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SCOX - The SCO Group Conference Call to Provide Updates on IBM lawsuit, UNIX Ownership and Copyrights

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SCOX - The SCO Group Conference Call to Provide Updates on IBM lawsuit, UNIX Ownership and Copyrights

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Boies, Shiller, and Flexner

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Jennifer Follett

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PRESENTATION

Operator

I'd like to turn the call over to Mr. Blake Stowell. Please go ahead, sir.

CONFERENCE CALL PARTICIPANTS

Dan Gooden

Bloomberg News - Analyst

Peter Galley

eWeek Magazine - Analyst

Dean Takahashi

San Jose Mercury News - Analyst

Don Marti

Linux Journal - Analyst

Todd Weiss

Computerworld - Analyst

Richard Waters

Financial Times - Analyst

Robert Maner

Copper Beach Capital - Analyst

David Banks

Wall Street Journal - Analyst

Stan Gruner

Tech Channel - Analyst

Laura Didio

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Reed Stevenson

Reuters - Analyst

Steve Shanklin

CNS - Analyst

Jonathan Collins

BNV - Analyst

Thor Ollisrud

Jupiter Media - Analyst

Gordon Half

Illuminata - Analyst

Larry Greenmile

Info Week - Analyst

BLAKE STOWELL - SCO group - Director, Corporate Communications

Thank you. Good day everyone and thanks for joining our teleconference today. We have on the line with us David Boies from Boies, Schiller & Flexner; Darl McBride, President and CEO of SCO; and Chris Sontag, Senior Vice President and General Manager of the SCOSource. Before we turn the time over to them, I would like to just let everyone know that the press materials are already made available on SCO.com in the SCO press room; you will find our press release there. If you have any follow-up questions following our call, feel free to call anyone from the SCO PR team or at Schwartz Communications. At this time I would like to turn the call over to Darl McBride, the President and CEO of SCO.

DARL McBRIDE - SCO group - President and CEO

Thanks, Blake. Good afternoon and thank you for joining our call. I would like to start by updating you on recent developments at the SCO. After my comments, we will then take your questions. SCO's legal counsel David Boies is available on this call to help address questions that you might have regarding SCO's legal position.

In May 2003, SCO warned Global 1500 companies that enterprise use of the Linux operating system may violate intellectual property rights in the UNIX operating system. Today we confirmed that fact. Enterprise use of any Linux distribution based on the 2.4 Linux kernel contains software code that was misappropriated from UNIX. This directly violates SCO's copyrights and contract rights in the UNIX System V operating system.

Linux contains hundreds of files of software code taken directly from UNIX System V or from derivative works protected by UNIX System V licenses. This infringing falls into

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three categories. First, literal copying of UNIX System V source code. Second, literal copying of code from UNIX System V derivative works without authority. And third, non literal copying of the structure, sequence, and organization of UNIX System V.

Much of the infringing code deals with new multiprocessor capabilities inside of Linux. This isn't a matter of changing a line or two of code. If all of the infringing code were removed today, Linux would have little multiprocessor code left and would be totally ineffective for enterprise use. Infringing elements found inside Linux are all protected by U.S. and international copyright laws. SCO announces today that it has registered all of its System V copyrights so that it can enforce its copyrights in situations where it becomes necessary.

IBM and others have tried to minimize their own copyright litigation risks by not becoming a direct distributor of Linux. For the first time in the history of the software industry, IBM and others are proposing that corporations adopt a major operating system that has no intellectual property warranty. The net effect is this. By not providing a warranty, IBM and others have profited from Linux and, at the same time, have shifted the risks to the end-users. They have shifted the legal liability and associated cost of running unlicensed software to the end-users.

SCO is trying to find ways to help customers solve this problem, balanced against our own legal rights to stop infringing uses of Linux. Under U.S. and international copyright laws, end-users are subject to injunctive relief and damages for improper use of copyrighted works. With registration of its UNIX copyright, SCO now has broad legal rights against end-users with respect to infringing use of the Linux 2.4 kernel release and any future release of the Linux 2.6 kernel. However, we intend to use these rights carefully and judiciously.

