why the Debtor allowed this to happen without

monitoring or investigation. Regardless, the Debtor's adversary proceeding seeks to resolve disputes between the Debtor, Venture Solutions as the court approved buyer of assets, and Xerox as the lessor of Debtor's equipment that was subject to the sale.

19. On July 22, 2014, the court approved a stipulation in which the Debtor, UCC, Venture Solutions and Xerox agreed to return all of the leased equipment to Xerox and stopped the continued accrual of rents. Docket #221. On information and belief, the equipment has now all been returned. The stipulation reserved for all parties involved the right to assert, defend and later resolve all claims and counterclaims (administrative or otherwise) arising from the sale transaction.

20. Previously in the case, the parties have also seen fit to bring and dispute a motion in limine (docket #187), and negotiate, file and seek approval for a protective stipulation (Docket #200).

21. On July 23, 2014, the court held a status conference among the parties to the case, including the Debtor, UCC, Xerox and Venture. At the hearing, the parties discussed the debtor's pending adversary proceeding against Venture and Venture's counter claims against the Debtor; Xerox's motion for allowance of an administrative expense claim (docket #201), and Venture's objection to confirmation of Debtor's plan (Docket #178). After the parties entered an agreement setting separate deadlines for serving and answering interrogatories and document requests, taking depositions, entering evidentiary stipulations, submitting witness and exhibit lists, etc., the court set a final hearing on all matters on October 14, 2014, booking the entire day.

Fees and Expenses Thus Far

22. According to the Debtor's most recently filed monthly operating report (MOR),

covering the month of June, 2014, the Debtor has cash on hand of \$4,369,372.16. Docket #219, p.2. On page 7 (Form 2-D) of the June MOR, the accumulated “officer compensation” thus far in the case is \$351,050, and the “legal and professional fees” are \$695,567.00. *Id* at p.7, column 2.

23. Scheduled for hearing on August 19, 2014, is an application for allowance of fees and expenses to Fredrikson & Byron, P.A. (Fredrikson). The application seeks allowance of fees and expenses totaling \$81,437.20. This is the third fee application filed by Fredrikson and, if allowed, Fredrikson’s total fees and expenses to date in this case will be \$502,494.35.

24. Also set for hearing on August 19, 2014, is the fee application for counsel to the Unsecured Creditors’ Committee (Docket #225). That application seeks a total of \$32,874.75 and, if allowed, the total allowed fees for the UCC to date would be \$89,122.94. Similarly, there is also set for hearing the application of Lighthouse Management Group, Inc. (Lighthouse), the financial advisor to the debtor (Docket #226) seeking \$4,126.19, for a total to date of \$70,807.31. For these three professionals alone, (excluding Shenehon), the allowed and pending fee applications to date total \$662,424.60.

Claims

25. According to Debtor’s sworn Schedule F, it owes the SciCom Data Services Plan (the pension plan) a total of \$13,540,662.00, an amount which is not listed as contingent, unliquidated or disputed. That claim represents underfunded pension obligations of the Debtor. On information and belief, the Pension Benefit Guaranty Corporation (PBGC) will step into the shoes of the Debtor’s pension plan and assume the liabilities to the debtor’s former employees. On December 5, 2013, the PBGC filed claim #22 against the debtor in the amount of \$17,081,868.00. It also filed claim #21 in the additional amount of \$375,382.00, and claim #20

in the amount of \$1,098,750.00. In total, the PBGC's filed claims against the estate are \$18,556,000.00.

26. According to Debtor's filed Schedule F, there are unsecured claims totaling \$17,801,787.00. This figure includes the claim of the SciCom pension plan in the amount of \$13,540,662, and also includes the claim of Actuate Corporation in the sum of \$3,500,000.00. Eliminating the pension plan's claim and reducing the Actuate claim to the \$999,999.00 mediated amount (described above), leaves total unsecured claims of \$1,761,124.00. Accordingly, the PBGC holds more than ninety percent of the unsecured claims in the case and will be entitled to about ninety percent of any distribution of estate assets.