In the past week, many Linux users have asked us how they can immediately resolve issues with Linux without litigation. This is clearly the path SCO prefers to take in resolving its issues with end-users of Linux. Therefore, as a viable alternative to legal enforcement against Linux end-users, SCO is prepared to offer a license for SCO's UnixWare 713 product for use in conjunction with any Linux offering. Specifically SCO will hold its licensees harmless and will covenant not to sue such licensees for running Linux in binary format on any CCU license under a valid SCO UnixWare 713 license. This licensing format will ensure that Linux users are able to run

Linux in full compliance with SCO's underlying intellectual property rights.

In making this license available to end-users, SCO does not waive any of its rights against IBM or others. This UnixWare 713 license offering is designed to give immediate relief to customers using Linux, so that customers can focus on their business issues without concerns of violating SCO's intellectual property rights in UNIX.

The pricing of this license will be dependent on customer past and future usage of Linux, and the number of servers that currently run Linux. We're working through the details now and will be discussing them with customers in the coming days and week. As with any licensing program, volume discounts will be made available; and every effort will be made to ensure that licensing fees for UnixWare are fair and reasonable under the circumstances, while appropriately compensating SCO for the unauthorized misappropriation of its intellectual property rights. At this point, let's go ahead and open things up for your questions.

QUESTIONS AND ANSWERS

Operator

(CALLER INSTRUCTIONS) Dan Gooden (ph) with Bloomberg News.

Dan Gooden - Bloomberg News - Analyst

Good morning, Darl and David. Had a couple of questions. It sounds like for the first time, Darl, I'm hearing you say that Linux violate SCO copyright. I have heard you guys typically say it violates your IP rights, but you stop short of copyright. Are you saying for the first time that people using Linux are violating SCO copyrights? If so, what has changed? What allows you to now predicate copyright law as opposed to contract law or some of the other things that you have talked about in the past?

DARL McBRIDE - SCO group - President and CEO

I will take the first side of that, David. Definitely this case started off as a contract case. When we filed it in March we were very clear that we had contract violations that we were concerned with; and we were going and had tried for months to resolve with IBM; did not get there; and that ended up in

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litigation. With respect to the copyrights, very clearly this is news as of today. Very clearly we have been talking, when we sent out the letters in May, we sent out letters letting them know that we had found problems inside of the Linux kernel as it related to our intellectual property. Today is really the formalization of our going down the path of broadening our case, to go beyond just contract but also to include copyrights. So what is new today is the copyrights have been registered. We have received the copyright registration notices back from the U.S. copyright office. And so essentially the legal fairway that we are working with here just got a lot wider.

Operator

Peter Galley (ph) with eWeek Magazine.

Peter Galley - eWeek Magazine - Analyst

One thing, if enterprises or business customers decide that they still believe you have no legal basis for this action, and that they are going to wait it out, there is no legal enforcements on your part at this point that you can take against those customers. Because the initial case against IBM hasn't been solved yet. And you would then have to litigate on a case-by-case basis with each of those enterprises. Is that correct? You're asking them to voluntarily step forward and agree to this?

DARL McBRIDE - SCO group - President and CEO

Yes. So again back on the first point here, on the IBM case; that was a contract issue. And very clearly we feel good about where that case is going. We are making good headway there. Today's announcement really is a new front that we are opening up. The first case has to do with people that we have relationships with; i.e, contracts. In this case with copyrights we have broad enforcement capability with those that we may not have direct relationships with.

So as we go forward, again, our goal is not to litigate. We have got dozens of people that have come to our source code viewing center in Lindon, Utah, to take a look with their own eyes; and the people have weighed in. And everybody that has come out there and made the track has come to the same conclusion; which is, yes, we have got a problem here in Linux.

Rather than going out and saying, let's just go sue everybody now, we are coming out with a well thought out, a carefully planned program that will help deal with the next issue that end-users have; which is, okay, I have seen the code, and I understand they're problems. Now what do you want me to do? Well, the answer is real simple. We have a solution here for you, that gets you clean, gets you square with the use of Linux, without having to go into the courtroom.

Peter Galley - eWeek Magazine - Analyst

Just to follow-up on that, obviously, at some point, if people do not come forward, or this was not otherwise resolved, there would have to be the possibility of some case-by-case litigation. Although I think that it is unlikely that you would have to have very many of those cases before some resolution was reached.

I think with respect to the first part of your question, it is not necessary to resolve the IBM case before resolving, or if it were to come to that, litigating with the customers. The issue with IBM is a contract issue originally. There may also be copyright issues with respect to IBM. But whether or not the IBM issue is resolved does not give the individual customers the right to engage in conduct in the interim. If the conduct is improper, the conduct is improper, even if it has not been held to be improper yet in the IBM case.

Operator

Dean Takahashi (ph), San Jose Mercury News.

Dean Takahashi - San Jose Mercury News - Analyst

I had a couple of questions. Can you more completely describe the offending code and its origins? Like when it got put into Linux, by what party? Also what kind of cost is there associated with getting a valid license for the customers?

DARL McBRIDE - SCO group - President and CEO

With respect to the infringing code, we see the three different types that are out there. You have the direct line by line code that is showing up in there; and it is very stark. When you lay down the UNIX code base and you lay down the Linux code base and you look at them straight across, you can see absolute 100 direct line by line copying that is taking place; including developer comments, errors, typos that were in the

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developer comments. So it is very stark. That type of code has come from various vendors; and that type of code is coming from vendors primarily other than from IBM.

With respect to the next category of code, what we would call the derivative works area, we are seeing a lot of code that has come in just the last year or two. And that has to do with a lot of the SMP (ph) high-end scalable technologies; the NUMA technology, or nonuniform memory access, RCU, recopy update. All these are technologies that allow you to really take a multiprocessor configuration and go big-time with it. In the early days of Linux and the 2.2 kernel, before it really grew up, you would get two to four processors running simultaneously. And now when we go to 2.4 kernel, you see 16-way, 32-way configurations. With the new 2.6 kernel coming out, it even jumps up higher than that. But you see incredible enterprise-level scalability going on.

The other thing that is interesting here is when you compare the amount of source code that was contributed by vendors in 2.2 kernel versus 2.4, which just came out a couple of years ago, you see in the 2.2 area there was literally no contribution; and since 2.4 has come out the number of files, not just lines of code, but the number of files that has been contributed by our UNIX vendors is in the hundreds. So that is the second bucket.

And then the third bucket is one of nonliteral infringing; areas of methods and concepts that are still protected under our rights. That is a broader bucket beyond the first two.

With respect to the pricing, we are talking to customers beginning this week. We are going to get out with more details, publication of that pricing model later. But we can tell you that it is benchmarked out from our UnixWare licensing structure that is out there today.

Operator

Don Marti (ph) with Linux Journal.

Don Marti - Linux Journal - Analyst

I am looking at a quotation from one of the professional C programmers who has actually participated in the source code review program; and that is Ian Lance Taylor. And he writes, looking around the net, I found close variances of code with the same comments and variable names in sources other than Linux distributions. Will SCO offer any additional

evidence to substantiate the claim that there is code in Linux copied from UnixWare?

DARL McBRIDE - SCO group - President and CEO

Sure. We have shown one example out there today of hundreds of files that are infringing. We will absolutely be showing that. In fact we are showing that today. The code that is showing up there today in large part is not even disputable or questionable; because IBM has put its stamp on it. When they contributed the RCU code, as an example, they were kind enough to put their signature on there. So a lot of this code isn't questionable with respect to where it came from.

With respect to whether it is a derivative work, they even indicated out there, this is a derivative of Dynix. And Dynix is a derivative; it is a flavor of the UNIX System V source code that we have. We feel very good about being able to defend that. In fact the people that have come in and taken a look at this have weighed in on the same side.

Let's be real clear here. We are not talking about BSD code. We are talking about high-end SMP code that has been donated in just the last year or two, but has not made the rounds through the BSD or the university settings or what have you. And we're not even talking about Linux 2.2 code. We are talking about enterprise-level Linux. That has taken our System V source code in a large way.

Operator

Todd Weiss (ph) with Computerworld.

Todd Weiss - Computerworld - Analyst

Couple of quick questions. Again, what was the name of the license that you had there?