Pending Plan and Disclosure Statement

27. On February 20, 2014, the Debtor filed a plan and proposed disclosure statement. (Docket #144 and #145). After resolving objections of the U.S. Trustee, the court, on April 4, 2014, approved the debtor's amended disclosure statement, scheduled a hearing on plan confirmation and solicited votes. Docket #159.

28. The approved disclosure statement provides, *inter alia*, that with the exception of the Actuate litigation, "there was no pending litigation as of the filing date and there is no other pending litigation at this time". Approved Amended Disclosure Statement, Docket #158, p.8, ¶ IV(A). This is the document on which creditors based their votes.

29. The plan now before the court, along with the approved disclosure statement, were drafted and first filed on February 20, 2014. The liquidation analysis attached to the approved disclosure statement is dated February 20, 2014. A confirmation hearing is set for October 14, 2014, almost eight months after the information was set forth in the plan and disclosure statement. During that eight months, the Debtor's situation has changed dramatically. In

addition to the substantial incurrence of additional administrative expenses including professional fees, the Debtor has had to address changes to the assumption/rejection of the Xerox lease and potential damages arising from the claimed breach of the asset purchase agreement with Venture. Not only have the facts on which unsecured creditors voted changed, the debtor's financial picture is changing and will in fact change more after another sixty days of litigation among the parties. It is not certain that votes cast on or before April 24, 2014 would be the same if cast on or about October 9, 2014.

30. By its terms, the Amended Plan dated April 3, 2014, which is now before the court, the liquidation of debtor's remaining assets and distribution to creditors requires the engagement of a "Liquidating Agent" and "Oversight Committee" members. The Liquidating Agent will charge \$375.00 per hour to address claims and make distribution to creditors. The Plan also anticipates the continued involvement of former employees Timothy Johnson and Marlene Tollefson (Plan, p.11). It will also presumably require the continued involvement of legal counsel to, *inter alia*, interpret committee bylaws, handle court hearings on claim objections, etc. The Bylaws of the Oversight Committee also appear to provide, *inter alia*, that the Oversight Committee consents to the employment of the Liquidating Agent's counsel (Amended Plan, attached Bylaws, ¶1.5)¹

31. Most notably, the Oversight Committee consists of the two of the three members of the UCC, but excludes the PBGC, which is by far the entity with the most at stake in the case. It also should be noted that there is no blanket secured creditor asserting a lien on debtor's assets

¹In fact, it is impossible to know what exact powers the Liquidating Agent and the Oversight Committee will have because the Bylaws attached to the Plan on which creditors voted are incomplete. The bylaws jump from ¶1.5 on the first unnumbered page to ¶2.5 on the second unnumbered page and clearly there are missing pages since the language does not track. The undersigned counsel to the U.S. Trustee did not see this when filing his original disclosure objections, but would have raised the issue then, if known.

in the case.

CAUSE FOR CONVERSION OR DISMISSAL

32. Cause exists to immediately dismiss or convert this case to one under chapter 7. Cause is based both on ongoing losses to and a diminution of the estate and an absence of reasonable likelihood of rehabilitation, as provided for in 11 U.S.C. §1112(b)(4)(A), and based on gross mismanagement of the estate under 11 U.S.C. §1112(b)(4)(B). Since cause exists for conversion, if the Debtor is to remain in chapter 11, it has the burden of proof under §1112(b)(2), to show that conversion is not in the best interests of the estate and the court must find and specifically identify unusual circumstances which establish that immediate conversion is not in the best interests of the estate. See attached Memorandum of Law. Further, the U.S. Trustee requests that the court address this matter within the time constraints set forth in §1112(b)(3).

Losses to and Diminution of the Estate and Absence of Rehabilitation

33. First, the cause based on ongoing losses to and a diminution of the estate and an absence of reasonable likelihood of rehabilitation, as provided for in 11 U.S.C. §1112(b)(4)(A), can be seen in many of the facts of this case.