DARL McBRIDE - SCO group - President and CEO

The license that we're offering?

Todd Weiss - Computerworld - Analyst

Correct.

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DARL McBRIDE - SCO group - President and CEO

We are just calling that -- well, it is SCO's UnixWare 713 product that we're basing that off of. So it is a SCO UnixWare 7.1.3 license. That will be, basically what you're talking about here is a run time or run only license that is a binary license, that basically ties indirectly to where our UnixWare license is today.

Operator

Richard Waters (ph), Financial Times.

Richard Waters - Financial Times - Analyst

Can you tell us a bit more about the rights? You know, how have you established copyright? For instance what penalties can you raise here and against whom? How many legal actions are you planning? When are you planning them?

DARL McBRIDE - SCO group - President and CEO

David, that is probably more of a legal side issue. Do you want to take that one?

DAVID BOIES - Boies, Shiller, and Flexner

Give me that again; because I am not sure I understood it exactly.

Richard Waters - Financial Times - Analyst

Have you established new rights, now, that you want to use to back your case?

DAVID BOIES - Boies, Shiller, and Flexner

By new rights you are referring to the copyright (multiple speakers)?

Richard Waters - Financial Times - Analyst

Copyright. That is right. What are the penalties for breaching that? What sort of extra claims do you think you have here? And against whom? And how are you going to make those stick?

DAVID BOIES - Boies, Shiller, and Flexner

The copyright laws provide a wide range of penalties. There are statutory penalties that permit you to recover an amount per violation without having to prove actual damages. In addition, if you can prove actual damages you are entitled to recover those as well. There are also additional penalties for what are described as willful violations. And I think one of the points of what the company is doing is to try to make sure people are aware of their obligations in the hopes that they will decide that they do not want to knowingly violate the copyright laws.

Operator

Robert Maner (ph) with Copper Beach Capital.

Robert Maner - Copper Beach Capital - Analyst

Quick question, and I'm not sure how you can answer this. But what is the implication for some of the Linux distributors like a Red Hat? What does this mean for them?

DARL McBRIDE - SCO group - President and CEO

This is a complicated arena we are talking about here. You have code that is protected under our source code agreements with vendors that is going into the holder of Linux, into (inaudible). And then it varies. Surrounded by the open first (inaudible) development (technical difficulty) of OCL (ph). Then you go on down the line to a distributor of Linux. And then it goes down the line down to a hardware vendor of Linux. And after many machinations, it finally ends up in the hands of an end-user. David, as I understand the copyright side of this, we have broad rights against anybody that is touching that. Clearly, it starts with the end-user because that (technical difficulty) being held. And no decisions have been made about where we would go and get recourse in the path that we're on now. But my understanding is it is fairly broadly available to us.

DAVID BOIES - Boies, Shiller, and Flexner

It is. And under the copyright laws you may sue both for infringement and what is referred to as contributory infringement. Which is that if anyone contributes to somebody else's infringement, that is somebody who can be sued directly under the copyright laws. So that if a third-party

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distributor was found to have engaged in conduct that contributed to an end-user's infringement, that person would also be liable under the copyright laws.

Operator

David Banks (ph) with Wall Street Journal.

David Banks - Wall Street Journal - Analyst

Can you tell me a little more about the process for these copyrights? Did you just now start the process to register them? Or have they been registered earlier? And if they were not registered earlier, why not?

DARL McBRIDE - SCO group - President and CEO

We just started filing the registrations here some weeks ago. Essentially, you can own a copyright that you don't - you typically go a lot of times to go register them when you expect to go through an enforcement action. That is where we are right now. So we filed these recently. And the major ones that we needed to embark down this path of enforcement have been returned back. We have received the major filings back, registered with the U.S. copyright office, as of last week.

DAVID BOIES - Boies, Shiller, and Flexner

The copyright laws do not require you to have registered intellectual property in order to obtain copyright protection. But having filed and received back the registration is a condition precedent to actually bringing a lawsuit. So that what you often have are people, indeed we found that as you may remember in the Microsoft case to some extent, where copyrightable material was not filed until there was some need or desire to actually bring an enforcement action. So what you have them doing over the last few weeks, as the possibility of bringing enforcement actions has become more of an issue, is to make the filings that are not a precondition to having a copyright but are a precondition to having the right to enforce it in the courts.

Operator

Stan Gruner (ph) with Tech Channel.

Stan Gruner - Tech Channel - Analyst

I have a question regarding the enterprise level. You guys, I think you emphasize really the enterprise level. However as I understand it, when you talk about Linux kernel 2.4, there are a lot more people using this kernel. Not just enterprise-level people; basically every Linux user out there. Are you guys going to go after every Linux user? Or are you going to go after enterprise-level users? If you would go after private users, would you cover that through partnerships with Linux distributors or some sort of alliances?

DARL McBRIDE - SCO group - President and CEO

I suppose there are a lot of options here in terms of how we go down that path. I will tell you our first and primary concern comes from the commercial users of Linux that are benefiting greatly from this from a commercial aspect; and so that is really going to be our starting point. With respect to where the next points are, the folks who are using Linux at home or doing things down at that level, that is not the direct path that we are going after right now. It is really the - all commercial users who are benefiting from this is really where we are concerned.

Operator

Laura Didio (ph), the Yankee Group.

Laura Didio - Yankee Group - Analyst

One of the things that we have been hearing since you first filed this suit is a lot of talk from the Linux community, which harks back to some of the questions we have heard earlier, on how can you be so sure that this code and the derivative code did not come from BSD UNIX or other version of UNIX and Linux, etc.? Second part of the question is, have you had any conversations with the Linux gurus like Linus Torvalds about this stuff?

DARL McBRIDE - SCO group - President and CEO

With respect to the first question, it is an interesting question when you step back and ponder, who really has the capability to understand where all of the code bases are coming from; and which ones are protected; and which ones should be protected; and which ones are not. And by virtue of the agreements we have in place with our vendors, we are in a unique position where we have the ability to see into each

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of the code bases from the vendors that we have agreements with; and each one of those code bases individually are protected. And so we put our code programming teams together; we have three different teams that have gone in. They have looked at all the major code bases out there. And we have a very strong understanding of which components are infringing and which aren't.

Is there an element of BSD-isms out there, if you will, that would be in Linux today that would be a tougher legal case? Or in fact a case where it is in fact not protected? Yes. We would agree with that. Is Linux 2.2 kernel more similar to some of those things? Yes.

As it relates to Linux 2.4 and beyond, there are absolute high-end multiprocessing capability that has not made any of these other rounds that is highly protected. That is really what we are talking about. So that is really the answer to the first question.

Second question, with respect to Linus, we have had several e-mail exchanges over the last couple of months. With respect to Linus, I think that he has actually done a pretty thoughtful job of coming out and articulating some things that I would agree with. We agree on the point that this case started off as a contract case against IBM. Point well taken. He secondly has ascertained that the case up to this point was not about intellectual property or copyrights. Point well taken.

As of today it is a different game. So again from Linus's perspective, I think he studies the stuff out pretty well. And from a going forward standpoint, he has chosen -- up to this point he has chosen not to look at the code from a confidentiality or nondisclosure standpoint. And I understand his position. But from a going forward standpoint we do have these copyright issues we have to deal with. We are not even saying that Linus created the problem; but clearly he has inherited them. And now it is going to be a question of how these things get worked out from an infringement standpoint.

Operator

Reed Stevenson (ph) with Reuters.

Reed Stevenson - Reuters - Analyst

I have two questions. I guess the first one would be for David Boies. Is there anything you can say on the status of discussions with IBM? Whether in your view the probability

of litigation or court trial versus a settlement, how that is coming along? Darl, my question to you would be, given the number of Linux installations out there, and even capturing let's say a small percentage of the two million plus installations, could potentially have a significant impact on your income outlook. So I was wondering if you are prepared to change your earnings guidance or provide any financial outlook at this point in time?

DAVID BOIES - Boies, Shiller, and Flexner

With respect to the status of what has happened at IBM, I really don't have anything to add, other than what has been published already. As a litigator, I always assume these cases are going to go to a court resolution. That is really what I am preparing to do.