A. The debtor has arguably now sold its business, has listed its real estate for sale, and has returned all its remaining equipment to Xerox. The debtor has no expectation of resuming business in the future. At this point, there is simply nothing to rehabilitate, yet the costs of going forward remain excessive, as shown herein.

B. The debtor has undertaken to sell its operating assets and business to Venture, having engaged in negotiations both pre petition and post petition. Yet today, the transaction not only remains unresolved, it has devolved to the point where the Debtor has accused Venture of acting in bad faith, scheming with Xerox regarding

executory contracts, forcing the Debtor to assume executory contracts for no reason, etc. The litigation costs to date are extraordinary, and will continue for at least another sixty days through a period during which the Debtor contemplates preparing for and trying an adversary proceeding after exchanges of interrogatories and document requests, the deposition of witnesses, and full blown trial preparation against two sophisticated parties in the case. The litigation costs, both in the past and future, establish the ongoing losses to and diminution of the estate contemplated in §1112(b)(4)(A).

C. The prior costs of things such as the motion in limine, stipulation for protective orders, stipulations to return equipment to Xerox without resolving underlying issues, etc., all likewise establish ongoing losses to the estate.

D. At this point, the case is really nothing more than a straightforward liquidation. The claims and counter claims among the debtor, Xerox and Venture, in essence, constitute nothing more than basic claims resolution. It is wholly unnecessary to spent tens or hundreds of thousands of dollars resolving such claims when the effect on all creditors, other than the PBGC, is negligible and the PBGC is bearing the brunt of the costs (see below).

E. Despite being a liquidation case that is now mostly complete, the Debtor and the bankruptcy estate continue to have an excessive number of professional involved. In addition to the president, Timothy Johnson, the Debtor continues to have Lighthouse Management involved and continues to incur attorney fees for its counsel at what is believed to be the highest hourly rate for bankruptcy attorneys in Minnesota. The UCC likewise continues to incur substantial professional fees for its counsel. Going forward with Debtor's "liquidating" plan, the professionals will all continue their involvement and

the “oversight committee” members will likewise be entitled to have their fees and expenses covered. Multiple levels of administrative and professional costs, both incurred in the past and certain in the future, likewise establish the ongoing losses to and diminution of the estate.

F. The plan now before the court is stale. The plan terms and the liquidation analysis on which creditors based their votes were figures from February 20, 2014. The debtor’s factual situation and financial situation have changed dramatically since the plan votes were solicited. For example, the Plan said there was no pending litigation, but now that is not true. The situation will change even more by the time of the confirmation hearing on October 14, 2014. It is not clear if the plan will need to be reballoted, but addressing the issue will, in itself, result in additional losses to and a diminution of the estate.

G. Likewise, the liquidation analysis attached to the Debtor’s plan shows chapter 11 professional fees to be estimated at \$137,005.00, a figure on which creditors would have relied in voting on the plan. To date, however, the fees and expenses for the three main professionals (debtor’s counsel, UCC counsel and debtor’s financial consultant) have totaled \$662,425.00. Again, there is an ongoing loss to and diminution of the estate in the incurrence of such fees, and the absence of likelihood of rehabilitation lies in the fact that the plan, as stale, may not be confirmable.

34. The Debtor is in a liquidation mode, having sold all of its operating assets and having nothing left but a parcel of real estate and legal claims and counter claims. As a result, there is no likelihood of rehabilitation. Moreover, there are substantial ongoing losses to and a

diminution of the estate arising from the continued litigation over claims arising out of the transaction for the sale of the operating business. Those costs will continue into the future, as will the costs of distributing funds under the liquidating plan. An ongoing losses to and a diminution of the estate and an absence of reasonable likelihood of rehabilitation is cause for conversion of the case, as provided for in 11 U.S.C. §1112(b)(4)(A).

Gross Mismanagement

35. Additional cause to convert is based on the gross mismanagement of the case under 11 U.S.C. §1112(b)(4)(B). Again, there are a number of instances of what is clear mismanagement of the estate.