DARL McBRIDE - SCO group - President and CEO

On the financial side of this, clearly the copyright protection we get here is significant in terms of the value to our company. The ability to seek injunctive relief and damages relief from end-users, all the way down to the amount or the price of the product that you would have sold for the similar infringing products, is pretty significant. When you take the over two million servers that are in the marketplace today on just 2.4 kernel reported that you see; and you multiply that out against a UnixWare type of a pricing model; obviously this becomes a multibillion dollar problem.

In terms of going out and putting something in place that allows us to get recourse against this, that is where we are going next. We really do hope to get this resolved in a friendly way. We're dealing with a large marketplace. The world has shifted to a game of UNIX on Intel, which is what SCO's was about for 20 years; now it has shifted into a game of UNIX on Intel for free, called Linux. And they have had that game, (ph) I suppose that works as long as you are clear on the intellectual property side. The moment that you cross the line and you are using our valuable intellectual property in producing that free product in the marketplace, then we have a problem. And that is where we are today. That is what we're trying to get some recourse on.

Clearly on the earnings side, the guidance side, we will reserve on that. We are going through the discussions on the financing modeling as we speak. As we get into -- probably as we get into our call next month we will be prepared more to talk about what that means to us going forward.

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Operator

Steve Shanklin (ph), CNS.

Steve Shanklin - CNS - Analyst

I was wondering; earlier you had argued that no, no, no, we're still a products company. All this intellectual property stuff is just a sideline. We are not just becoming an IP shop. But particularly in light of this action today, and the fact that Linux has succeeded in the marketplace where UnixWare has pretty much faded into almost complete obscurity, it certainly seems to me that you are becoming more of an IP shop. I'm wondering if you would agree with that assessment? When you talk about potentially capturing the UnixWare revenue off the Linux installed base, it seems to me that that would be far more significant than your UnixWare or open server revenue.

DARL McBRIDE - SCO group - President and CEO

That is a good question. If you look at this company three years ago, we were nearly 250 million in revenues and growing, at a point in time when this UNIX on Intel thing was just going to boom. Then, instead of our revenues going up they went down. So the product that has been damaged here, UnixWare, is the very product that we're going after to get intellectual property recourse to. So at one level I guess you could say we're going down the past of an IP side; in other discussion you would say, well, we are just getting recourse against our product that was damaged in the marketplace illegally.

I think maybe the other way of thinking about this is, we have 330 employees inside of the company, and the majority of those are working on the product side of the business. So whereas our product side is still moving strong, what we are getting huge uplift with right now is the IP side of our business and enforcing that. So it is a little bit like -- the large vendors out there, that have strong IP shops; IBM collected \$1.5 billion last year. They had another huge business on top of that obviously.

And so what is new here is that we are just layering in, we are coming in reverse. We already had the product side going, but we weren't doing any of the IP licensing side. We're now laying that on. But because there was such huge damages done along the way, clearly the upside of this side of the

business would be greater than the product side at this point in time. So I agree with you on that.

Operator

Jonathan Collins, BNU (ph) .

Jonathan Collins - BNU - Analyst

Doesn't this move to copyright the Linux (inaudible) go against the GNU organization and the way that they copyright Linux? Do you have to get permission from them? Or are you open to counterclaims from the GNU (inaudible) .

DARL McBRIDE - SCO group - President and CEO

I think if you look real closely at what we have done here, we have put in a run time only licensing. Run only license on the binary side of our UNIX product. This basically allows users to run both of these licenses parallel with each other without conflict.

Jonathan Collins - BNU - Analyst

How does that poach against (inaudible) how that doesn't leave you open to --.

DARL McBRIDE - SCO group - President and CEO

In other words the GNU licenses, the GPL license, you're talking about licenses that are source code that are openly modifiable, distributable, copy, you can make copies of, etc. But it really comes down to the source. The source is what you can take and modify, redistribute, etc. With our license we're talking about here with UnixWare, we're talking about a binary license that protects you to run our intellectual property that is out there; but it in fact does not conflict with the (technical difficulty) source now (ph) licenses coming down the GPL side.