A. Although the negotiation of the asset purchase agreement with Venture occurred pre-petition, the adverse consequences of that negotiation continue today. It is unclear why the Debtor's management, in negotiating the Venture sale transaction, never pinned down Venture on whether or not it would take the Xerox equipment as part of the sale transaction and no explanation for this oversight by management has ever been given. From the documents in the record, it appears that Debtor's management simply took Venture's verbal word and never bothered to get a written commitment from Venture regarding the Xerox leases. Similarly, the Debtor's management failed to draft protection for itself under the terms of the purchase agreement. The failure to anticipate the Venture problems and protect the bankruptcy estate from a potentially large administrative expense claim constitutes gross mismanagement of the debtor. That mismanagement is additional cause for conversion to chapter 7 under §1112(b)(4)(B).

B. Similarly, after the sale closed and Venture took possession of the Xerox equipment, the Debtor apparently assumed that Venture would pay Xerox for the use of

Debtor's equipment, while in reality allowing a potentially large administrative expense claim to arise. Although the Debtor subsequently tried to rectify the situation by filing the adversary proceeding against Venture, the damage had been done. (See paragraph 18, above). The failure by Debtor's management to properly monitor and manage the use of its property likewise constitutes gross mismanagement and is cause for conversion under §1112(b)(4)(B).

C. Gross mismanagement can also be seen in the Debtor's treatment of the PBGC. The true party in interest in the case is the PBGC, with its claim in excess of \$18.5 million. There is no secured creditor. It appears the PBGC will be entitled to a very large majority of the estate's assets, yet their interests remain substantially unrecognized. The PBGC's only involvement in the case is as one of three members of the Unsecured Creditors' Committee. The PBGC was excluded from being a member of the liquidation "Oversight Committee" under the Debtor's Plan and liquidating trust that are now before the court. To the extent administrative expenses continue to accrue in the case, they come mostly out of the pocket of the PBGC. As a governmental agency based in Washington DC, the PBGC is not in a position to fully monitor and independently protect its interests by being active in the case, (and it can be outvoted on any collective decisions made by the UCC). Simply put, there's little incentive for any party in the case to limit the ongoing litigation when it's being paid for mostly by the PBGC. The continued, contentious litigation, which includes the adversary proceeding against Venture, the claims and counter claims with Xerox, the contested plan confirmation, etc., all constitute gross mismanagement, when considered in the context of the Debtor's debt structure.

36. Based on the foregoing, it is clear that there has been substantial mismanagement of the debtor by current management both before the case was commenced and during its pendency under chapter 11. The facts clearly reveal that the gross mismanagement is cause for immediate conversion to chapter 7 under 11 U.S.C. §1112(b)(4)(B).

Other Cause for Conversion

37. An impartial, third party fiduciary such as a chapter 7 trustee is now essential to the case. Unlike the protracted litigation the debtor in possession estate now faces, a chapter 7 trustee would not have had the prior personal involvement and would be more inclined to settle the Xerox administrative expense cure claim. In a conversion, there would be an independent determination into whether it is really necessary to do full discovery and obtain competing deposition testimony regarding what representations were made during sale negotiations. Resolution of the Xerox claim would in turn cause Venture to no longer have a claim for breach of the asset purchase agreement by the Debtor (See Venture Solution's Objections to confirmation of Plan, Docket #178, p.6, ¶16). Conversely, the debtor in possession has, as shown in the recent status conference, set up a litigation and discovery schedule requiring full discovery and trial preparation, virtually all at the expense of the PBGC, an absentee creditor. The best interests of the estate and its creditors require the immediate appointment of a new fiduciary in the form of a chapter 7 trustee.

38. According to the liquidation analysis attached to Debtor's plan (Docket #158, last page), the funds anticipated to be distributed to creditors are between \$7.8 million and \$8.6 million. Although compromising and settling the Xerox administrative cure claim would have the funds taken off the top before payment to unsecured creditors, the resolution would be immediate and relatively small as a percent of the overall distribution to creditors. It would do

so without the need for multiple levels of professionals incurring fees and costs which also come out of the pocket of creditors, principally the PBGC. Again, the entity most affected in the case is the PBGC which will be entitled to 90% of the remaining funds in the estate. It is clearly in the best interests of the creditors, particularly the PBGC, to have this case converted to chapter 7 as soon as possible.

Burden of Proof

39. Under §1112(b)(1), the court shall convert the case upon a showing of cause for conversion or dismissal. To rebut the required conversion, the debtor must establish that there is a reasonable likelihood that the plan will be confirmed within a reasonable period of time. §1112(b)(2)(A). Here, there is no guarantee of confirmation in the short term, not only due to the ongoing litigation, but also due to the fact that the Plan is stale.

40. To deny this motion, the court must also find a “specifically identify unusual circumstances” establishing that conversion is not in the best interests of creditors and the estate. See §1112(b)(2). What is “unusual” about this case is the ongoing litigation with Venture and Xerox over the executory contracts which should never have happened in the first instance. The Debtor simply cannot meet its burden without now making substantial concessions regarding the claims brought by Venture and Xerox, as well as admitting its complicity in the mismanaged sale process. Moreover, to the extent any “unusual circumstances” do exist in this case, they do not justify continuing the *status quo*, rather they compel a review by an independent trustee. Such a trustee makes no sense in the context of chapter 11 since the debtor’s estate is now mostly liquidated. Instead, an independent chapter 7 trustee is in the best interests of all parties.

CONCLUSION

41. Based on the foregoing, cause exists to dismiss or convert this case to chapter 7 under 11 U.S.C. §1112(b)(4). The existence of such cause compels the court to hear this matter and to order the conversion to chapter 7. The Debtor in Possession cannot rebut the fact that it cannot get its house in order quickly, efficiently and inexpensively. Moreover, the Debtor cannot show the court, and the court cannot specifically identify, unusual circumstances which establish that conversion is not now in the best interests of the estate. Accordingly, the case must be converted to chapter 7 now.

42. If necessary, the United States Trustee intends to call as a witness the following individuals:

Laddy Janovsky, Bankruptcy Analyst
Office of the U.S. Trustee
1015 U.S. Courthouse
300 South Fourth Street,
Minneapolis, MN 55415

Mr. Janovsky will testify to the information in the monthly operating reports, the likelihood of ongoing losses to and diminution of the estate, the Debtor's inability to confirm a plan, and other germane facts. The U.S. Trustee may also call the Debtor's principal Timothy Johnson, as an adverse witness in support of this motion to testify to the same facts and other facts as set forth in this motion.

43. The Debtor is not a person described in 11 U.S.C. §1112(c). The Debtor is qualified to be a debtor under chapter 7, and the U.S. Trustee believes conversion to be a preferable alternative so that a trustee can investigate and resolve pending litigation and make distribution to creditors.

44. The United States Trustee believes that the foregoing constitutes cause for conversion or dismissal of the case. The United States Trustee believes that the court should

order conversion of the case to chapter 7 forthwith.

WHEREFORE, the United States Trustee moves the Court for an order immediately converting this case to one under chapter 7 and for such other relief as may be just and equitable.

Dated: August 1, 2014

DANIEL M. McDERMOTT
United States Trustee
Region 12

By: s/ Michael R. Fadlovich
MICHAEL R. FADLOVICH
Trial Attorney
MN Attorney I.D. No. 158410
United States Trustee's Office
1015 U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
(612) 334-1350

VERIFICATION

I, Michael R. Fadlovich, attorney for the United States Trustee, the movant named in the foregoing motion, declare under penalty of perjury that the foregoing is true and correct according to the best of my knowledge, information and belief.

Executed on: August 1, 2014

Signed: s/Michael R. Fadlovich
MICHAEL R. FADLOVICH
Trial Attorney

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:)	
)	Bankruptcy #13-43894
SCICOM DATA SERVICES, LTD.)	
)	Chapter 11 Bankruptcy Case
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MEMORANDUM OF LAW IN SUPPORT OF
MOTION TO CONVERT OR DISMISS

The United States Trustee, by the undersigned attorney, submits this memorandum in support of the motion to dismiss this case or convert it to a Chapter 7 case.