DAVID BOIES - Boies, Shiller, and Flexner

It does not protect those who are touching and greeting (ph) Linux source code.

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DARL McBRIDE - SCO group - President and CEO

Right.

Operator

Thor Ollisrud (ph), Jupiter Media.

Thor Ollisrud - Jupiter Media - Analyst

What sort of deadlines have you guys established for these companies to buy a license, before you're going to consider litigation?

DAVID BOIES - Boies, Shiller, and Flexner

Basically we are saying that for every computer you have got running Linux, (technical difficulty)

DARL McBRIDE - SCO group - President and CEO

We have not set a deadline on that right now. We are rolling this out. We're talking to users over the next coming days and weeks here. We will be more formalized with our actual pricing on this after some of those discussions move along. And we will just see how it goes.

Operator

Gordon Half (ph), Illuminata.

Gordon Half - Illuminata - Analyst

I have got a question around this derivative work. Is SCO contending that any contribution from the various UNIX source code vendors are inherently infringing? Even if the code in question was entirely developed by the UNIX vendor?

DARL McBRIDE - SCO group - President and CEO

No, not at all. We are very clear on -- if you look at the Linux kernel between 2.2 and 2.4, it jumps from a couple of thousand files up to over 5,000 files. And a large increment jump or large reason for the jump there is the huge number of files that came from vendors that we do have System V source code licenses with. Now, just because there are thousands of new files showing up from vendors doesn't

inherently create a problem with us. But when we take -- very clearly works that are protected and are derivative works; so in other words, when they take a development path on our System V kernel and expand that and create a derivative work, and then turnaround and donate it, that is where it creates the problem. And that is the area that we are saying that we have hundreds of files. Now, if there are thousands of files that have come from vendors, we are saying that there are hundreds that we deem to be under these protected clauses on our derivative works.

Operator

Larry Greenmile (ph), Info Week.

Larry Greenmile - Info Week - Analyst

I just wanted to find out the difference between the licensing of UnixWare for the actual end-users and the licensing -- and how that would affect the distributors and vendors of Linux?

DARL McBRIDE - SCO group - President and CEO

Could you repeat that? I had some feedback coming out of my side. Could you try that one more time.

Larry Greenmile - Info Week - Analyst

How is this licensing program that you are proposing going to affect end-users versus the Linux distributors? Will Red Hat have to pay you for each Linux distribution that it sells? And the customers also have to pay you? Or will it just be one license per use of Linux?

DARL McBRIDE - SCO group - President and CEO

Right. No, this is very targeted for the people who are using the product, which is the end-user. I think from the end-user standpoint, it is a run only license; it protects them; it gives them the protection that they need. As we said earlier, this is unprecedented that a product has shown up in the software industry at an operating system level where you are building an application on top of this platform. You have this platform and you are building your applications on top of it; and you are receiving it from a vendor with no warranty attached to it.

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So I am guessing that those end-users are going to be looking around to the vendor or vendors involved in supplying that to them, whether it is Red Hat or IBM, and saying, what is up guys? What is happening here? But that is going to be their beef with their particular vendor. Again, this is a run only license. And it doesn't have anything to do with the source level distributions that is come out of the vendors there.

Operator

Gavin Clark with Computer wire.

Gavin Clark - Computer Wire - Analyst

One (inaudible) basic question. I just wanted to make sure what exactly has been copyrighted? Was it the multifirst papers (ph) in the System V net? (multiple speakers) Also just a sort of more background check. What was -- you mentioned other; you kept saying IBM and others. I wondered if you had any more insight on who the others were yet? If you were planning a traditional legal action. And also any more news on licensing for UNIX (inaudible). I wondered if any other UNIX vendors that license had come to you to kind of bed (ph) down their own licensing.

DARL McBRIDE - SCO group - President and CEO

On the copyrights we received back, it is basically UNIX System V licenses, as well as our System V copyrights, as well as our UnixWare copyrights. And so there are various versions out there. We have a substantial number of those covered with the registrations we receive back. The other ones are in process and soon to be received.