A proceeding to dismiss a case or convert a case to another chapter is governed by 11 U.S.C. §1112 and FED R. BANKR. P. 9014. A request for dismissal or conversion of a case shall be made by motion. A motion to dismiss or a motion to convert a case shall be deemed a motion either to dismiss or to convert, whichever is in the best interest of creditors and the estate. Local. R. Bankr. P. 1017-2. A case may be converted to a Chapter 7 case if the debtor may be a debtor under Chapter 7. 11 U.S.C. §1112(f).

Under 11 U.S.C. §1112(b), the specific requirements for the conversion or dismissal of a chapter 11 case are set forth. That section provides:

(b)(1) Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, 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, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

(2) The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best

interests of creditors and the estate, and the debtor or any other party in interest establishes that:

(A) there is a reasonable likelihood that a plan will be confirmed within the time frames established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and

(B) the grounds for granting such relief include an act or omission of the debtor other than under paragraph (4)(A)-

(i) for which there exists a reasonable justification for the act or omission; and

(ii) that will be cured within a reasonable period of time fixed by the court.

...

(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;

(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

(D) unauthorized use of cash collateral substantially harmful to one or more creditors;

(E) failure to comply with an order of the court;

(F) 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;

(G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 under the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;

(H) failure timely to provide information or attend meetings reasonably requested by the United States Trustee

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

(J) failure to file a disclosure statement or to file or confirm a plan within the time fixed by this title or by order of the court,

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144 ;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligations that first becomes payable after the date of the filing of the petition.

11 U.S.C. §1112(b) (emphasis added).

Cause for conversion or dismissal is not limited to the reasons expressed in §1112(b), (e).

11 U.S.C. 102(3); Moody v. Security Pac. Business Credit, Inc., 85 B.R. 319, 352-53 (W.D. Pa.

1988). In this case, cause is based on the ongoing losses to and diminution of the estate, an absence of reasonable likelihood of rehabilitation and gross mismanagement by the debtor, all as described in the U.S. Trustee's motion. Consequently, cause exists to immediately dismiss this case or convert it to one under chapter 7.

“The purpose of §1112(b)(1) 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.” Loop v. U.S. Trustee, 379 F.3d 511, 515 (8th Cir 2004), citing In re Lizeric Realty Corp, 188 B.R. 499, 503 (Bankr. S.D. N.Y 1995). The parties to a case are entitled to rely on facts established in the record in making a case for conversion or dismissal under §1112(b). Loop, at 518.

In the present case, the Debtor's business has been sold and there is nothing left to do but resolve claims and sell one parcel of land. The costs of doing so while remaining under chapter 11 have proven to be extraordinary and wholly unnecessary. The excessive litigation in the debtor's immediate future must be addressed, as should the plan now before the court which is stale. Going forward in a chapter 11 simply makes no sense and the debtor in possession cannot rebut the facts that conversion is appropriate.

The Debtor cannot remain under chapter 11 based on any “unusual circumstances”, as permitted in §1112(b)(2). As described in section 1112(b)(2), the requirement of establishing “unusual circumstances” shifts to the debtor in possession after a court finding of cause for conversion or dismissal. See In re Attack Properties, LLC, 478, B.R. 337, 345 (N.D. Ill. 2012). An assertion by the debtor that the liquidating chapter 11 plan now before the court establishes unusual circumstances is inadequate. It would be inappropriate and contrary to the estate's best interests for the court to allow the debtor in possession to bootstrap itself into chapter 11 by simply

claiming excessive estate funds have already been spent drafting and filing a liquidating plan. This is particularly true given that the plan is now stale.

Subsection 1112(b)(2) goes on to state a number of requirements for a debtor in possession to rebut the requirement of conversion and remain under chapter 11. The debtor not only must show that the plan could be confirmed within a reasonable time, but also that there was a “reasonable justification” for the prior acts or omissions of the debtor, and that the acts or omissions can be cured within a reasonable period of time. 11 U.S.C. §1112(b)(2)(A)–(B).