With respect to question number two, what was the issue there? Okay, as far as the other vendors. We had (technical difficulty) a very positive visit to Tokyo last week and a good visit over there. And we are dealing with this issue. It has been a lot of an educational exercise for the most part, to go out. System V vendors we do have contracts with, so they don't have to actually even sign a nondisclosure; we already have confidentiality protection in place. So we have shown them the code. People understand the problem. And the focus of the issue right now really has turned off from one of is there a problem? to what are we going to do about the problem? That is a substantial amount of discussion that we have right now.

The final point, what was the final question again? The licensee that we talked about before was Sun. So we basically have -- in the last quarter we have deals that were done with Sun, Microsoft; and we have deals that are in the works with other large vendors; we're discussing in Japan; we have other vendors here in the U.S.; ongoing discussions here. And so we are basically encouraged about the way those discussions are going as well.

Operator

Due to time constraints, we will take a follow up question from Jennifer Follett (ph), CRN.

Jennifer Follett - CRN - Analyst

You were talking earlier about contributory infringement. I was wondering would that also create liability for VARs or integrators that might be implementing Linux? If so, do you have plans to pursue litigation against those people?

DAVID BOIES - Boies, Shiller, and Flexner

I think that it could include those people. It would depend on the circumstances. But certainly in a number of situations, contributory infringement could include those people. As I think was said at the outset, I think what the company is interested in is a resolution of this issue that protects its copyright and intellectual property rights without litigation. If litigation is necessary, I think the company has shown in its suit against IBM that it is prepared to do that. But that is not the first or even second choice. You get to litigation here only if the other choices don't work out.

Operator

That concludes today's question-and-answer session. Mr. McBride, I would like to turn the call back to you for any additional or closing remarks.

DARL McBRIDE - SCO group - President and CEO

Thanks. We started down this path a few months ago. Very clearly we started off on a contract concern we had with IBM. We did not get resolution with that concern. That ended up in litigation. In the process of moving down that path, we have really gone through with a fine-toothed comb what is going on inside of Linux and what is going on inside of our

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UNIX code base. And that has in fact generated this wide range of infringement problems that we are dealing with here today.

So to summarize what we have announced today, we have registered our copyrights to protect our UNIX intellectual property. We have a very strong ownership position, obviously, in the UNIX IP. We now have the registered copyrights to go behind that. SCO's UNIX IP has been misappropriated into Linux. And if anybody has any more doubts about that, you are more than welcome to come and visit our viewing office in Lindon, Utah; or we are having a conference in Las Vegas on August 18. You're welcome to attend that conference and we will be glad to show it to you there as well.

SCO has given customers the ability today to license to run Linux legally on a run only basis. So as we found the violations and the problems that were there inside of Linux, we came out and stated to the world in May, when we sent out the letter, that we saw a problem. Immediately we had a strong wave of attention and requests around, show us the code. In June we showed people the code; that is still going on. After seeing the code we had a strong reaction from customers, saying I want to continue on with Linux. Is there some way we can work this out without having to have this tied up in the courts? Is there some way we can work it out, without having to go in and rip out the implementation I have been working on? We have others that we are aware of, that were in the process of implementing and now they have been in a hold pattern.

We think that this allows both parties' concerns to be met. We are balancing the needs of the marketplace and the demands of the marketplace with our demands and our rights to protect our very valuable UNIX based intellectual property. So that is where we stand today. We look forward to getting out in the marketplace and getting these issues resolved. We said last month that we would come out in July with a program that will allow us to move forward. We're starting that here today. We will be announcing the finalized pricing of that within the coming days or weeks. So that is where we stand right now. I would especially like to thank our lead counsel on this, David Boies, for joining us here today. And David, I don't know if you have a final comment or two you want to make?

DAVID BOIES - *Boies, Shiller, and Flexner*

No, not really. I think that, obviously, we have made a lot of progress since this started in identifying the specifics of the use of SCO's intellectual property and copyrights. I think that what the company did was begin with those claims, like the contract claim against IBM, that it had certain evidence of. There were concerns and questions; and the company was public about those. But what has happened since is that we have taken those concerns and, by investigation, discovered what the actual evidence is. And I think what you see today is the reflection of the developing evidentiary base that the company has.

(CONFERENCE CALL CONCLUDED)

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