Section 1112(b)(2) is drafted in the conjunctive, so the Debtor or another party that opposes this motion to convert must meet each of the stated requirements if the court is to deny immediate conversion. As set forth in the motion, the debtor’s failure to anticipate and address the executory contract with Xerox in advance of the sale, and subsequent failure to investigate and manage Venture’s use of the equipment post sale, cannot be shown as having “reasonable justification”, as required by the statute and cannot be cured within a reasonable time.

The U.S. Trustee also submits that due to the ongoing incurrence of excessive fees and expenses, the matter must be addressed by the court as soon as possible. Under §1112(b)(3),

“The court shall commence the hearing on a motion under this subsection not later than 30 days after filing of the motion, and shall decide the motion not later than 15 days after commencement of such hearing, unless the movant expressly consents to a continuance for a specific period of time or compelling circumstances prevent the court from meeting the time limits established by this paragraph.”

11 U.S.C. §1112(b)(3).

Although a liquidating plan may be an appropriate alternative in some cases (See §1123(b)(4)), such an outcome is no longer appropriate in this case since there remains substantial discovery and administrative claim resolution before the parties can even address the plan which is now over six months old.

CERTIFICATE OF SERVICE

In re:)
) Bankruptcy #13-43894
 SCICOM DATA SERVICES, LTD.)
) Chapter 11 Bankruptcy Case
)

The undersigned hereby certifies under penalty of perjury that he is an employee in the Office of the United States Trustee for the District of Minnesota and is a person of such age and discretion as to be competent to serve papers. That on August 1, 2014, he caused to be served a copy of the attached: United States Trustee's Motion to Convert Case to Chapter 7 or to Dismiss case, with supporting Memorandum, Proposed Order, and Certificate of Service, by placing said copy in a postpaid envelope addressed to the person(s) hereinafter named, at the place and address stated below, which is the last known address, and by depositing said envelope and contents in the United States Mail at Minneapolis, Minnesota.

SCICOM Data Services, Ltd.
10101 Bren Rd E
Minnetonka, MN 55343

James C. Brand
Fredrikson & Byron PA
200 S Sixth Ste 4000
Minneapolis, MN 55402-1425

HLB Tautges Redpath, Ltd.
4810 White Bear Parkway
White Bear Lake, MN 55110

Wewco
1905 Wayzata Blvd Suite 120
Wayzata, MN 55341

Roberts Business Form
3761 Dunlap St. N
Arden Hills, MN 55112

Thea Davis, Esq.
Office of the Chief Counsel
Pension Benefit Guaranty Company
1200 K Street NW Suite 340
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David Runck, Esq.
Fafinski Mark & Johnson
400 Flagship Corp Center
775 Prairie Center Drive
Eden Prairie MN 55344

Phillip W. Bohl, Esq.
Grey Plant Mooty
500 IDS Center
80 South 8th Street
Minneapolis, Minnesota 55402

Other creditors have been served via the bankruptcy court's CM/ECF electronic case filing system.

By: e/Michael R. Fadlovich
Michael R. Fadlovich
Trial Attorney
MN Atty I.D. No. 158410
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Minneapolis, MN 55415
(612) 334-1350

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:)
) Bankruptcy #13-43894
 SCICOM DATA SERVICES, LTD.)
) Chapter 11 Bankruptcy Case
)

ORDER

The above-entitled chapter 11 cases came before the court on the motion of the United States Trustee seeking an order dismissing or converting the case to one under chapter 7.

Michael R. Fadlovich appeared on behalf of the U.S. Trustee. Other appearances were as noted in the record.

Based upon the motion filed by the U.S. Trustee, the findings of the court on the record, and all of the files, records and proceedings herein, it is hereby ORDERED:

That the chapter 11 case of SCICOM Data Services, Ltd. is converted to a case under chapter 7.

MICHAEL E. RIDGWAY
United States Bankruptcy Judge